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Let Simplicity be Your Guide – A History Lesson

When I reflect on 2008 I am drawn to events in the great Depression.

In his address to the U.S. Congress in 1936 President Roosevelt referred to the promise he had made to fix his nation's financial problems and how he knew he would have to battle with groups who had vested interests. He said, in part, "I made that plain when I took the oath of office in March, 1933. I spoke of the practices of the unscrupulous money-changers who stood indicted in the court of public opinion. I spoke of the rulers of the exchanges of mankind's goods, who failed through their own stubbornness and their own incompetence. I said that they had admitted their failure and had abdicated."

President Roosevelt noted that, as the danger passed, the vested interest groups forgot their damaging admissions and withdrew their abdication. He went on to say, "They seek the restoration of their selfish power. They offer to lead us back round the same old corner into the same old dreary street."

Now, more than 75 years later, we have again witnessed entrenched greed pushing aside moral values for the selfish interest of personal profit. Mortgage sellers ignored basic rules of credit-worthiness in order to line their pockets with fees. People in Wall Street financial organizations disregarded due diligence hoping to fill their vaults and their pockets with profits.

Concurrent with the historical replay there was widespread use of derivatives and seemingly endless hedge fund leverage which exacerbated the collapse when it came. While the economy was running smoothly and companies were hitting their targets, investors reaped the rewards. Unfortunately the investing world tried to get too fancy, with convoluted investment products and strategies becoming the norm.

But a question remains: Did anyone actually understand many of these complicated products? It appears many people felt secure in a bull market and risked their money on products they apparently didn't understand. Then, when everything collapsed with the onset of the credit crisis, the effect on world markets devastated ordinary investors. Pension funds were hit hard and personal retirement portfolios experienced huge losses. Even home equity values dropped.

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You can't change 2008 but you can learn from it. First and foremost, do not go "….back round the same old corner into the same old dreary street." If you are to improve your future outlook you must stick to the basics and eschew investment products that can't be explained clearly. Your mantra must be: "If I don't understand it, I won't own it."

There are opportunities now to buy stocks at bargain prices but you must think rationally. You should focus on owning solid, well-managed companies that have concrete plans for the future, that have good business ethics and which produce consistent profits and dividends. Balance sheets should be scrutinized while applying the principles of fundamentals analysis with a strong and objective focus on items like net assets, revenues, profit margins, debt, dividends and cash flow. If the company is going to prosper, so are you.

Demand full and transparent disclosure. If you do decide to invest in a leveraged product, you must know how the leverage is applied and to what extent.

Simplicity is beautiful, and it is particularly so in these times. It should be your guiding principle in forming a well-reasoned investment philosophy.

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