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Browsing at
Cracker Barrel

Drawing by
Chichi Guy

▲
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Managing Investment Emotions

Among the many emotions affecting net worth, anger is the most expensive. Consider the following mistake made by a professional investor.

In 1991 my son Alexander was thirteen years old. For several years he had owned a growth mutual fund that had performed very well. At mid-year, the president of the management company responsible for that mutual fund offended me deeply. (I still feel the pain.) Out of anger, I immediately sold that mutual fund, and purchased another. The decision felt good—for a few months. It was not until I prepared my son's 1991 income tax return that I realized the cost of my anger. The excess capital gains tax was more than \$1,500. “Excess” is tax I could have avoided by more reasoned decision making. All I had to do to avoid the excess tax was to wait until January, 1992, to sell the fund, because in that year Alex was fourteen years old, his income no longer taxed at my tax bracket. The total cost was higher than \$1,500. If I had not sent \$1,500 to Uncle Sam, it would be worth about \$2,200 today, assuming a ten percent return since 1992. Furthermore, I would not have incurred a second sales charge on the mutual fund purchased as a replacement. In total, anger reduced my son's present financial resources by about one-half of one semester's tuition at a state school—and I am a professional who should know better.

Investors cannot control markets, and their power to correctly time purchases and sales either is limited or nonexistent, but investors can attempt to control personal emotions. The most damaging is any form of emotion that

drives an investor to make potentially expensive decisions. Here are a few examples:

■ An investor called the office of his brokerage firm at 10:30 p.m.* A senior account executive answered (not the client's account executive), but declined to provide service stating, “We are closed, and I am on another line. Please call tomorrow.” Next morning, the investor called and said, “I will transfer my account unless I receive an apology.” The senior account executive,

*“Investors can't
control markets,
but they can attempt
to control emotions.”*

believing that his actions were not unreasonable, refused to apologize. The client transferred the account. The client's new account executive, being unfamiliar with securities in the account, recommended sale and replacement of many securities, generating both capital gains taxes and commission expense.

■ A brokerage firm paid dividend income to an investor. The investor was not entitled to the income because he had sold the relevant security before the ex-dividend date. When the investor refused to return the dividend, the brokerage firm filed a claim at

**This investor's corporate responsibilities included financial transactions in world markets, and he frequently spoke to various agents in the middle of the night.*

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arbitration. The investor made a counterclaim alleging various misdeeds. The arbitration panel threw out the counterclaim and ordered return of the dividend. The client's total legal costs exceeded \$10,000 to block return of an \$8,000 dividend. When asked why he made the claim, he said that he did not like his broker.

■ Investors frequently become infatuated with a new investment or strategy, or they befriend a new investment advisor. Resources to fund the new circumstance might be limited to assets on deposit with another advisor. Therefore, investors transfer assets, in most cases without talking to the former advisor, believing that the former advisor will try to "talk them out" of the decision.

When the first custodian receives the order to transfer, nontransferable assets might be sold and a termination fee might be charged. It is possible for total costs to exceed ten percent of the amount transferred. Potential costs are commissions or markdowns on assets sold, capital gains taxes, and commissions or markups on assets acquired.

The new-advisor phenomenon is a

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fascinating aspect of account transfers, which I describe by reference to relationships between the sexes. When a man and woman court, they each put forth their best appearance, and neither has responsibility to the other. Following marriage, the partners see each other more intimately, and begin to deal in subjects likely to produce disagreement, such

as family finance and raising children. Frustrations of dealing in this new way lead to a belief that someone else is more friendly and attractive. The movies "Seven Year Itch," "10," and

most Woody Allen films memorialize this phenomenon. Clients and financial advisors experience the same evolution of feelings. After years of dealing with one financial advisor, clients feel a need for something or someone new. Advisors might inadvertently exacerbate negative feelings by becoming too confident in the personal relationship. With time, advisors become willing to openly disagree with the client or to state that an investment decision is wrong. Though clients respect candor, being corrected is not fun. In these conditions, presentations by a new advisor have appeal. Unfortunately, changing advisors entails expense.

■ A person recently divorced is filled with emotions that include resentment and personal and financial insecurity. The most sensitive financial advisor has difficulty gaining trust of recently divorced individuals because emotions are volatile. Two cases demonstrate this point and associated costs. In the first case a recently divorced woman obtained a referral to a financial advisor who had no relationship with her former husband and lived in a different community. Her share of assets was transferred to the new advisor/custodian, but paper work was long and complicated. At one point the client

asked the new advisor to guarantee the signature of her former husband. The advisor, lacking a specimen signature, declined. She then transferred the account, producing commissions and fees. Queried two years later, she remembered as the reason for transfer refusal to tender the signature guarantee stamp, an event of no financial consequence.

