Mr. Market

by Ben Graham

Imagine you are partners in a private business with a man named Mr. Market. Each day, he comes to your office or home and offers to buy your interest in the company or sell you his [the choice is yours]. The catch is, Mr. Market is an emotional wreck. At times, he suffers from excessive highs and at others, suicidal lows. When he is on one of his manic highs, his offering price for the business is high as well, because everything in his world at the time is cheery. His outlook for the company is wonderful, so he is only willing to sell you his stake in the company at a premium. At other times, his mood goes south and all he sees is a dismal future for the company. In fact, he is so concerned, he is willing to sell you his part of the company for far less than it is worth. All the while, the underlying value of the company may not have changed - just Mr. Market's mood.

The best part of this entire arrangement: you are free to ignore him if you don't like his price. The next day, he'll show up at your door with a new one. For your interest, the more manic-depressive he is, the more opportunity you will have to take advantage of him [don't worry, he doesn't have feelings or mind being taken advantage of.] As long as you have a strong conviction of what the company is really worth, you will be able to look at Mr. Market's offers and reject or accept them... the choice is yours.

This is exactly how the intelligent investor should look at the stock market - each security that is traded is merely a part of a business. Each morning, when you open up the newspaper, go online, or turn on CNBC, you can find Mr. Market's prices. It is your choice whether or not to act on them and buy or sell. If you find a company that he is offering for less than it is worth, take advantage of him and load up on it. Surely enough, as long as the company is fundamentally sound, one day he will come back under the sway of a manic high and offer to buy the same company from you for a much higher price.

By thinking of stock prices in this way - as mere quotes from an emotionally unstable business partner - you are free from the emotional attachment most investors feel toward rising and falling stock prices. Before long, when you are looking to buy stock you will welcome falling prices. The only time you want to invite high stock prices is when you are eager to sell your securities for some reason. Thankfully, in most cases, you are free to wait out Mr. Market's emotional roller coaster until he offers a price that you consider equal to or higher than intrinsic value. This is perhaps your greatest advantage in your investments.

Questions for Discussion *(use space provided; 2 sentences each)*

1. Who is "Mr. Market"? Explain.

2. What is the purpose of using Mr. Market when thinking about investing?

3. What's your opinion? Is the "Mr. Market" metaphor helpful? Explain.

The Investor vs. Speculator

Over the course of the past several decades, the term "investor" has been used for anyone who owns a share of stock. It is important that you understand this is not the case. When a person buys a stock, they are doing it as one of two people: either an investor or a speculator.

What's the difference? An **investor** is someone who carefully analyses a company, decides exactly what it is worth, and will not buy the stock unless it is trading at a substantial discount to its intrinsic value. They are able to say, for example, that "Company X is trading for $48 per share, but it is worth $62 per share." They make their investment decisions based on factual data and do not allow their emotions to get involved. A **speculator** is a person who buys a stock for any other reason. Often, they will buy shares in a company because they are "in play" (which is another way of saying a stock is experiencing higher than normal volume and its shares may be being accumulated or sold by institutions). They buy stock not on the basis of careful analysis, but on the chance it will rise from any cause other than a recognition of its underlying fundamentals. Speculation itself is not necessarily a vice, but its participants must be absolutely willing to accept the fact that they are risking their principal. While it can be profitable in the short term (especially during bull markets), it very rarely provides a lifetime of sustainable income or returns. It should be left only to those who can afford to lose everything they are putting up for stake.

How do these two different types of activity affect stock price? The speculator will drive prices to extremes, while the investor (who generally sells when the speculator buys and buys when the speculator sells) evens out the market, so over the long run, stock prices reflect the underlying value of the companies. **If everyone who bought common stocks were an investor, the market as a whole would behave far more rationally than it does.** Stocks would be bought and sold based on the value of the business. Wild price fluctuations would occur far less frequently because as soon as a security appeared to be undervalued, investors would buy it, driving the price up to more reasonable levels. When a company became overpriced, it would promptly be sold. Speculators on the other hand, are the ones who help create the volatility the value investor loves. Since they buy securities based sometimes on little more than a whim, they are apt to sell for the same reason. This leads to stocks becoming dramatically overvalued when everyone is interested and unjustifiably undervalued when they fall out of vogue. This manic-depressive behavior creates the opportunity for us to pick up companies that are selling for far less than they are worth.

This leads to a fundamental belief among value investors that although the stock market may, in the short-term, wildly depart from the fundamentals of a business, in the long-run the fundamentals are all that matter. This is the basis behind the famous Ben Graham quote "In the short-term the market is a voting machine, in the long-term, a weighing one." Sadly, some reject this basic principle of the stock market. Several months ago, I received an email from a reader who asserted that "the economic fundamentals of a company have no relation to the stock price." This is completely false. My response was a simple message that read "If fundamentals don't matter, what if Coca-Cola never sold another bottle of Coke? How long do you think the stock price would stay at its current level?" When put in this light, the folly of the "fundamentals don't matter" becomes evident. The next time someone preaches this, simply ask "what happens to the stock if the company can't make its payments and defaults on its loans?" When they answer "it goes bankrupt", simply smile and walk away. Fundamentals do matter.

Questions for Discussion *(use space provided; 2 sentences each)*

4. What is the difference between an investor and a speculator?

5. According to the author, the fundamentals of a company (their financial data and underlying business) are incredibly important to stock prices. Why?