How to avoid the mood-swings of "Mr. Market"

Analysts often use colorful images to explain how the markets work ... or why a particular index or asset

class is "behaving" in a certain way.

We'll hear references to the "Goldilocks" economy, a Santa Claus rally, tigers and tea leaves, bubbles and roller-coasters. A single adjective in a Fed speech may dominate headlines and drive speculation for two days running.

This sells newspapers and gets ratings. But the danger is that in over-simplifying an analysis, it becomes simplistic – almost without decision-making value.

Today's round-the-clock news cycle demands a talking-head rationale for every minor indigestive day in the market. It seems even the slightest 20-point movement must be attributed to something: obscure remarks by a finance minister or an after-hours rumor about labor negotiations in Detroit.

In this media environment the Dow, the S & P 500 and other indexes acquire quasi-human characteristics, as if they were capricious Greek gods.

As you watch television and read the papers, notice how often these statistical indices are subtly endowed with feelings or moods: the market "has an appetite" for energy stocks on Monday, the market is "panicked" by a Labor Department report on Tuesday, the market "doesn't like what it heard" in a speech on Capital Hill.

Some of this is journalistic license, of course. But it contributes to and reflects a "what-is-the-Dow-doing- today" obsession among investors with actively-managed portfolios, a chronic anxiety level that has sabotaged many a program.

Often you'll hear the anthropomorphic mantra "the market is always right." This attributes some innate "wisdom" to an index. Even the godfather of all analysts, Adam Smith, famously coined a metaphorical reference to an "invisible hand" – an often-misunderstood allusion to macro-economic forces, not to stocks.

Fact: the stock market is not a person (nor is it a god!).

Personification of the market – resulting so often in the downfall of investors who try to predict or time its behavior – was superbly satirized by a man whom many call the father of value investing, the Columbia University economist Benjamin Graham. He was such a pioneering influence that two of his most famous disciples, Warren Buffet and Irving Kahn, named sons after him.

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It was Graham who invented the bi-polar, emotionally disturbed character he called "Mr. Market."

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In his allegorical lessons, Graham had the ingratiating Mr. Market arriving at your door every other day with something new to sell ... suddenly becoming depressed over, say, a slump in the bond market ... constantly jumping from sector to sector ... dumping everything one day, buying everything the next ... worrying himself into paralysis over quarterly earnings.

Trying to keep up with the schizophrenic Mr. Market was a recipe for ruin, said Graham. Focus on the fundamentals. Build your asset allocation on scientific data. Keep your emotions firmly in check. Diversify. And stay the course. That was Graham's advice to all managers (and by extension, all investors).

Set your allocation, said Graham, and establish your rebalancing methodology. Then, if you really can't resist the distractive ups-and-downs of Mr. Market, go and "live in a cave for a few years," to paraphrase the Columbia professor.

Just stay away from that addictive stock ticker ...

Graham compared the short-term performance of all markets to "voting machines" in which temporary winners and losers are chosen by popular and often ill-informed sentiment; whereas long-term returns are sorted out by the unerring scale of time, which always balances true.

In other words, Graham said, put history on your side.

Think of the markets as a measure, a data base, a colossally efficient repository of collective daily investment decisions. As the Nobel laureate Friedrich Hayek pointed out: the market is a mechanism "more immediate and precise than any system a human has ever devised."

So in your daily perusal of the business press, watch out for those fairy tales and amusement-park metaphors ... and that unpredictable Mr. Market.

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