Navigating

The best compass for navigating the financial markets is to go where the value is.

In the stock market, this means valuing businesses and paying a low or reasonable price for them.

Many believe the best compass for navigating financial markets is to forecast economic conditions. There is no shortage of interest rate, GDP, and stock market predictions in the media and on Wall Street. Unfortunately, a review of economic forecasts and subsequent events would make a bad weatherman blush. Economics is essential for creating sound economic policies and regulations, not for making money from economic forecasts.

The only economic forecast the investor needs is that the US free market system will continue to function. As long as it does, businesses will pay wages, people will spend those wages, businesses will profit from the spending, and investors will profit from the interest and dividends paid by business. This is free markets breathing.

Imbalances such as a negative savings rate and too much debt may occur, but as long as they do not result in complete collapse, they eventually correct themselves, sometimes painfully, and life goes on. The investor who sticks with quality and pays a reasonable price for his or her investments will largely avoid the pain and reap the rewards that our system produces.

Another misconception about navigating financial markets is how and when an investor ought to change course. On one hand, there is too much change. The average mutual fund replaces over half its holdings each year. The result is high transaction costs and a large tax bill. This kind of frenetic trading is like a ship zigzagging back and forth for no apparent reason.

On the other hand, there is not enough change. Under the “asset allocation approach”, the typical investment advisor might recommend 50% US large company stocks with a range of 10% plus or minus the target. What if practically all US large company stocks become over-valued? Our investment ship steadfastly zigzags toward disaster.

This is exactly what happened at the beginning of this decade. Large company stock managers were busy buying and selling bloated portfolios of hundreds of large companies while investment advisors continued to recommend this over-valued asset class. Meanwhile, Niagra Falls was fast approaching. Large company stocks declined 44% from peak to trough in 2000-2002.

Alpine’s strategy is different. Our valuation compass – based on ground level company inspections rather than 30,000 foot asset allocation views – shows us precisely where and where not to go. In 2000, we owned mostly quality mid-sized and smaller companies and only a few large companies. Instead of declining 44% from peak to trough in 2000-2002, our portfolio increased in value by 53%.

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From the time of the speculative peak to now we have slowly and significantly changed course. While our buying and selling was limited (less than 15% of our portfolio was replaced each year), we are now heading in an entirely new direction. The table below shows this change in the language of the asset allocation approach.

Allocation	2000	2006
Large-Cap	14%	65%
Mid-Cap	71%	25%
Small-Cap	15%	10%

Our slow but hard change of course positions us well for the next market cycle. We can't forecast when that will be, but we do know our go-where-the-value-is compass will have steered us to the right destination.

In the meantime, solid double-digit return years can be had as this year shows. More importantly, our modest but respectable gains since the 2002 bear market bottom will not turn into permanent losses during the next bear market. Funds stuffed with high-priced small and mid-sized companies are positioned to suffer a less fortunate fate.

Nick Tompras
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As of November 4, 2022, we have provided this supplement to accompany the commentary and satisfy changing regulations: https://acr-invest.com/commentary-supplement/

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