MuhlenkampMethods
For the Intelligent Investor
Answers to questions you may not even know you have.

The Game of the Stock Market versus the Business of Investing

This essay was originally published in Muhlenkamp Memorandum *Issue 33, January 1995. A client had asked Ron to summarize his investment philosophy. This was Ron's response.*

I entered this business in 1968. At that time, I had never owned a stock or bond, and I had never taken any courses in Wall Street finance. (I had taken courses in corporate finance.) So I began my studies with a clean slate.

I soon learned that there are an unlimited number of people with ideas about how to invest your money, and all the ideas sound good at the time. Some of these people are paid to sell newspapers and magazines; some are paid to entertain on radio or television; some are paid commissions to sell financial products; and some are actually paid to manage other people's money.

Only this last group publishes the results of their advice. The others tell me when they have been right, but I have to research what they wrote three to five years ago to get a complete picture. I also noticed that the gurus and the managers who were heroes in any one year seldom repeated; those who had good long-term records tended to stay on top, but they were seldom heroes in any one year.

Since my goals are good, reliable, long-term returns, I decided to study the philosophies of the people with good long-term records. I found that they all own corporate stocks, but their approach is to look at companies as businesses. And I learned that, over time, stock prices do reflect the values of the underlying businesses.

I also learned that these values and the resulting stock prices have increased by 9%–10% per year, indicating that if a person just buys good companies and holds them long enough, their returns would be 9%–10%. By contrast, long-term returns on bonds have been 4%–5%, and CDs have been 2%–3%. So I have concluded that, as a long-term investor, my "normal" position is to be 100% invested in corporate stocks.

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The "Game" versus the "Business"

All the problems with investing in stocks are in the short term, where changes in stock prices often seem unrelated to long-term values. Short-term prices are determined by whatever hopes and fears are currently driving the American public to buy and sell stocks. These hopes and fears are fanned by the media, the brokerage community, and various pundits with a short-term agenda.

But it is also true that much of the public insists on this short-term agenda and revels in the drama of it. I call it "The Game of the Stock Market" (as opposed to "The Business of Investing"), and it is very entertaining. The game focuses on the most dramatic and volatile aspects of price movements. Even the language is borrowed from gambling, focusing on "winners" and "losers." The game can also be quite profitable, but requires an iron stomach and an *against-the-crowd* discipline that few people have.

A Reliable Business

Identifying a top or a bottom does no good unless you have the intestinal fortitude to act decisively on it. Professionals face the same problem. In mid-1987, Elaine Garzarelli became justly famous when she identified a short-term market top and avoided the decline in October of that year. But she then failed to buy in a timely fashion, even though her research told her to do so. Consequently, her advantage was dissipated as the market recovered to new highs in 1988 and 1989.

For most people "The Game of the Stock Market" is a distraction that prevents them from making money in "The Business of Investing." Periodic setbacks and a focus on the game result in their selling stocks when they should be buying, and vice versa. We focus on the long-term "Business of Investing" because we have found it to be more profitable and more reliable.