

Mickey Roth – 10/30/2008

As the current investment market situation unfolded I was telling myself, “You’ve seen this before. It’s like 1973 and ’74.” But after weeks and weeks of plunges in stocks, bonds, commodities and most interest rates, I began to think, “No, it’s not like ’73 and ’74.” Then a few days ago an Air Force Academy classmate sent me an email video of a small airplane doing intense maneuvers, losing its right wing (yes, it’s right wing) and being safely landed by one incredible pilot. My classmate and I were Air Force pilots and we both remember perhaps the greatest lesson from that experience. When the unexpected happens you immediately think and then begin trying one thing after another until you regain control. In an airplane you might have only 30 seconds to accomplish this; in the investment arena there’s a bit more time.

What has emerged for me in the past few weeks is that the behavior of financial markets has been overwhelmed by general panic. My wife is mad at me for not telling her this was coming. I tried to explain to her that markets are gauged by probabilities and by human behavior, but her father was a rocket scientist so she always expects perfection. I gained a bit of breathing room when Alan Greenspan went before Congress and said he had not seen this coming.

As the panic evolved I began to notice some interesting things. I manage bond portfolios and the pricing of bonds is much less precise than the pricing of stocks. That’s because any specific bond will actually trade, and thereby display a market value, only rarely. That’s opposed to almost all stocks which trade, and can be followed, minute to minute. So, bonds are lumped together in types or classes by pricing agencies and given a broad-brush pricing treatment. The results, especially in tax-exempt bonds, began to surprise me. So I began calling some agencies in several states that issue these bonds and the results were interesting. They have had very few calls like mine asking about problems. They told me, and presented data to backup their statements, that they are not seeing serious problems. Based upon these conversations and research, I have begun an effort to buy such bonds at what appear to be unusually depressed prices.

In the stock market, the same panic has manifested itself in a somewhat similar ways. About 25 years ago it was possible to buy the stocks of very fine, large companies at yields (that’s dividends divided by price) that were competitive with bond yields. But, dividends have a most attractive characteristic. Over time they have a high probability especially those of these venerable companies of increasing. This sets up a situation where you can buy into an attractive current rate of income coupled with a good probability that over many years that income will maintain its purchasing power.

So, suddenly, in midst of panic, a few bright spots have emerged. They are not without risk. One additional, very macro event has been the fact that, unlike during the early years of the Great Depression, the U.S. and other nations are taking major steps aimed at countering the dire situation we are facing. With that background, these bright spots are very interesting. Maybe we can safely land this airplane on one wing. Then we could fly again.