



## **Quarterly Commentary – October 1, 2010**

*The error of optimism dies in the crisis, but in dying it gives birth to an error of pessimism. This new error is born not an infant, but a giant.*

Economist Arthur Cecil Pigou (1877-1959)

Over the past few years, it's been hard to avoid news coming out of our nation's capital. Given the many challenges presently facing our country, the intensity of interest in the activities of the U.S. Congress is understandable. If nothing else – and often it is nothing else – our elected representatives are good at holding hearings. These hearings typically feature expert witnesses, whose testimonies are then ostensibly used as a basis to create public policy.

Congressional hearings are nothing new, of course, and we were reminded of one hearing that took place not in today's highly charged environment but back in the relatively simpler days of the mid-1950s. A big stock market rally had begun in 1953, and by 1955 there was great public worry that we were on the brink of a crash similar to one that had occurred in October 1929. The U.S. Senate Banking and Currency Committee convened a panel of experts to analyze this bull market, and one of the witnesses called to Capitol Hill was the esteemed Harvard economist John Kenneth Galbraith. Dr. Galbraith was a brilliant and widely-followed economist, in large part because he had just penned a definitive history of the 1929 crash.

At that March 1955 hearing, Galbraith testified that the prospects for the stock market were not attractive. He warned of speculative excesses and recommended that Congress and investment firms on Wall Street adopt policies designed to save investors from the same risks that befell them 26 years earlier. Galbraith's testimony surely sounded wise and reasoned, but there was only one problem: the professor could not have been more wrong with his prediction. Over the next 12 months, the market rose 38% (including dividends) and over the next 10 years, it returned more than 12% per year.

History has demonstrated time and time again that, when asked about the future of the stock market, expert economic prognosticators are wrong more than they are right. Today, we hear the constant drumbeat of these concerns, and we of course do not dismiss them without careful thought. But there is a clear moral here: the opinions of economists are generally best ignored when it comes to investing. Why? Because economists are human, just like the rest of us, and they often make the same mistake of focusing on the past rather than on the future. Dr. Galbraith joined what must have been many in that hearing room in paying too much attention to the '29 Crash and the Great Depression that followed. In a phrase, his "expert" testimony was merely conventional wisdom, and the conventional wisdom at that time was fear.

The conventional wisdom today also seems to be fear: economic fear, geopolitical fear, stock market fear. We truly believe that the way to make good investment returns is to eschew conventional wisdom. So today we do not dismiss this fear but embrace it. Back in 1955, when investors were still consumed by thoughts of the Great Depression and when the great



Dr. Galbraith gave his inaccurate forecast to Congress, many blue chip stocks had to pay more in dividends on their stocks than they did interest on their bonds. That's where we are today: there is so much fear in owning stocks that for the first time in 60 years, many of our greatest blue chips are yielding more on their stock dividends than they are paying in interest on their bonds.

History demands us not to follow the forecasts of today's pessimistic economists and instead heed the observation of another economist, whom we've quoted at the top of this letter. Embrace the pessimism – and profit from the most important lesson history teaches about investing in stocks: when public fear is high, that is precisely the time to buy. That was true in 1955, and it is just as true today.

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We want to take a moment to congratulate you, and to thank you. There is no doubt that these have been difficult times for individuals, having their hard-earned capital on the line in the midst of volatile securities markets. Despite the wide swings through the course of the year, the S&P 500 finished the third quarter with a gain of 3.9% for the year-to-date period.

In this volatile environment, you have exercised patience. Consequently, you have the temperament that will enable you to succeed as an investor. You will succeed because you understand that stocks are not simply pieces of paper or blips on a computer screen. Rather, stocks represent an ownership interest in something that is real, tangible and valuable: a company that invests, produces goods and services, generates income and distributes wealth to its owners in the form of dividends. By owning shares, you own this income; you own the capital and equipment employed by the business; and you receive the dividends you are owed.

You will succeed because you recognize that the market can choose to value these investments, income streams and dividends at a different price every minute of every trading day, and you know that the assigned price at any particular moment is completely irrelevant. You know that the only things that matter to an investor are that:

- (1) The businesses you own have the financial strength and management depth to endure through good and bad times;
- (2) The probability is that this wealth will grow and compound over time; and
- (3) Today's market price undervalues the real wealth and prospects of the business.

Also, paradoxically, volatility in the markets is in fact a gift to investors. Volatility doesn't hurt anyone unless they sell at points of weakness or buy at points of ebullience. Volatility can be the friend of the investor who understands the difference between price and value, and who has the courage to buy when the market signals fear and sell when the market signals complacency. We believe that our job as investors is to take advantage of this knowledge: to recognize the difference between fact and fiction, truth and emotion, and to build conviction and exercise good judgment in the face of volatility.



So, congratulations for having what it takes to succeed as an investor, and thank you for having the confidence in us to be your guide.

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We are pleased to announce an addition to the Golub Group team. Jimmy Yung has joined us in San Mateo as a Business Development Associate. Jimmy has a degree in Economics and Psychology from UC-Davis and was most recently with Gruber & McBaine, an investment firm in San Francisco. For those of you who are more comfortable speaking with us in Cantonese Chinese, please use Jimmy as a resource.

Lastly, we ask that you save the evening of November 5<sup>th</sup> for our upcoming Open House at our office in San Mateo. A formal invitation will be forthcoming, and we look forward to seeing you here.

As always, included with this commentary are your quarterly performance figures, management fee invoices, and a copy of your portfolio allocation as of 9/30/10. If you have any questions about your accounts or would like to come in for a visit, please drop us a note or give us a call.

With warm regards,

The Golub Group

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