Mr Market and the Lemmings

Today I want to share with you some extracts from Robert G. Hagstrom JR's (RH) 1990's book **The Warren Buffet Way** and explain how many of these concepts tie in beautifully to the volatility in the precious metals markets. For those of you unaware, **Mr Market** is the name Benjamin Graham (One of Warren Buffet's most influential mentors) affectionately had for the stock market when explaining to his students the folly of stock market fluctuations. The story went as follows:

> **"To understand the irrationality of stock prices, imagine that you and Mr Market are partners in a private business. Each day without fail, Mr Market quotes a price at which he is willing to either buy your interest or sell you his. The business that you both own is fortunate to have stable economic characteristics, but Mr Market's quotes are anything but. For you see, Mr Market is emotionally unstable. Some days, Mr Market is cheerful and can only see brighter days ahead. On these days, he quotes a very high price for shares in your business. At other times, Mr Market is discouraged and seeing nothing but trouble ahead, and quotes a very low price for your shares in the business."**

> **"Mr. Market has another endearing characteristic, said Graham. He does not mind being snubbed. If Mr Market's quotes are ignored, he will be back again tomorrow with a new quote. Graham warned his students that it is Mr Market's pocketbook, not his wisdom that is useful. If Mr Market shows up in a foolish mood, you are free to ignore him or take advantage of him, but it will be disastrous if you fall under his influence."**

Unfortunately or fortunately depending on which way you want to look at it, many of the participants in this precious metals bull market are driven by short term **"price action"** rather than fundamentals. If something is going up in price, people generally feel compelled to buy it on expectation of higher prices to come (Regardless of the fundamentals). To consider selling in an overbought environment becomes completely out of the question, as the thought of selling early and missing out on **"extensive"** future gains are too difficult to take. I can still remember some of the nasty emails I had the pleasure of receiving this time last year. I suggested in an article that **"some"** profit taking may be a prudent strategy, given the excessive valuations that existed at the time (Gold equities trading at 2.5–3 times NAV).

Conversely, if people own something and it is dropping in price, human nature dictates that you sell what it is that is falling in value, especially when the pain of holding becomes too much of a burden. This usually means holding the asset initially as it falls in expectation of a short term correction and the resumption of the existing rally. Once this rally fails to materialize, the pain and frustration of holding an asset falling in price becomes overwhelming and results in its sale (Invariably at the worst possible time). For many the idea of buying during these downturns goes completely against the grain and is made increasingly more difficult when nursing significant losses or even worse, margin calls.

When you study some of the most successful investors of our time such as Warren Buffet and Benjamin Graham, you very quickly learn that their success was not a function of buying and selling price action. At least not in the way the majority of market participants do so. The underlying principle of their success came from buying businesses that traded below their intrinsic value or what they perceived the assets of the business to be worth at the time. Many of the businesses they bought were undervalued as a result of this **irrational selling**.

RH in describing Benjamin Graham's investment philosophy states the following:

> **"Graham's conviction rested on certain assumptions. First, he believed that the market frequently mispriced stocks. This mispricing was most often caused by the human emotions of greed and fear. At the height of optimism, greed moved stocks beyond their intrinsic value, creating an overpriced market. At other times, fear moved prices below intrinsic value, creating an undervalued market."**

There are very few sectors in my opinion where this concept is more applicable today than in the precious metals market. Given the volatility and the opportunities to make seemingly fast money, this sector attracts hedge funds as well as many **"Get Rich Quick"** market participants. These people very often integrate margin into their strategies and are hence driven primarily by **price action**. RH in the following paragraph talks about Warren Buffet's thoughts on the futures markets, which I think are equally as pertinent to the precious metals sector:

> **Buffet worried that naïve investors would be seduced into purchasing futures contracts in hopes of reaping large gains. The low margin requirements associated with futures contracts he said would invite gamblers seeking quick profits. Such short-term mentality, he said, is the reason why promoters of penny stocks, casino gambling and lottery tickets never face a shortage of takers.**

These market participants are responsible for the wild fluctuations we have grown accustomed to over the last 5 years and will in my opinion increasingly become a significant part of the landscape. This environment is also exacerbated by a select group of opportunistic stock promoters and precious metals writers. These individuals take advantage of the conditions to sell more newsletters and jack up stock prices. The following are promotional examples based on what I have read at various market peaks over the last few years (The information is a mix of both free and subscription based services):

- **"With the introduction of the Silver ETF, Silver is going to US$30 plus an ounce over the next few months! Buy these stocks and take advantage of the move!" –** The price of Silver dropped to under US$10 an ounce over the following months and the Silver stocks fell like a stone.

- **"This stock has 10 Bagger written all over it! It trades at a PE ratio of 5 and Gold stocks generally trade at an average PE ratio of 20+"** – I latter discovered this same stock was simultaneously being promoted by Jim Cramer just before we had a correction in the precious metals markets.

- **"I hold so much of this stock that my wife will divorce me if it doesn't perform well! It is a 10 bagger in the making"** – Incidentally the stock halved a few months later but as far as I know this individual is still married! I questioned this rather overzealous prediction and to my surprise I was deregistered from the mailing list (Needless to say I was devastated). It was no coincidence that he was paid by the company on a promotional basis.

- **"This is one of the most promising Silver exploration plays in China**. **(A buy up to $3.00)"** – This stock had no defined resource to speak of and at a price of US$3.00 attracted a market capitalization of US$100 million +. The last time I looked at the price it was US$0.03 a share. Questions to the editor went unanswered (I am no longer a subscriber).

Whilst these conditions create frustrating corrections, they also bring about wonderful buying and selling opportunities. The trick is to be able to train yourself to **focus your attention on the fundamentals** rather than the **price action** and the **associated noise**. Provided you have done your homework and are convinced we are in a long term bull market in precious metals, these short term corrections should be welcomed. Energy should be directed towards exploiting these buying opportunities rather than worrying too much about which way the prices are going to go over the short term.

> **"The most common cause of low prices is pessimism – sometimes pervasive, sometimes specific to a company or industry. We want to do business in such an environment, not because we like pessimism but because we like the prices it produces. It's optimism that is the enemy of the rational buyer".**
>
> **"We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful"**
>
> **Warren Buffet.**

For anyone interested I write a free newsletter on the precious metals market which you can sign up for at the website below.

Troy Schwensen

The Global Speculator

DISCLAIMER

This publication has been prepared from a wide variety of sources which the editor to the best of his knowledge and belief considers accurate. The editor does not Warren the accuracy of the information and forecasts contained in this publication. This information is provided for educational purposes and nothing written should be construed as a solicitation to buy and sell securities.