KIM: Financial crisis offered investors painful, but valuable lessons.

Mickey Kim
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The following is an excerpt from Kirr, Marbach & Co.'s Q4-2013 Client Letter at kirrmar.com.

At the depths of the financial crisis five years ago, Warren Buffett said: "Amid this bad news, however, never forget that our country has faced far worse travails in the past. Without fail, however, we've overcome them. Though the path has not been smooth, our economic system has worked extraordinarily well over time. It has unleashed human potential as no other system has, and it will continue to do so. America's best days lie ahead."

We hope to never endure another period similar to when the Dow Jones Industrial Average (DJIA) and S&P 500 both ***plunged more than 50%*** from their highs on October 9, 2007 to their lows on March 9, 2009. In addition, the first quarter of 2009 marked the sixth consecutive quarterly decline for U.S. stocks. Here's what we had to say at the time.

On why we continued to buy stocks during the decline (January 8, 2009):

One of the "curses" of value managers is the tendency to be both early to buy when stocks appear cheap and early to sell when stocks appear expensive. In the current market, we've bought some new companies we thought were attractively cheap and watched them go to ridiculously cheap. In the short-term, we look like idiots.

Value investing, in particular, is a balancing act between two forms of regret. In the first, we can identify companies whose stocks have declined to levels we believe represent, without any heroic assumptions, outstanding long-term return potential. If we buy these stocks and they continue to fall, we have short-term regret for having bought too early and looking like idiots.

Conversely, if we identify stocks with outstanding merit, but don't buy them because we're scared they might go down some more, we risk permanent regret if they run away to the upside. If that happens, not only do we look like idiots, we actually are idiots. It's a constant balancing act between the regret of taking opportunities but enduring further price declines and the regret of missing opportunities identified but not taken.

On why the next 10 years would likely be better than the prior 10 years (April 3, 2009):

The Leuthold Group calculated the 10-year compound and total loss for the S&P 500 as of 12/31/08 was -1.38% and -13.00%, respectively. The important investment lesson from Leuthold's study of various 10-year periods is that weak 10-year periods have always been followed by strong 10-year periods.

When 10-year compound returns fall to 1% or less, the following 10-year period has average compound and cumulative returns of 10.7% and 182.7%, respectively. Out of the 15 observations, the worst 10-year recovery was 7.21% and 100.63%, respectively and the best recovery was 15.58% and 325.30%. We've learned that historical guideposts don't protect you in abnormal times, but we still find this compelling.

Five years later, the DJIA and S&P 500 have eclipsed their 2007 highs. This is not about how smart or brave we were, but the lessons learned. As Sir Winston Churchill said, "The farther back you can look, the farther forward you are likely to see." Keep that in mind the next time it seems the world is coming to an end.

Kim is the chief operating officer and chief compliance officer for Kirr Marbach & Co. LLC, an investment adviser based in Columbus, Ind. He can be reached at (812) 376-9444 or mickey@kirrmar.com.