STOCKBOY

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The Big Game……and: Oil Prices Clearly Down For Good

The Big (Investment) Game: Harvard vs. CalPERS

Recently, CalPERS (California Public Employees' Pension System), the largest pension organization in the United States, reported a severe cut back in its exposure to 'alternative' investments such as hedge funds and private equity. Conversely, Harvard's endowment management team stated it's moving further into alternatives. What gives? Harvard, carrying notable underperformance compared to their Ivy League peers in recent years, clearly believes the alternative universe has a great deal of value. In contrast, CalPERS believes alternative investments have not indicated their worth and, further, lack transparency and are fee heavy.

Though we won't know for a while which organization made a better choice, it is already clear CalPERS is wiser. A hallmark of good investing is 'know your investments'. I find it very hard to believe Harvard knows all of what they're invested in with these assets. Alternative investments sometimes buy and sell holdings very, very quickly and sometimes take big bets on fast-changing trends (and I emphasize the word 'bets').

Alternative investments also include non-marketable securities lacking easily known market values. As such, the firms that invest in this arena have a natural (and difficult to monitor) incentive to err on overly-optimistic estimates when valuing investment performance, as they get paid based on performance. Until you, as the investor, get your money back, along with anticipated profits fully in your pocket, you don't really know how good these investments are (or are not).

Unless alternative investments specifically create a unique and clear asset class for the investor, with well-understood characteristics, they don't really add known value, yet have both substantial known and perhaps unknown costs.

It's early in the game, but CalPERS has the early lead by demonstrating common sense as they move forward.

Gas Prices: Life(style) Changing?

With the plummeting oil prices in late 2014, there have already been falling dominos. One domino is that sales of SUV's and other gas-guzzling vehicles have spiked.

It seems rather shortsighted to make a decision on purchasing a car, which one typically owns for many years, based on the gas price trends for just a few months. History has shown, again and again (particularly since 1973), that oil prices move up and down – sometimes dramatically and certainly unpredictably. Even experts get fooled. This time is likely no different. I find it hard to believe low oil prices are here to stay; instead, I believe oil prices will continue to gyrate and could head up again.

As with investing, you should choose your car (investment) based on long term criteria and not what is new and different today. History has shown you often don't need to wait long for trends to moderate and reverse.

Companies that use oil and gas, such as the airlines and some manufacturers, can lock in prices through hedging, and probably should do so currently as a form of prudent investment. Unfortunately, typical drivers like you and I cannot lock in current low prices and should buy cars accordingly.

Active Management and 2014

When the market is going up, index (passive) funds are a pretty nice place to be, both on an absolute and relative basis, including the past almost 6 years. That said, index funds' advantages often fade in other types of markets. In down markets, index funds provide no protection from the storm. In bear markets such as 2008-2009, there weren't many places to hide anyway as most investments plummeted. However, in the bear market of 2000-2002, there were plenty of places to 'hide' that were better than the indexes. For example, value stocks fell about a quarter of the market during that tumultuously time.

Index funds also don't allow you to personalize your stock holdings, such as focusing on dividend-paying stocks (often preferred in retirement, for good reason), or avoiding controversial stocks such as Walmart and Phillip Morris.

Finally, buying index funds doesn't allow you to do what *Stockboy* likes to do: buy good companies when they get temporarily roughed up by Wall Street, which seems to happen regularly. In the past year the *Stockboy* has stepped up as quality companies such as Target and Whole Foods endured short term problems and have since bounced back nicely (there are many other examples from years past such as JP Morgan after the 2011 'white whale' scandal and Merck in 2004 after the Vioxx problems, just to name a couple).

Of course, this strategy doesn't always work; but if done properly, the odds fall in your favor. Why? Because it's hard to buy and hold (and buy more of) a stock that's getting a lot of negative coverage in our 24-hour news culture. It doesn't make for good cocktail conversation as people often look at you rather quizzically….and with sympathy, at least at the time.

Institutions tend to not want to show the "negative news" stocks in their portfolio and sometimes sell them simply for appearances.

This environment is where value can be created. Where there is mass, kneejerk selling of a solid (not weak or failing) company, the price often gets unreasonably diminished. If you hold your nose and buy the stock, you can wait, often not all that long, for sentiment and perspective to change back to the positive, and buyers again bid up the price.

While Target and Whole Foods have already proven their worth (both up over 25% in the year or less that we've owned them), companies such as GM are still in the process of proving their value. As I commented in the Spring '14 *Stockboy*, I'm willing to wait it out as I see better days ahead for GM.

It's true that the stock picking (active) investment approach doesn't work well every year, but that's true with every investment style. The Stockboy is up 9.67% this year, not including dividends (with about 20% in cash for future opportunities). This trailed the fully-invested S&P 500 by about 1.75% and was ahead of the Dow Jones by about 2%. However, since 2000, the S&P 500 is only up about 40% without dividends while the Stockboy is up 170% without dividends. The primary reason (besides a great year in a strong 2003: the Stockboy held up much better than the index during the down years in the market (2002 & 2008 and especially 2000 & 2001).

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