LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

"The key to making money in stocks is not to get scared out of them."
~ Peter Lynch

The long-term trend for the stock market has been up, but it has never been easy. Since the founding of Lawson Kroeker in 1986, the stock market has experienced a decline of 10% or more on twenty separate occasions. During declines, investor sentiment can quickly change from: "*I'm-in-for-the-long-haul."* to *"Get-me-out…I-can't-take-it-anymore*!" Why is that? It turns out that the human brain does not like losing. In fact, it's what the academics call loss aversion. The brain feels the pain of a loss more acutely than it experiences the pleasure of a gain. Nobel Prize-winning psychologist and Princeton professor Daniel Kahneman has found that a loss yields roughly twice the psychological effect of an equivalent-size gain (i.e., losing $50 has twice the emotional impact of winning $50).

Although the stock market has risen over time, if one focuses on the daily ups and downs it becomes easy to lose sight of these long-run gains. Since its creation in 1957, the S&P 500 Index—a widely accepted benchmark for the U.S. stock market—has earned an average return of approximately 10% per year with reinvested dividends. However, during this time the Index fell on 46% of all its trading days. Psychologically, the probability of having a good or bad day was practically a coin flip. If history is any guide, checking the market weekly barely reduced the number of times one confronted a loss (from 46% to 43%). Checking at month-end would still have shown a down month 40% of the time. Investors who checked market values daily, weekly, or monthly were more likely to get scared out of stocks. On the other hand, the investor who took a longer-term view and only checked the market at the end of each year would have experienced a gain 77% of the time (45 of the last 58 calendar years were up). Stretch this concept to every five years and the historical winning percentage jumps to almost 90%.

At the daily level, the stock market can seem like a roller coaster even though a purely financial calculation reveals that the gains have historically more than made up for the losses. If people perceive loss at twice the extent as they perceive gain, it's the sort of ride one might decide to avoid. This is why human nature can be an investor's worst enemy. The best remedy is a change in mental attitude. When an investor thinks about stocks, they should be *mentally* buying a collection of private businesses, not *wiggles* on a chart. A private business owner does not ask for an appraisal on a daily, weekly, or even monthly basis but instead focuses on profits and long-term growth potential. As Benjamin Graham said, "Investing is most intelligent when it is most businesslike."

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