Buy Fear And Sell Greed

By David J. Waldron

Editor's Note: The following excerpt is from the upcoming book, ***Build Wealth With Common Stocks****: Market-Beating Strategies for the Individual Investor* by David J. Waldron. The hardcover edition is now available for pre-order in advance of its January 19, 2021, worldwide release. Ebook, audiobook, and paperback formats to follow at later dates. Reprinted with the permission of the author.

Buy or add common shares on surprise socioeconomic events and market fears. Sell or reduce on surprise company events and market greed.

The intelligent value investor purchases a slice of a stable company with strong fundamentals when the market is retreating based on fear, then divests or reduces the holding when the market gets greedy and overbuys the stock despite weaker fundamentals or an inflated stock price when microeconomic events erode the financial strength of the company or the demand for its products and services.

Buy on fear and sell on greed, assuming the share price is attractive or above your cost basis. Erratic market corrections such as the COVID-19 coronavirus pandemic notwithstanding, the market prefers to entertain the purchase of attractive fundamentals at high prices and narrow margins of safety. As a result, in the later stages of the post-Great Recession epic bull market, The Model Portfolio had evolved into more of a watch list than a buy list.

This chapter defines the macro and microeconomic impacts of intelligent investing.

Attempts at Market Predictions is a Fool's Game

When the market timer is wrong—the probable outcome—in predicting a surprise market, industry, or company event, substantial assets are lost because the trader is too long or short. On the other side of the trade, the patient investor is prepared to take advantage of the surprise occurrence by allocating planned cash reserves for new or increased positions in the shares of companies with strong fundamentals.

The disciplined investor takes advantage of depressed prices from the indiscriminate macro event. These surprise incidents, any tragedies notwithstanding, trigger a contrarian's opportunity for the thoughtful individual investor. For example, investors who held, added to, or initiated quality positions following the market crash of 1987, during the dot-com bear market of 2000–2002, or the run-up after the Great Recession of 2007–08, profited from subsequent booming portfolios. The market meltdown from the coronavirus pandemic produced similar opportunities for bargain hunters in March of 2020. A few did predict these events, and perhaps each benefited from a stroke of luck. Many investors reacted by selling already depressed securities in the aftermath, and more than a few of these victimized portfolios have yet to recover.

The investor who predicts an impactful market, industry, or company event becomes intoxicated by the lucky call and begins to base an investing philosophy on the sudden perceived ability to foresee future events. Such inebriation of financial intellect induces the proverbial gazing into the crystal ball, encompassing a false state of being. With poetic justice, the luck soon runs out, as does the principal on the investments.

Unless one has the magical instincts of Warren Buffett.

Fear and Greed as Pricing Mechanisms

This chapter supports a value investment theory of becoming greedy from the fear by buying when a surprise macro event affects an entire economy or sector and being fearful of the greed by selling on the surprise micro event limited to a company or industry. Widely credited to Buffett, the metaphor of buying fear and selling greed produced the most famous value investor of our time.

The lesson is another reminder for the independent investor to stop market timing or stock trading and start investing or divesting as macro and microeconomic conditions dictate. Such discipline requires a contrarian's retreat from the crowd. The thoughtful value investor sticks to the tried-and-true approach of researching the fundamentals of the targeted business to determine the potential level of ownership worthiness. And, if warranted, measures the valuation multiples of the underlying stock to decide whether to initiate, add to, maintain, reduce, or sell the holding.

The patient value investor is steadfast in waiting for random macroeconomic events that often lead to fearful retreats from stocks on Wall Street. As prices drop to attractive valuations, sift your watchlist for superb companies with sound fundamentals trading at appealing multiples offering what you perceive as sufficient margins of safety.

As an alternative, add dry powder to your present holdings, as the first and seventh ideas already sitting in your portfolio are perhaps a better value than a new investment opportunity presented by the market. And whenever greed prevails—thereby affecting the valuation or the fundamentals of a single holding—consider reducing or eliminating your ownership in the position at a profit. On the other side of the investment, if the microeconomic event or trader-induced fears render valuations with perceived wide margins of safety, purchase a new stake or add to the position.

