

## What Did **You** Think Was Happening?

In seven recent trading days—climaxing on Tuesday, August 25—the broad equity market, as represented by the S&P 500, went down 11%. From its all-time high in May, it had declined 12.4%. This was the first time in nearly four years that equities had experienced a correction as that term is customarily defined: a decline of at least 10% on a closing basis. That in itself was somewhat remarkable, in that since 1980 the market has experienced such a correction on an average of once a year, and these corrections have averaged just over 14%.

Those, at this writing, are the dry facts, but they have nothing whatever to do with this little essay. The subject at hand is not what happened, mundane and even overdue as it was. Rather, the question is: as this short, sharp market decline was unspooling, *what did you think was happening?*

It is clear from the statistics showing huge and even record net liquidation of various equity investment formats during those seven days that many if not most market participants thought there must be a deep and/or long-lasting decline at hand. It is less clear why people thought that.

Much of the blame was laid by the financial press at the feet of communist China. There, a wild stock market bubble was in the process of imploding, with the government inexplicably trying to prop it up. At the same time, China's economic growth was perceived to be continuing to slow—or perhaps the fiction of the government statistics regarding that growth was beginning to unravel. It doesn't make much difference to the inquiry we're pursuing.

To thicken the plot, China then devalued its currency to some noticeable degree, in what seemed a desperate attempt to restart growth through exports,

an economic model which the country's leaders had avowedly been trying to leave behind.

Since less than one percent of America's exports are to China, and since cheaper Chinese goods are an unalloyed boon to the American shopper, it was as I say unclear what the genuinely negative effects of China's difficulties might be. But financial journalism was both clear and unanimous to the effect that China was the cause of our swooning equity market.

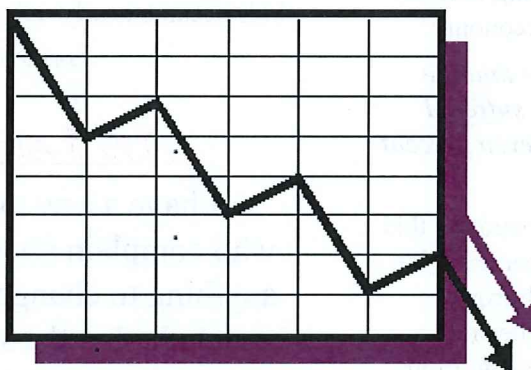
A secondary issue was said to be wide-spread concern that the economy might stall and equity values topple if and when the Federal Reserve, for the first time in nine years, raised its short-term interest rate from effectively zero to just slightly above zero. Again, the negative causality was not made clear, but sufficient unto the day are the manufactured terrors thereof, especially when the proverbial spaghetti is hitting the proverbial fan. Yet these, too, are actually outside the narrow focus of this essay.

Which, as you remember, is *what did you think was happening?* And what did you feel impelled to

do in response?

When seized by moments of incipient fear—which might, if we gave in to them, cause us to abandon our long term investment plan and “get to safety”—I've always found it helpful to begin reciting my mantra until the dread passes. My mantra is, “Remember that **stocks are companies.**”

The practical fact seems to me to be that the prices of stocks in the short run are significantly more volatile than are the enduring values of well-financed, well-managed companies in the long run. And it is the long run that my family and I—and every rational investor I've ever personally known—are investing for.





Hence my discipline, in moments of stress, of drawing a sharp distinction between **stocks** and **companies**.

If we process the day-to-day experience of being equity investors through the prism of the phrase *the stock market*, we are liable to all sorts of negative and downright frightening emotions. The phrase itself, particularly to those of us reared by Depression survivors, connotes instability at best, and dire peril at worst.

If on the other hand we are investing in, just for purposes of illustration, the S&P 500 Index, we may be more apt to think of the experience as *owning five hundred of the larger, better-financed, more profitable companies in America and the world*. If you're anything like me, you may find yourself breathing a little easier just reading that long phrase. And just see what happens to your mood when you read it out loud.

In the case of a sudden sharp decline in stock prices—say, 11% in seven trading days—consider the following exercise. Write down the names of ten large companies, irrespective of whether you own them, directly or indirectly. Just: your idea of ten large companies that intuitively strike you as being intrinsic to America's (or, even better, the world's) economy.

Then ask yourself: *do I really believe that the enduring values of these businesses have suffered long-term impairment of anything like eleven percent just in these seven days?*

I don't know how I'd go about demonstrating this to you. But I believe that the torrents of panic selling during the recent decline were not so much from people who got the wrong answer to this question. Rather, I think the emotion-driven selling came from people *who were incapable of framing this question in the first place*.

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*You see much more of  
your children once  
they leave home.*

*Lucille Ball*

## AS GOOD AS A GOAL

Goal! From 20 yards out! It was a great moment in a soccer match, especially for a team of kindergartners—some of whom might have trouble simply kicking 20 yards, let alone scoring.

So what was with the coach? After allowing the team to congratulate the boy who scored the goal, he took the boy aside and started talking to him seriously. Then, unbelievably, the coach took the boy out of the game.



Here's what the coach was doing: teaching a valuable lesson at an especially opportune time. After congratulating the boy himself for the long goal, he asked him to name two members who were closer to the goal when he shot—and to whom he should have passed to assure the team of scoring. Without scolding the young player, the coach left him on the bench until he could remember those players' names.

The coach's standard was simple: An assist was as good as a goal. The emphasis was on making good things possible, and those who helped were as much stars as those who scored. Not surprisingly, that team of kids became nearly unbeatable.

Adapted from Insights on Leadership

### *In their own words*

*I have a low tolerance for people who complain about things but never do anything to change them. This led me to conclude that the single largest pool of untapped natural resources in this world is human good intentions that are never translated into actions.*

Cindy Gallop

Webb and Associates, Inc.

John, Kelli & Jordan Webb

600 S Santa Fe, Suite C

Salina, KS 67401

Local# 820.8161 or 888.756.6670

[webbandassocinc@ofgfinancial.com](mailto:webbandassocinc@ofgfinancial.com)

[www.webbandassociatesfinancial.com](http://www.webbandassociatesfinancial.com)