

## Mister Market

The uncertainty leading up to and following the UK's recent General Election, and the fall-out from the Greek debt crisis has certainly given us all an opportunity to watch stock and bond markets in operation and to reflect on how (or indeed if) they are in any way indicative of the state of the underlying economy and therefore the value of the companies underpinning the economy.



Between 15<sup>th</sup> April and 7<sup>th</sup> May 2010, the FTSE All Share Index fell by 11.3%<sup>1</sup>; does anybody seriously believe that the combined real value of the companies that produce the majority of the wealth of this country fell by nearly £200 billion<sup>2</sup> in less than three weeks? Conversely, when I began this article, the same index was up 3.6% since opening that morning (10<sup>th</sup> May) - I find it equally difficult to believe that the same value increased by nearly £60 billion in 2½ hours.

These numbers should help us to understand the difference between price and value. Warren Buffett expresses it thus, "Price is what you pay; value is what you get."

Benjamin Graham (of whom the aforementioned Warren Buffett is perhaps the best-known disciple) was one of the first people to propose that investors should look at value rather than price. Ben Graham invented the concept of Mr Market, a mythical investor who offers to buy and sell shares, each day offering a different price. Often the prices seem reasonable, but on occasion they are considered daft, whether low or high. The shareholder can choose to ignore Mr Market, or can accept his offer and trade. Mr Market never takes offence, and always comes back tomorrow to offer a different price.

The message of this parable is that investors should not regard the whims of Mr Market as a determining factor in the value of the shares. They should profit from market folly rather than participate in it. Investors are advised to concentrate on the real life long-term performance of their investments and receiving income via profits reflected in dividends, rather than be too concerned with Mr Market's often irrational behaviour.

Benjamin Graham's books and research date from the 1920s and 30s, and have been built on by the work done by Markowitz, Sharpe, Fama, French and others, leading to Modern Portfolio Theory and other models.

<sup>1</sup> Source: Financial Express

<sup>2</sup> Based on market capitalisation of FTSE £1,704,350 million at 31/03/2010. Source: FTSE.com

Graham operated in an age before computers, when financial data about companies was compiled on paper and accessed through bureaus and directories such as Moody's. Nowadays, enormous amounts of financial data are available, free of charge and instantaneously, to the point that it is impossible (in our view and in that of many experts including Warren Buffett) to identify pricing anomalies and then to profit from them with any certainty or consistency, because everything happens so fast that such aberrations disappear almost as quickly as they arrive. Many fund managers ignore this and spend clients' money chasing the elusive and unattainable dream of better-than-market performance, using techniques such as charting and fundamental analysis to try to spot pricing anomalies. The money spent is reflected in higher annual expense ratios, and is wasted because the increased costs are not reliably reflected in better returns.

Short term, it is very easy to be alarmed by movements in price, because that is the information that is constantly thrust in front of our eyes and into our ears daily, if not hourly. In the long term, movements in price pale before the effects of dividends. Since January 1986, shortly after the FTSE All Share Index was launched, the total return



including dividends has exceeded the price return by a multiple of almost exactly three times. Expressed another way, if the FTSE All Share had collapsed to zero price on 7<sup>th</sup> May 2010, an individual who had invested £100 on 1<sup>st</sup> January 1986 and held onto the investment would still have £572 in dividends received.

**Much better to take the view that all information is already priced into the market, buy the market as a whole (fixed interest and equities in the correct proportion according to one's risk profile) and hold for the long term, enjoying the stream of dividends and interest, and resisting the urge to be side-tracked by the occasionally irrational behaviour of Mr Market.**

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The indices quoted are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is no guarantee of future results, and there is always the risk that an investor may lose money.

Cartoon by Nicholson from "The Australian" newspaper: [www.nicholsoncartoons.com.au](http://www.nicholsoncartoons.com.au).

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