In the wake of fear and greed, the value investor reemerges to take advantage of rare opportunities to initiate new positions because quality enterprises seldom trade in the bargain-basement bin except in the aftermath of market downturns. To paraphrase Buffett, as the bull market tide goes out, the junk equity holders are left swimming naked.

If you buy a quality company at a favorable price and the value proposition of the enterprise remains intact, why sell other than to fund new opportunities or finance an upcoming milestone in life with the proceeds?

Again, the value-based investor has the temperament of a contrarian.

Buying is Exhilarating; Selling is Exacerbating

An overlooked challenge for any investor is when to sell a holding. Execute a sell order to deliver profits with a more proactive and less reactive well-thought-out decision process. The occasional *It was a good idea at the time* investment sometimes leads to unloading the persistent underperforming equity to cut further losses.

The fundamentals-driven value investor sells or reduces a slice of the business if it no longer meets the investment thesis.

There was a time when I sold the stocks of companies as much as I bought them. The share prices of many of the sold-out companies are higher today. Selling a stock out of fear of current or future events often works against the best interest of the investor. Just ask Apple (AAPL) shareholders—including yours truly—who went bearish based on Wall Street analyst forecasts following the death of its founder and icon Steve Jobs in 2011.

Hence, it is an obligation as the innkeeper to write follow-up alerts on the common shares held in The Model Portfolio as evolving fundamentals and metrics dictate. It is important to remember that long-term results are the best barometer of equity performance to the dedicated, individual investor. You don't need to chase quarterly performance as do many of the players on Wall Street and the hordes of followers on Main Street. For this reason, as stated in the investment objectives of *Build Wealth with Common Stocks* and The Model Portfolio and elaborated in Chapter Five, patience is the value investor's best friend.

Sell to Take Profits — Not Quell Emotions

These days, I sell less often having learned repeated buying and selling support the Wall Street fee machine more than positive returns from my portfolio. I had sold out three stocks represented in The Model Portfolio during the post-Great Recession bull market. Murphy's Law had the price of two up significantly before the COVID-19 coronavirus correction.

When buying enduring quality companies at reasonable prices, there are fewer incentives to sell other than to perhaps finance an essential milestone in life. Take profits on a long-held common stock to finance college tuition, a wedding, a home purchase, a business start-up, or retirement. Your approach to investing in common stocks must be cognitive. Other than the appropriate celebration or brief pity party, there is limited room for feelings and emotions in successful investing.

During the epic 2009 to 2020 bull market, individual securities continued to show attractive fundamentals and enticing dividends; however, prices were steep concerning acceptable valuations and margins of safety. Regardless of how we measure the subjective estimation of intrinsic value, the stock prices appeared stretched. Perhaps the market will keep climbing. Who knows?

Then, the coronavirus pandemic arrived out of left field.

Counter to the heightened impatience in the Wall Street arena, practice patient risk management by waiting for prices of quality stocks to drop to acceptable levels. Avoid predicting specific macro events you have limited control over, and leave the erratic behavior to speculators who own the equities or hold the bonds of companies with suspect business models.

When the surprise event does happen, it is often a buying opportunity for the common shares of quality companies prevailing despite the temporary economic or industry downturn. The disciplined value investor is inclined to wait for the economy's macro- or company micro-events to deflate the stock to a bargain price.

Also, be cautious of the price fluctuations of commodities such as energy, basic food ingredients, and precious metals, to name a few examples. Although enticing to the investor with a Type-A personality, such commodity pricing is often determined from legal manipulation by the producers or traders, thereby transcending the basic economic theory of supply and demand.

The disciplined investor on Main Street, with an occasional exception, avoids direct investment in commodities or the companies in the energy and materials sectors producing and marketing raw materials. Invest in companies as opposed to pricing arbitrage. Be willing to take ownership of businesses that use commodities to manufacture useful products, or else you risk eliminating a broad sampling of quality, publicly traded enterprises.

Insiders Trading and Buybacks

It does amaze how C-suites and boards of directors house some of the worse value investors in the contexts of managing buybacks and stock options. I stopped tracking insider selling some time ago because what motivates each private exercise or sale is unknown. The reasons may include: options are expiring, tuition is due, a new vacation home waits, a director's board term is up, or the seller's wealth manager is recommending portfolio diversification beyond the company stock. The motives to exercise options and sell holdings are endless.

