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Do You See What I See?

Investor emotions are magnified by a microscopic view, while the telescope promotes a longer-term outlook

As a child, mom once told me that I needed more science to go along with my passion for sports. To bolster that interest, I received a microscope and a telescope for Christmas. I vividly remember switching between trapping insects between two small panes of glass for further microscopic inspection, and catching glimpses of the moon through the telescope.

The question for investors is, with which apparatus do you view your stock portfolio? Those preferring the microscope will concern themselves with every short-term event, such as the recent sub-prime mortgage crises, the price of oil, the Enron scandal, and so on. Moreover, two emotions may tend to drive their behavior into a state of reaction (and even over-reaction!).

Two Motivating Investor Emotions

Fear may induce investors to reduce or even eliminate their stock holdings after the market tumbles. “Cut my losses,” is the mantra of those caught in the “fear factor”. Listen carefully and you may hear a mumble following the tumble: “I’ll get back in when things are more stable.”

Usually that means re-entry into stocks after the market bottoms out and is halfway back to a new high! Of course, the fear reflex is based on a microscopic assessment, causing one to sell near the bottom of a decline and, quite possibly, missing half of the upward rebound.

Greed is the other motivating emotion. Its mantra is, “I want more.” Though apparently contrary to fear, greed tends to produce similar results. This is because, during a run up in stock prices, the greedy investor may be tempted to move funds allocated for bonds over to stocks. Greed may likewise induce an investor to move from one segment of stocks into another (such as shifting small caps to large caps). Greed can throw the notion of a well-diversified and balanced investment strategy out the window, causing one to concentrate on those asset classes that are presently outperforming others, despite the fact that this may result in excessive risk and the abandonment of historically sound investments. Thus, this micromanaged move tends to buy near the top of an advance.

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Opt for the Telescope

Now consider the wisdom of the investor who sets aside the microscope in favor of the telescope. This person has a long-range view. His or her good judgment creates more and more investor confidence in the capital markets and promotes a buy and hold strategy. Its discernment promotes allocation among many sub-asset classes, and reminds one that there has always been, and will always be, an investment "malaise du jour" (problem of the day) to fret over. Thus, we presently are not in uncharted waters.

The book of Ecclesiastes, chapter one and verse nine, reminds us: "That which has been is that which will be, and that which has been done is that which will be done. So there is nothing new under the sun."

This verse has certain application in the world of investment management.

My advice: take a hammer to your investment microscope and clean the lens on your investment telescope. As an aside, my childhood microscope didn't last long… my little brother broke it! But alas, we are now best friends and business partners!

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