THE COMPASS

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"THE ONLY THING WE HAVE TO FEAR IS FEAR ITSELF."

HOW VIEWING VOLATILITY AS OPPORTUNITY BRINGS CLARITY TO INVESTING

Summary -

This timeless quote delivered by President Franklin D. Roosevelt in his first inauguration speech at the depths of the Great Depression was made not to placate or appease us. It was a rallying cry used to set an agenda as to how we as a country were to respond to what at the time was the worst economic crisis we had ever faced. Although the first part of Roosevelt's quote has received the limelight over the decades, the latter portion, in our estimation is where the substance of his comment lies.

Fear is the only thing to be feared most certainly, however it is the backend of FDR's quote "nameless, unreasoned and unjustified terror that paralyzes our efforts to convert retreat into advance" that has not received the proper recognition over the years and it is that section of his famous quote that we want to draw attention.

"Let me assert my firm belief that *the only thing we have to fear is fear itself;* nameless, unreasoning, unjustified terror which paralyzes needed efforts to convert retreat into advance." – Franklin D. Roosevelt

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We see no industry where unjustified fear paralyzes its participants needs to convert retreat to advance more prominently than in today's Investment industry.

This is duly appropriate when applied to how investors react to price declines in the companies they own. Unfortunately, these stock market corrections are almost always accompanied by a series of "unjustified and unreasoned" financial news stories. The news media stokes the flames of fear, usually suggesting that the current "pullback" is only the first step to a more severe market meltdown. If you want to preserve your wealth you better get out now is the rally cry following each pullback. These unreasoned and unjustified stories bombard investors with temptations to sell perfectly sound businesses at discounted prices when the more appropriate and sensible response is usually to consider investing more in the business while at a lower price. In our paper we hope to prove that just as FDR's quote ultimately led us to victory in what was a time of great peril, so must investors take to heart in the fact that downside volatility in the price of stocks should not be a cause for fear, but can be on many occasions a chance for great investment opportunity.

Astute investors realize that when the price of a stock drops, it usually drops for one of two reasons. The first reason is most common and is usually due to an emotional reaction to a broader story associated with a macro event. This would include, geopolitical events or natural disasters. When these types of events occur, the overall market and the stocks that trade within them drop in price until what was once feared as a negative outcome of a perilous event is corrected. During this time of peril, and not due to any fundamental change within the business, prices of perfectly sound companies drop in response to this negative information. When this occurs, we refer to that drop in price as the case of a "damaged stock." Damaged stocks create tremendous buying opportunities as they happen for no reason other than the rest of the market has dropped and to reiterate, due to short-term emotional reasons.

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The second reason the price of a stock drops is a more legitimate one. This occurs when the fundamentals, such as Cash Flow, Profit Margin, Market Share, and Economic Moat, of a formerly sound business deteriorate due to major changes within the operations of that company. These types of significant changes within a business are usually directed by management mistakes and poor decision-making. Think of old-line technology businesses that did not foresee the rapid adoption of cloud-based storage or the bricks and mortar based retailers who were late in moving to an internet-based sales model. We see this type of drop in price as a more legitimate reason to consider liquidating a stock from one's portfolio compared to one based on fear or emotions.

We firmly believe that if a perfectly sound business has not changed from a fundamental standpoint, any drop in price should be viewed as an opportunity to reinvest back into that business by buying more shares at lower prices if appropriate. Investors who have clarity in how they view business ownership and how the media often exaggerates a story when prices fall should do the following:

1

Inquire with their advisor or portfolio manager if they intend to take advantage of what appears to be a great opportunity to buy more shares, rather than if they are going to "dump this loser", and ask about whether the fundamentals have changed.

2

Based on their advisor's or portfolio manager's response, be pleased with the pullback, as it's an opportunity to buy more of a great business on sale (if the fundamentals have not changed), or be better informed as to reasons their position is being sold.

3

Hold steady in their belief that the headline of a stock market story is usually far removed from the bottom line of the true story. Also, remind themselves that the adage "If it bleeds, it leads" applies to creating readership more than reporting an accurate story.

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Conclusion -

Just like fear was the only thing we had to fear during the worst economic fallout this country has experienced, so is fear the only thing that we have to fear as it pertains to investing when the "market" drops based on short-term headline stories that have shallow substance. This, as FDR would call it, unreasoned and unjustified fear that paralyzes investors efforts to convert retreat (the pressure to sell) into advance (buying great businesses on sale) can only be countered when we understand the three key points we've discussed.

If investors know what companies they own and the reasons why they own these companies they can be less influenced by sensational news stories and therefore be less influenced by them. They can embrace stock price volatility as a potential opportunity to invest more in great business. They can stick to their investment plan, or as we like to say, "stick to the knitting"–always having a clear and sober mind and always operating under the premise of Clarity. When an investor realizes the truth in these statements they are on the Road to Clarity forming the foundation of clear understanding and judgement and can definitely see the vast and stark difference between what we refer to as a damaged stock versus a damaged company.

Remember to always Invest With Clarity™

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