



Rick's investment opinion newsletter

Capital Drain

May, 2006



v.2 no.4

Hi Readers,

I'll finish my MBA a week from this evening, when our team will turn in a ~75 page paper. Until then, I'll be pretty busy.

After then, I'll be gainfully self-unemployed, i.e., trying to start a company.

This letter will be really short, as I have a lot of other writing and editing to do.

It's a sprint to the finish; let's go. In my opinion:

Executive Summary:

Do I wish that I'd sold gold & overseas stocks right at the peak a few weeks ago?
- Of course.

Is being able to do that a reasonable expectation?
- Of course not.

Does it bother me to see the value of these things drop?
- Of course.

Do I wish I'd invested in something different?
- No. Definitely not. All those investments are still up for the year.

Am I planning to sell now to 'take profits' or avoid further losses?
- No. The fundamentals are just as they were a month ago.

As before, I think even in the best of times everyone is best off with a **broad diversification** that includes at least **3/4 overseas** assets (easily purchased via US no-load mutual funds), reflecting the distribution of world economic activity.

These are **not the best of times**, so investors need to be in the best of securities: stick to value, to safety, to short maturities (for debt), and call me to chat if you're concerned about anything you're holding.

Above all, avoid the investments that are at all-time extreme valuations: junk bonds, developing-country bonds, and headline-grabbing stocks such as Google, Whole Foods, or Taser.

Sure, Google is doing great. So was Pets.com once upon a time. Google's a pretty good company, but at the current price you could only buy based on the Greater Fool Theory: "Sure, I paid too much, but I'll find a Greater Fool to whom I can sell it for even more!"

The Details:

A month ago I wrote that I was pretty pleased with the way gold and foreign stock and bond investments had been going.

About a week later, they dropped pretty sharply.

To my mind, that changes nothing. All those investments had been leaping up at a phenomenal rate. It was unnatural that they should have been rising by such big percentages without any sort of pause or stumble; it is only natural that such a big short rise could be followed by a short sharp partial fall.

In a behavioral finance framework, this is a perfect teachable moment.

A drop like this is difficult to watch. Stomachs churn out acid, sleep is lost, and emotions run high.

This is precisely the time when it's important to take a deep breath and put your logical mind back in control.

OK, actually it's precisely one of two times when logic is important; the other was a month ago. When prices are screaming upward at an irrational rate, ignore the "Gosh everyone is getting rich except me" impulse to jump in and buy.

When prices plummet like now, ignore the "Gosh this will go down forever" impulse to jump out and sell.

That does not mean that an investor should sit immobile. It means that investors should *think* and make decisions rationally. Never mind the rise or the fall, is this a good investment or a bad one? Does the logic of the situation say "buy" or "sell"?

If logic says you're in the right position for the right reason, stay put. If logic says that something in the world has changed so that your earlier investment decision is no longer correct, then take action.

Right now, I am still rationally convinced that the dollar has quite a distance to fall, that overseas high-quality stocks and bonds are a better investment than US ones,

and that gold will rise as the dollar falls. That's what I'm staying invested in. I expect the rise for all of these to resume.

I think the fall in US stocks is for real, though. The valuations are very high, and profit growth is cyclically slowing. This is different from GDP or sales slowing... profit growth slows after an expansion is mature; it does not require that a recession have begun or even be imminent.

Today could be a great time to sell some US stocks and long bonds and move the money to overseas stocks and bonds.

That's it for this end-of-the-MBA-program month.

If you have any questions, please please write or phone. If you want to read more, I've got a [web site](#) with old editions of this letter and some links to other interesting sites.

Please feel free to forward this to any friends who may be interested.

Take care,

Rick

Rick Drain
P.O. Box 5425
Redwood City CA 94063-0425

CapitalDrain @ Ricks-Cafe . net
<http://www.ricks-cafe.net/CapitalDrain.html>

"Our doubts are traitors,
And make us lose the good that we oft might win,
By fearing to attempt."
--W. Shakespeare

A collection of fine industrial Boilerplate, but true:

Nothing in this e-mail should be considered personalized investment advice.

Although I may answer your general questions, I am not licensed under securities laws to address your particular investment situation. No communication from me to you should be deemed as personalized investment advice.

Any investments recommended in this letter should be made only after consulting with your investment advisor and only after reviewing the prospectus or financial statements of the company.

The information and opinions herein are for general information use only. I do not guarantee their accuracy or completeness, nor do I assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice.

Copyright © 2006, Frederick L. Drain