STOCKBOY

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The Story of Interest Rate Hopes and The Wall of Worry

Hey Bud – Can I Have a Rate Cut?!

Some seem to look at the Fed as a drug dealer of sorts –whenever things get a little rough in the market or economy, they look to the Fed to cut interest rates to make everything feel better again. There is a danger here. If cuts are made to keep our economy feeling good while we're in an economic expansion, what will we do when things get bad again? In 2008, when many things hit the fan at once, interest rates were over 5% and there was a lot of room for rate cuts. Now, the interest rate elevator is already near the ground floor, so pressing the button for a still lower floor seems unwise. Perhaps we should take the stairs instead.

Skeptical Markets are Good Markets

We've now experienced a 10 year bull market—a historically long run. Yes, this bull came on the heels of one of the worst bear markets ever, nevertheless this bull's duration suggests we're likely much closer to the end than the beginning of this run.

One thing that keeps me from being even more concerned about our lofty market than I currently am is there still seems to be a good amount of investor skepticism in the market.

It's said that bull markets climb a wall of worry –that guarded opinions can moderate the market on the way up and keep it intact. This contrasts with overly confident markets, which often indicate a market top, as everyone is already aboard the bandwagon.

But Optimists Are Good Investors

Though markets often climb a wall of worry as skepticism keeps things in check in the shorter term, I also believe that optimists tend to make the most effective long term investors, and it's pretty easy to see why. Optimists believe things will ultimately improve which is an appropriate and useful mindset in an investment world where the stock market goes up more than it goes down. Warren Buffett is always an optimist, though he's also known for the saying: "be fearful when others are greedy and greedy when others are fearful."

One of the keys to successful investing is being willing to see beyond the short term to the long term. Thus, even if things are rocky today or even for a year (say, back in 2008), optimists still feel things will work out with time, and thus don't panic. Optimists even buy more stock when the market is struggling–a hallmark of successful long term investing yet hard to execute when others won't do the same or even question your wisdom. Pessimists rarely step up in these cases.

NBA Success….and Investments

NBA teams spend millions to find the best players, yet they're often wrong – both in who they identify and who they don't. Some of the players who have great statistics during the NBA regular season are not effective in the playoffs and others who are not big in the statistics department during the regular season end up making big contributions in the playoffs, thus being extremely valuable.

Defensive skill often ends up being the key characteristic to playoff success and the NBA is not terribly good at identifying the traits that make a good defender. It takes hustle, heart and game smarts. These traits are harder to measure than points scored or assists made and can get overlooked in analyzing who will be a valued team addition.

Investing has a similar element. Some characteristics that lead to good investments can be parsed by algorithms and heavy analysis. However, other elements of investing are hard to quantify and require judgement and nuance. In a *Stockboy* last year I examined the Tampa Rays baseball team and their unlikely success given their small payroll. The key to their success is both identifying players that produce a lot with lower salaries and then utilizing those players in untraditional, creative ways to get the most out of them.

This approach works with stock portfolios as well. Consider buying good companies when others are disinterested or concerned (i.e. Boeing and Facebook with their recent well-documented PR problems, which are of their own making but resolvable). Add solid growth stocks as well where the world loves their products now and likely will in the future. Then add a few stocks currently flying under the radar of the institutions, analysts and quants. Be patient and don't trade frequently, but also don't be stubborn. This sounds like cooking or baking something, and in a way it absolutely is.

CEO Pay Problems

Bob Iger, Disney's CEO, has an annual compensation 1400 times that of the median salary of Disney employees. Walt Disney's great-niece Abigail recently spoke out against this giant pay gap by saying that though she believes Iger is doing a very good job overall, she still believes that the pay ratios are simply not justifiable or reasonable. It's hard to argue her point– when all the spoils flow to the top, it both creates an unhealthy dynamic and defies common sense.

Disney is certainly not alone in this pay disparity. However, as Abigail points out, perhaps a household-name company like Disney should be the one that leads the way to greater equality and team building. Disney officials state that most of Iger's pay is based on performance of the company's stock. Fine–it probably should be. But why can't the typical employee at Disney enjoy at least a prorated share of the same profits when the company does well? Does the board of directors think only Iger makes the company successful?? Capitalism and stock ownership are great concepts, but they shouldn't benefit just the very top.

Common Sense

The general rule of capitalism, at least as it relates to investing, is to maximize shareholder value. This rule is the major reason publicly-traded companies focus on quarterly earnings. However, the short term decisions made to manage quarterly earnings often compromise long term success, not only for the company and its shareholders but also its customers and even society as well.

Capitalism, in its best form, can create win-win-win scenarios where most every stakeholder's interest becomes aligned. This is usually achieved by companies that put employees and customers first, where management stays in the background and benefits from this very dynamic. Think Costco, Zappos and LL Bean, where customers become very loyal and employees are treated fairly and well. Even the gruff and narrow-minded (certainly in some ways) Henry Ford saw the value in paying his workers more than necessary when he paid them $5 a day, which was unheard of elsewhere.

More companies should re-examine their priorities and focus on win-win-win outcomes where everyone benefits.

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