"Leave 30 days between the point of anger and the point of decision."

A second experience involves a wealthy recently divorced woman who became disenchanted with four advisors in two months. Her first step was to move

assets from one full-service brokerage firm to another. Simultaneously, she sought counsel from a financial planning firm. After perceiving deficiencies in both the financial planning firm and the new full-service brokerage firm, she moved on to a fourth advisor, another financial planner. The costs of these moves involved various commissions and fees, disputes and emotional pain. She also lost opportunities. For example, had her money been invested for one year in tax-exempt municipal bonds instead of in a taxable money market fund, her net worth would have grown by an additional \$40,000.

■ In a future issue, I hope to find appropriate, sensitive words to discuss financial costs incurred by children who take charge of aging parents' net worth and change financial advisors. As we grow older, we increasingly depend on our children, and many decisions are made to accommodate needs of children. Decisions might involve complex, emotional estate-planning issues. Children might want a new financial advisor, someone younger, closer to home. However, change of advisors might be expensive and might leave parents with loss of a good

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friend—their long-standing financial advisor. Parents might feel lonely, dependent, uncertain. This transition of responsibility is very difficult.

Reducing emotion in investment decisions requires effort and planning.

The rules are:

- Never make a decision while angry. Leave 30 days between the point of anger and the point of decision.
- Discuss account transfers with the former advisor. While it is difficult to tell anyone that you are abandoning their services, ascertaining costs is more important. Professional advisors understand that some clients will move on, and the high professional standards of our society require that all advisors render comprehensive service regardless of the quality of a personal relationship. (Republican President Ronald Reagan jokingly asked his surgeons if they were Democrats—he knew it did not matter.) Advisors give important information to clients, if asked. When advisors receive a notice of transfer without prior notification, they do not volunteer information and advice, for the implied message of the transfer order is: “I don’t want to hear from you any more.”
- Analyze reasons for dissatisfaction.

Determine if dissatisfaction is a personality conflict with an advisor, an inefficiency by the advisor’s company, or a requirement of the financial system. If the dissatisfaction is personal, try to find a new advisor in the same company to avoid costs of changing firms.

- When dealing with a new advisor during times of stress, allow ample time, at least twelve months, to get to know the new advisor. Try to understand the reasoning behind each recommendation. The grass always is greener in a new pasture—until we trample on it.
- When assuming control of parents’ assets, converse at length with their advisors. Attempt to learn the rationale of investment and estate-planning decisions. Long-standing advisors have affection for clients and will work hard to help. If a change of advisors/custodians is required, discuss the change with the former advisor, and learn how to reduce the expense of change. Be very careful that sale of an investment or retitling of assets does not damage a well-designed estate plan.
- Write these rules down. Knowledge of rules is useful only when you need them. ▽

A Good Investor Knows the Territory

Learning to fly an airplane can help make a person a better automobile driver. You might guess that this would be the case. But when I tell you that flying also holds lessons for the investor, the reasoning may escape you.

An obvious characteristic of a good pilot is sensitivity to the condition of his aircraft and to safety in general, but he also learns to KNOW WHERE HE IS. Because a pilot must deal with multiple spatial relationships all at once—up, down, left, right, forward, backward—he develops a remarkable sense of where he is in the sky relative to compass directions, distance and time to a destination, and his position relative to hazards such as other aircraft. He brings this sense with him, on the ground, when he steps into his automobile for a routine drive around town.

Just as the experience of learning to fly makes a person a better driver, the experience of learning how to invest improves personal and financial management in general.

Good investors understand and accept their own relative position “in the scheme of things.” Without great thought, they learn how to deal with their own circumstances, such as age, marital status, net worth, obligations to children and job, and to their community and charitable interests. They come to grips with these issues so thoroughly that they can determine immediately whether an investment fits the limitations of their life. They know where they stand “spatially” with reference to the investment environment as a whole. Good investors are willing to abandon the search for certainty and to fully acknowledge that today’s decisions might not produce ideal results, yet to believe deeply and sincerely that it is OK to make a decision, despite unknown ramifications. A good investor KNOWS WHERE HE IS and applies this knowledge to both his personal and investment goals.



Drawing by Chichi Guy

What do you mean the market went down!