As a real-world example: I had been the fortunate recipient of stock options in a former career, which colleagues and I sold at various times for personal reasons. I noticed an uptick in company-wide sales disclosures when a blanket option grant was vesting or expiring, regardless of the performance or prospects of the business at the time.

Instead, focus on companies with believable value propositions whose stocks are trading at sensible prices despite market forecasters trying to steer you elsewhere. The skepticism of the prognosticators, including followers, creates any temporary mispricing. Why the rampant commitments to this narrow approach?

In twenty years of studying, observing, and practicing equity investing through trial and error, buying the value-priced common shares of quality enterprises is the one path that has been profitable with consistency. The lesson: One cannot sell an overpriced bull to a value-minded butcher.

In the Pursuit of Quality

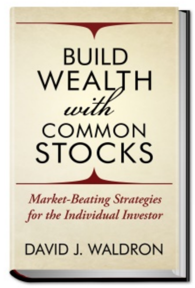
During the research of this book, the Wall Street consensus appeared as an overheated bull market where speculation ruled and valuations went ignored. Shorts were perhaps the exception, although engaged in speculative activity, nonetheless. As a result of the climate, portfolios were performing more as watch lists than buy lists. Hence, continue to seek excellent, publicly traded companies with strong fundamentals inspiring you to take part as a proud owner. Be an advocate of the companies harboring quality products or services and consistent profitability.

The lesson is to practice patience and discipline in advance of the unpredictable surprise macroeconomic event or the market's fearful retreat from stocks. Each juncture presents an ideal opportunity to add targeted dividend-paying common shares of select enterprises to your portfolio.

Call me an idealist, but I prefer contributing to society and my family by taking an ownership slice of a company providing quality and value to a world starving for each. Great businesses always find ways to endure by surviving internal micro issues or external macroeconomic and geopolitical events. Since the pursuit of quality plus value works well in many areas of our lives, it is essential to include investing in the realm.

Never celebrate macro and microeconomic events and the inevitable harm each does to fellow workers or investors who become the unfortunate victims of an affected economy, sector, stock, natural disaster, or health crisis. Instead, revisit your portfolio and watch list and commence new research to look for individual companies where strong fundamentals, sensible valuations, and comfortable margins of safety merge in a rare perfect storm of opportunity. As an everyday investor on Main Street, it is your inherent responsibility to be greedy when the market is fearful. And when the market or management gets greedy in an invested company or industry, reverse course and reduce or sell off as key metrics dictate.

Pursue alpha with large doses of rationale, saving any emotion to celebrate successes or assess failures after the trade — never before. The lesson for the independent investor is to stop market timing or stock trading and start investing or divesting as macro and microeconomic conditions dictate. Such a contrarian's retreat from the crowd requires the accumulation of the rarest of commodities: thought, common sense, patience, and discipline.



"An informed individual investor has a far greater chance of getting rich slow than getting rich fast and getting rich slowly is better than not at all."

Written for individual investors by an individual investor, in *Build Wealth with Common Stocks*, David J. Waldron shares actionable ideas to construct a potentially market-beating portfolio of the common shares of enduring companies to fund life's significant milestones.

Waldron offers inspiring wisdom and memorable anecdotes to keep the reader moving forward during the endless roller coaster rides of market cycles.

Hardcover is now available for pre-order at major online bookstores in advance of the book's January 19, 2021, worldwide release.

Disclosure: The author's family portfolio held a long position in AAPL at the time of this writing.

Disclaimer: This book excerpt presents source material as general information for reference by the interested reader. The accuracy of the data cannot be guaranteed. Narrative and analytics are impersonal and neither tailored to individual needs nor intended for portfolio construction beyond the author's model portfolio presented solely for illustration. The author is an individual investor and not an investment advisor. It is the responsibility of the reader to engage in independent research. Consider consulting, if appropriate, a fee-only certified financial planner, licensed discount broker/dealer, flat-fee registered investment advisor, certified public accountant, or specialized attorney before making any investment, income tax, or estate planning decisions.