AMBUSH INVESTING

POSSIBLY THE ONLY RELIABLE, RISK-FREE WAY TO CONSISTENTLY BEAT THE MARKET

OR

GREAT-AUNT POLLY'S PORTFOLIO

by
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TABLE OF CONTENTS

PREFACE

The young lioness crouches down stone-still in a shallow ditch behind a thick row of bushes, watching intently as a stately herd of wildebeests tramp by. Not having made a kill in days she is ravenous and the wildebeests no further than twenty yards – yet the lioness does nothing. Several still painful scars remind her of an impetuous attack she'd made on the same herd when, barely out of adolescence, she had let hunger overcome common sense. This time, unseen, she quietly lies in wait. Motionless. Infinitely patient.

The massive animals have almost all passed by when the reward for her forbearance approaches – a large, meaty buck, struggling with a bum leg and barely able to keep up with the herd. The lioness' eyes narrow as the straggler limps along, now directly in front of her.

Then, in a blur of explosive force, she strikes.

INTRODUCTION

You might think beating the market to be difficult, given its rarity. Indeed, 93 out of 100 mutual fund managers seem unable to pull it off despite (presumably) heroic exertions day and night to do better.

Yet, as these pages should make clear, to grow your portfolio with minimal risk, you need not chain yourself to your computer 24/7 massaging your investments, nor is an MBA required. Instead, *ambush investing* – consisting of a simple timing mechanism, adherence to a few rules, a bit of focused planning, and above all, patience – should soon have your burgeoning financial holdings working hard for you, so in short order you won't have to.

Ambush investing is based on the congenial premise that good things come to those who wait – that you can build an enviable portfolio at modest cost if you choose appropriate targets, then at the optimum time (and only then) make your move. A unique variant on a traditional buy and hold strategy, ambush investing maximizes profit while minimizing risk, and then does one thing more:

It is the rare investor who hasn't one time or another thought – *if only I had done this (or that) back then*. Well, ambush investing does in effect enable the investor to recreate the past and accomplish today what he wished he had done years before.

Lamentably, none of the principles to be offered here, though eminently rational pathways to wealth, guarantee that you will always get things right. The market is too complex and can be upended by unpredictable events in faraway places. In fact it seldom does what it's "expected" to do. But if you are merely right more often than wrong you will come out ahead. Most probably way ahead. Certainly not every day, perhaps not every week --but over time you *can* beat the market.

I

MARKET BASICS

In 1908, a novice investor is said to have asked J. P, Morgan, the great financier who was then America's wealthiest man:

"What will the market do, J.P.?"

Without hesitation J.P. came up with what I consider to be the single most useful investment principle. J.P. replied:

"The market – *will fluctuate."*

I believe J.P. was alluding to two salient facts. First, without movement, be it up or down, no investor could make a dime. Volatility is the investor's friend. If markets didn't gyrate we'd all be left with the equivalent of a portfolio of certificates of deposit. The value of a CD is of course fixed, and given current anemic yields, ownership is akin to stuffing your money under a mattress. In fact, given that inflation ranges historically from 2–6%, these days all CDs *lose* you money. Guaranteed. Ergo, to protect your hard-earned dough, let alone increase it, you have no choice but to invest in securities, however mercurial.

Second, no one, not even J. P. Morgan, his uncommon talent and years of experience notwithstanding, knows what the market *will* do. Not he, his inquiring novitiate, nor those of us facing the complexities of twenty-first century markets can base investment decisions on supposed *predictions*, however persuasive.

For the sad fact is, neither Harvard economists nor Wall Street "experts" have yet to conjure up even a soupçon of clairvoyance with which to identify those stocks that are going to advance versus those heading for a fall. Contrary to the vociferous affirmations of (and bookshelves of obtuse, scholarly tomes written by) "technicians" and chartists, there are no consistent formulae for predicting market behavior. Every celebrated system designed to second-guess the market does indeed appear to work – until inevitably it doesn't.* But their failure goes beyond an eminently reasonable inability to predict the future. What I find striking is how consistently Wall Street professionals get it so extravagantly wrong. The best all those diligent, computer savvy technicians and chartists can offer us are some useful data as to what the market is doing *now*, not what it's *going* to do.

Let me say it again: claims that a particular pattern of past movement foretells future behavior of a particular stock or group of stocks are no more supportable than the roulette wheel gambler's assurances that because the wheel has come to rest on black a half dozen times in a row, there's a many-fold likelihood that the next spin will come up red. No such luck. Past performance is *not* predictive. Not in Las Vegas, not on Wall Street.

Likewise, there is little relationship between the earnings estimates offered by securities "analysts" and how the companies they cover actually perform. The reason is obvious: analysts are paid to be optimists. (Note that less than 10% ever issue *sell* recommendations and those few who do risk losing their jobs.)

But however useless a prognosticator, technical analysis can provide serviceable contemporaneous information – a window on what is happening *today*. For example, it can tell you whether at this moment you are investing in the midst of a bull market, a bear market, or one which is volatile (cycling up and down) or nearly flat. It can

*As for example "Dogs of the Dow," Krispy Krem," "Long Term Capital Management," etc.

ascertain whether a particular stock is “expensive” or “cheap” against its own historical performance. It can determine a company’s (1) *Return on capital,* i.e., how much by way of profits a company is able to generate relative to its overall net worth; and (2) *price/earnings ratio,* i.e., how much you’d pay that day for a share of those earnings, in turn a measure of Wall Street’s expectations for that company. (Obviously you want return on capital to be high, reflecting efficiency in the company’s use of its productive capacity; and the price/earnings ratio to be low, suggesting a possible investment bargain vis-a-vis the company’s future ability to generate profits.)

Financial rewards, conventional wisdom maintains, are commensurate with risk -- the market is not inclined to reward you with great sums for playing it safe (i.e., see discussion of CDs above). Squirrel away your money in a savings account, and though entirely secure, not only is your money not up and about working hard for you, it’s sound asleep. (If you’re lucky and inflation rates remain uncommonly low, you might break even.) By contrast, should you choose to speculate on, say, cotton commodity contracts, a single trade could reward you with a return of 1,000 percent on your investment. That’s right: *1,000 percent!* If you’re lucky. Unfortunately most commodity traders quickly manage to lose their cotton (or wool, or silk) shirts.

Similarly, while day traders can theoretically make a lot of money in a hurry, all the traders I know seem to lose a lot of money in a hurry (giving rise to a simple formula: start with one’s entire kitty as the numerator, divide it by the number of trades made over the course of the year, and that will equal the amount of money left by December 31st.) To paraphrase, the quickest way to a small fortune is to start with a large fortune – and become a trader.

As you have doubtless discerned, the ambush investor makes few trades and is in for the long term.

This brings us to the first rule of ambush investing and one which informs every chapter that follows:

Rule #1:

MINIMIZE RISK

You might well be an uncommonly astute stock picker, and perhaps even one of those rarer birds, a prescient market timer, thereby ensuring terrific returns. But if at the same time you're risking everything by ignoring the safeguards to be outlined here, it doesn't matter how much money you (briefly) make. Our principal concern that *you not lose money* subordinates everything else. Consequently we will shortly discuss not only how to make inspired choices most likely to generate substantial rewards, but describe ways to simultaneously so reduce risk that you get to *retain* most of your gains.

One reads that "all the great entrepreneurs of history have made great fortunes, lost them, then made them again." Good for them. Such a scenario might work swimmingly for Donald Trump and his ilk but with all respect for the world's super-rich, the ambush investor pursues a decidedly less exciting road to wealth – and one far more certain.