LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

"The only certainty is that nothing is certain."
– Pliny the Elder, First Century Roman Author

The Efficient Market Theory proposes that stock and bond markets incorporate all the available information at a given time. Generally we would agree that the markets rightly factor in predictable and slow forming issues like government debt problems (think Greece last year), national growth rates, interest rates, and earnings forecasts. After all, market analysts spend many thousands of hours each year on these kinds of issues. But what can't be anticipated are developments that by their very nature are unpredictable. In the past couple of years there have been several such developments:

- The volcanic eruption in Iceland shut down global air traffic and cost the airline industry an estimated $2 billion,
- The Deepwater Horizon oil rig exploded in the Gulf of Mexico,
- Protests in a number of countries in North Africa resulted in a change of leadership and war in Libya, and
- The earthquake, tsunami, and nuclear-reactor crises in Japan.

Two things can be learned from events such as these—expect the unexpected and avoid overconfidence. The risk of one-time events can't be eliminated from portfolios but the damage done by such negative events can be reduced by prudent risk management techniques. First, one must identify the proper target asset mix that—based on historical precedents and current valuation levels—will over time provide a high likelihood of generating the returns needed to achieve the investor's long-term goals within an acceptable level of portfolio volatility. Second, diversify. No matter how optimistic or *sure* you are about the prospects of an industry sector, region, or company, diversification helps protect you from the unforeseen. And last—and perhaps most important—stay balanced. Over time certain asset classes, industry sectors, and individual stocks do better than others increasing their presence in the investor's portfolio. The process of rebalancing portfolios to reduce overexposure to any single stock, sector, or region goes a long way to prepare a portfolio for the unexpected.

Research has shown that overconfidence is among the most costly traits an investor can have. The feeling of absolute certainty Silicon Valley employees had about the future of their high tech firms served them well right up until the tech bubble collapsed. Mark Twain said, "It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so." This quote is right on point for investors. It isn't the things one has identified as question marks and causes for concern that get you in trouble. Portfolios crater because of the things that we are absolutely positive about, right up until the unanticipated catches us by surprise.

We have always had unexpected events and always will. Despite this, economies have grown, companies have prospered, and stock markets have generated positive returns. The key to success has been to ensure that no single event can create permanent damage to portfolios. When it comes to long term investing, it's not only the slow and steady approach that wins the race—but more importantly—slow and steady survives to cross the finish line. April 2012

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