“Bear Markets are when stocks return to their rightful owners.”
-Benjamin Graham

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I surmise that when Graham formulated his statement above he was not only speaking about the uncomfortable but tolerable cyclical bear markets that come along about every four to five years and cause the market to decline around 30% or more. Rather, I suspect he was referring to the painful and in some ways terrifying secular bear markets that historically have lasted 11 – 19 years. These secular bear markets are typically characterized by stock prices see-sawing back and forth between optimism and pessimism and where stocks appear to make some progress only to have further disappointment take hold. As Charles Dickens so eloquently stated, “these are the times that try men’s souls.”

Ben Graham knew that while stocks offer investors the best long-term protection and growth prospects against outliving one’s money in a world where every year nearly everything costs more, he was also keenly aware of how difficult owning stocks are when one watches their portfolio bounce around in price. You’ll notice, I didn’t say bounce around in value. For you see, Graham was intently aware of the difference between price and value. Price is subject to the winds that blow. Value, on the other hand, is much more stable and is defined as the present value of all of the earnings the owners can have delivered to them over the life of the business. Thus, it is important to remember that bad economic times do not last forever. Eventually the natural healing mechanism of free markets will clear out the cause of the economic turmoil (in this case too much debt on the consumer level). Graham had an analogy he called Mr. Market. This “person”, Mr. Market, is a manic-depressive. Sometimes, everything is rosy, and he has no fear of the future and will pay high prices for businesses. At other times, he’s gripped by depression where all he can see is future difficulty and will only pay low prices for businesses.

I find it helpful and liberating to recognize that the market has “mental illness.” Many times Mr. Market is acting perfectly rationally and pays reasonable prices for businesses based on their long-term “value.” Where investors get confused is when Mr. Market transitions to a manic or depressive state. Investors think that Mr. Market is acting rationally and “predicting” terrible long-term prospects.

As many of you know, we have felt that markets have generally been over-priced for the last 18 months or so. We feel Mr. Market has shifted from being in a manic phase to perhaps being simply rational. We have no predictive power about when and whether Mr. Market will enter a depressive state. However, when he does, we and our managers are prepared to become more constructive in our stance and buy wonderful businesses at attractive prices. For many of you in or near retirement, we have generally kept a higher level of fixed income and alternatives. We consider these holdings as “dry powder” that can be deployed back into stocks as prices become more and more attractively priced. In addition, many of our managers have maintained higher levels of cash as they found attractive opportunities difficult to come by. We have no idea about how long or deep the current market decline will be. We do know that buying low priced businesses when others are fearfully selling has offered the best long-term rewards. In fact, there is a subset of high quality, dividend paying, multi-national companies that are very close to fair value given the recent decline in our assessment. Whether Mr. Market’s pessimism will carry these businesses to significantly lower prices is anyone’s guess. However, we are pleased to see this opportunity for us and our managers and will continue to overweight this investment area for our clients.