Variety will lessen effect of market fluctuations

With the stock market in retreat, now may be a good time for all of us armchair investors to reassess what will help achieve our long-term financial security. In

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light of the recent fires in our neck of the woods, I couldn't help but wonder if the local real-estate moguls were thinking about the basic mantra of long-term management: diversification, diversification, diversification. We received a few calls from clients wanting to know whether to bail out of the Santa Fe real-estate market, an instinctual response not dissimilar to some new investors' reactions to the stock market's decline this past spring.

For all of the wealth built up over the last decade through rising share prices, the true test of our resolve as investors remains a challenge we must face. We should, according to historical standards, expect to lose money in the market once every four years. At least once in our investing lifetime, then, we should assess our long-term strategy for financial health.

As the smoke billowed above Los Alamos and Pecos, I found myself wondering how many of us have actually pondered the inescapable situation of having a losing streak that lasts three years, with our portfolios declining at least 10 percent during each of those years. What we need to remember, of course, is that the odds of losing money in stocks over any 20-year period remain almost nonexistent, with at least a one-in-three chance of having a portfolio return in excess of 10 percent per year. Those of us lacking the requisite fortitude to withstand a 30 percent decline on paper ought to reconsider reallocating resources from stock allocations.

For those investors who possess both fortitude and patience, stock-market declines present an excellent opportunity to put new cash to work. While most of us might like to offer a convincing argument that inaction is a plausible substitute for patience, for whatever reason, such complacency essentially fails to provide the most viable answer to the bull and bear markets we now all face.

If we sink down further into our armchairs and survey the temporary scars in our state's landscape, or in our own portfolios, perhaps it will become apparent how these ruminations on life's cycles can help us in more than a passing philosophic way. While real property, stocks and bonds, retirement accounts, precious metals, jewelry, or art may make up our stash of liquid personal wealth, the best investment of all lies in developing one's knowledge base. In our line of business, we look for companies that we know personally, and then build portfolios based on people and markets in which we have trust and confidence. How do we find out about different kinds of investment opportunities and evaluate them?

Warren Buffett and Peter Lynch, two of this century's most successful long-term investors, suggest that we should follow a process in evaluating our options similar to the one we use when we decide on where to live and on how to choose the best school for our children. People should buy stocks in companies with which they have had some personal experience. We have to balance out our particular ideas and preconceptions with what we actually see going on in the world around us. For example, if I frequently observe people who talk on cell phones while simultaneously driving and drinking coffee, I might surmise that Nokia, the largest manufacturer of hand-held devices, and Starbucks, the country's largest retailer of hot, addictive liquid, would make decent investments.

I then pause to ask myself whether "double, short, skinny, high-test brownies," i.e., small, extra-strength, caffeinated mixtures of espresso and chocolate with skim milk, are here to stay. Not being a coffee drinker, I dismiss the idea of buying stock in this highly successful franchise and, instead, look at the four cell phones in my desk drawer. Two of them are obsolete, one lacks the ability to go anywhere, anytime, free of charge, and the survivor lacks a car charger, leather case, earphones, and spare battery. Besides, it is too big to fit in my shirt pocket without being noticed, unlike the really cool, streamlined Motorola unit that a client recently showed me in Farmington last week.

My next question is whether or not I would be willing to stand in line for two hours to replace the accessories noted above in order to get everything I want in a cell phone. The answer is probably, yes, so Nokia and Motorola creep up on my radar screen as possible buys. I then consider the indisputable fact that in a year or less this currently essential business tool will inevitably join the other fallen angels in my cubby, abandoned for a combination phone/e-mail, retrieval/memo device currently being tested in the California and Boston marketplaces. If more is better, and if faster is more efficient, my investment in technology will pay off. I might be a "fast adopter" of new technology without having thought so, and new technology is a good place to invest if you are of that ilk.

Maybe I simply discovered Nokia, Ericsson, Samsung, Qualcomm and JDS Uniphase too late, once the really smart money has come and gone. This may be true, but in some significant ways, my discovery doesn't really matter.

Making a lot of money quickly without working hard, is not reality. It does happen occasionally, but some deleterious side effects are often attached. Buying great companies at reasonable prices is not hard to do, but staying with them through thick and thin is difficult. We want to be the kind of investors who have the discipline to forgo pursuing the easy money. As disciplined investors, we need to be able to feel comfortable that when the stock market goes down it does not pose a situation that should cause immediate concern.

By having a variety of investments, sustaining a philosophical view about market fluctuations will be that much easier to maintain. What goes down usually comes back up. Cycles constitute an indisputable part of life. Ravaging infernos create new opportunities even as they destroy. For better or worse, the spirit of entrepreneurs is only made stronger by adversity. As Philip Kapleau, a Zen teacher, once inscribed for me on the inside cover of his book, "If it doesn't kill you, it will make you stronger." Let's use this current opportunity to bring our portfolios in line with our personal experience.

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