

The Fortnighter

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One of the things I like most about the markets is that they are completely forward-looking. The past is basically irrelevant – it's only what happens in the future that's important (wouldn't it be great if we all thought this way – kind of a nice thought for the holidays...).

Understanding this simple fact explains a couple of "market conundrums" that I know puzzle many investors - the first being the surprise of seeing a company's shares rally strongly when a negative event is announced.

I think back to the days when the courts were handing down judgments on "big tobacco". Often the fines were in the tens of billions of dollars – a significant set-back, you would think. Yet tobacco company shares typically rallied strongly on the announcements. Why? Because "the number" was now known, the overhang (uncertainty) was gone and the company could get on with business.

A couple of similar, and more recent, events have been BP's MULTI-billion dollar tab for the Gulf of Mexico disaster and HSBC's \$2 billion fine for money laundering – the price of both stocks went UP once the actual details of the fines were announced.

When uncertainty is present, human nature causes us to over-estimate the potential for bad news. As I've said before, savvy investors use these times to put money to work. When an event is known (even if it's bad news!!), the removal of that uncertainty can often cause a nice upward move in the stock.

On the flip side, we've all seen examples where a stock has sold off on seemingly great news. So what if company X made \$5 billion last year – what's really important are the expectations for next year. Apple stock is down 20% over the past few months despite record earnings and a cash pile that could solve the European debt crisis. Instead, Apple investors worry about declining margins, competition and what the company will do with all that cash...

What's the future look like now? Pretty good actually. Volatility is down, the bull market of the past 3+ years is intact and investors seem complacent. That's why I'm leaning a bit towards caution.

*I will be away Christmas week and will not be publishing the Dec 28 issue of The Fortnighter. All the best for a Merry Christmas and a Healthy and Happy New Year!!

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