KIM: Long-term investors: Let short-term volatility be your friend

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Investors have endured a brutal couple weeks—the worst period since 2011. Predictably, front page headlines and breathless lead news stories use words like “crash,” “plunge,” “plummet” and “disaster,” all meant to transfix the reader/viewer. Since the beginning of mankind, a strong “fight or flight” instinct was necessary for survival. Similarly, behavioral finance research shows the pain investors feel from a loss is about twice as strong as the pleasure felt from an equivalent gain.

We’re biologically wired to avoid losses at any cost and the bad memories of 2008 are still fresh, so it is perfectly understandable investors are having a visceral reaction and feeling a great deal of anxiety. By the same token, we believe investors must overcome these biases in order to succeed.

Warren Buffett said in Berkshire-Hathaway’s 2013 annual shareholder letter, “it should be an enormous advantage for investors in stocks to have those wildly fluctuating valuations placed on their holdings – and for some investors, it is. After all, if a moody fellow with a farm bordering my property yelled out a price every day to me at which he would either buy my farm or sell me his – and those prices varied widely over short periods of time depending on his mental state – how in the world could I be other than benefited by his erratic behavior? If his daily shout-out was ridiculously low, and I had some spare cash, I would buy his farm. If the number he yelled was absurdly high, I could either sell to him or just go on farming.

“Owners of stocks, however, too often let the capricious and often irrational behavior of their fellow owners cause them to behave irrationally as well. Because there is so much chatter about markets, the economy, interest rates, price behavior of stocks, etc., some investors believe it is important to listen to pundits – and, worse yet, important to consider acting upon their comments.

“Those people who can sit quietly for decades when they own a farm or apartment house too often become frenetic when they are exposed to a stream of stock quotations and accompanying commentators delivering an implied message of “Don’t just sit there, do something.””

“For these investors, liquidity is transformed from the unqualified benefit it should be to a curse. A “flash crash” or some other extreme market fluctuation can’t hurt an investor any more than an erratic and mouthy neighbor can hurt my farm investment. Indeed, tumbling markets can be helpful to the true investor if he has cash available when prices get far out of line with values. A climate of fear is your friend when investing; a euphoric world is your enemy.”

We evaluate stocks, which represent ownership in a company, as if we were purchasing the entire company, which we will own for 5-10 or more years. While stock ***prices*** are lower, nothing that has happened in China over the past couple weeks has impaired the ***long-term value*** of the companies we own.

It’s important to have a disciplined investment approach, particularly during rocky times. Crandall, Pierce determined since 1900 the stock market has been impacted by a ***correction (>10% decline), bear market (>20% decline) or recession 44.9% of the time (almost half)***. According to Strategas, it has been 46 months since the last correction, *the* ***third longest stretch in the history of the S&P 500.*** Corrections are a normal part of the investment landscape and we were overdue.

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