Resources Management Corp

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MARKET COMMENTARY

THE "WISDOM" OF THE CROWD

"Whenever you find yourself on the side of the majority, it is time to pause and reflect" - Mark Twain

Though Mark Twain was not much of an investor (he lost substantial portions of his net worth in a variety of ventures and stocks), his take on the wisdom of consensus views very much applies to security analysis today. Many investors, both professional and amateur, fall victim to what is known as "confirmation bias." Confirmation bias suggests that, rather than evaluating circumstances objectively, humans tend to place more weight on facts that support their initial or developed view of a matter. In practice, this applies not only to the financials of a particular security, but to the comfort of having a large portion of investors agree with a position. Rather than blindly taking solace in the fact that the broader market agrees with you, it is important to consistently evaluate whether or not the view continues to make sense.

Benjamin Graham is cited as saying "You're neither right nor wrong because other people agree with you. You're right because your facts are right and your reasoning is right - and that's the only thing that makes you right. And if your facts and reasoning are right, you don't have to worry about anybody else." The idea that facts and rationale need to be the fundamental drivers of investment decisions sounds obvious, but far too many market participants, many of whom are speculators as opposed to investors, decide whether to buy or sell based on what market sentiment seems to be. A similarly misguided approach is to take the contrarian view of the market at all times, disagreeing with current trends simply because they are in favor. While both of these strategies can incidentally be profitable (not all strong performers are dramatically overvalued; not all underperformers are poised for a breakout), the results of an investment will ultimately be determined by the underlying fundamentals of the security in question.

Historical stock price movements, in and of themselves, have no actual bearing on the merits of an investment. The price of a stock is nothing more than an offer from "Mr. Market" to buy or sell an interest in a business. The value of this interest is based on the expected cash flows that will be generated in the future, the present value of which should be compared to the price that is being offered in the market at that point in time. Whether or not the stock had been rising or falling in the previous days, weeks, months or years does not offer any indication as to whether or not the current price provides an adequate margin of safety to warrant an investment in the company. Similarly, hearing CNBC hosts discuss a security, either positively or negatively, does not provide any insight into whether or not it belongs in a portfolio, except to the extent that new facts are being presented.

In the highly connected world that investors face today, it can be difficult to not be influenced by the increasing levels of noise that surround the stock market. From the 24-hour news cycle to analysts constantly sharing their views on social media, the trap of searching for agreement is ever present. In evaluating investment opportunities, however, it is critical that we separate our thinking from outside opinions and consider only the facts and logic behind our analysis. In doing so, we will not only be able to make informed decisions at the outset, but will be able to endure, and potentially capitalize on, periods in which the market price of a stock is disconnected from the intrinsic value of the underlying business. At RMC, our strategy continues to be based around a keen understanding of the value of the businesses we invest in, and actively testing our rationale to avoid becoming caught up in the sentiment of the day.

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