Consistency Reconsidered

Consistency in personal investing is advocated universally by investment advisors. Consequently, it was surprising to read that professional investor and author Michael O'Higgins has abandoned his most famous idea, "The Dogs of the Dow."

The Dogs investment strategy is based on averages published by Dow Jones. The most famous is The Dow Jones 30 Industrials Average, a descendent of an average started in 1884 that was composed primarily of transportation stocks. Since inception of the average, commentators have used it to forecast events or to choose investments. For example, one theory is that every time The Dow sells with a total dividend yield of less than 3 percent, subsequent market action will be sharply negative. In 1991, Michael O'Higgins described a theory that had been informally floating around brokerage offices for years. His book, *Beating The Dow*, was a bestseller. The theory is that investors can earn above-average rates of return by purchasing shares of companies in The Dow that are selling at the highest dividend yields. These stocks are presumed to be out of favor because their prices are low relative to their dividends. Corollaries of this hypothesis are:

- Investors should purchase and hold the 10 highest-yielding of the 30 stocks in The Dow whenever cash is available.
- Investors should sell the lowest-yielding Dow stocks and use proceeds to purchase the highest-yielding, perhaps once each year, always maintaining a portfolio of ten securities. This approach is more expensive than the first one above because it incurs more commission costs and taxes.
- Investors should modify the strategy by acquiring the five highest-yielding stocks instead of ten, or perhaps buy

"O'Higgins believes the Dow 'Dogs' are too popular for the gambit to keep working."

only the one highest-yielding stock.

These disciplines are compelling because stocks in The Dow Jones 30 Industrials Average are large, long-term, quality enterprises, and implementation is automatic and inexpensive. O'Higgins viewed his thinking as contrarian. He said, "I look at how the majority is thinking. Then I do the opposite." (The highest-yielding stocks are relatively low in price and therefore presumably less popular than the lowest-yielding stocks, which are high in price.) He also stated that "Dow stocks are the smart place to be in the 1990s," and claimed that his book demonstrated "that the individual investor [using his theory] can consistently outperform the market and most professionals by rather awesome margins . . ." Finally, he cast doubt on all other investment strategies by declaring that 75 percent of professional money managers fail to beat market averages.

That was 1991. Toward the end of 1997, The Dow 10 had earned 16.9 percent, not bad, but less than the 22.9 percent earned by the entire Dow, and much less than the over-thirty percent performance of the S&P 500. According to a *Time* magazine column (Daniel Kadlec, December 8, 1997, page 76), O'Higgins now believes that his dogs ". . . 'have become too popular and the market has become too high' for the gambit to keep working." *Time* reported that O'Higgins is writing a new book and will launch a new mutual fund based on "a different scheme . . ." This one has him 100 percent in bonds."

O'Higgins might be correct to change strategies, because the Dow Dogs strategy is extremely popular. Its popularity might be a force pushing prices too high compared to stocks that are not part of The Dow. Or, stocks in

general might be too popular; they might be selling at high prices relative to other asset classes, such as bonds. A switch to high-quality, long-term, long-call-date bonds could produce stellar relative returns in a very low-inflation or deflationary environment. But, a major, wholesale shift makes me very uncomfortable because:

- Funding a new strategy requires sale of the Dow stocks, generating large capital gains taxes (presumably some short-term) and transaction expenses.
- If O'Higgins is wrong, results could be disastrous.
- *Time* reported that O'Higgins sold all his stocks in 1993, a terrible decision. (However, he apparently did well in zero coupon bonds in 1997. Unfortunately, in taxable accounts both the income of coupon bonds and the accretion of zero-coupon bonds is taxed every year at ordinary income-tax rates, whereas price appreciation of stocks is taxed only on sale at low capital-gains tax rates.)
- Most individual investors are not prepared temperamentally to make dramatic shifts.

■ The old rule to remain consistent, to "stay the course," is likely to work best for most individuals, at least with respect to that portion of assets already committed to The Dogs. Most individuals change strategies at the wrong time. Those individual investors who do change strategies at the opportune moment do not revert to the former strategy at the next opportune moment.

The message is: Do not change asset allocation and investment techniques that have worked for you. Whether it be "The Dogs," or emerging growth stocks, or laddered bonds, or hedging in options, stick with it. Its day will come again. 📌

(I did not converse with Mr. O'Higgins, despite knowledge that newspaper and magazine sources often are either inaccurate or provide an incorrect slant. The reason I did not seek confirming information is that details are not relevant to my point that investors should stick to what they know best.)

Cracker Barrel Old Country Store

A good meal at Cracker Barrel might give you the taste of a good investment.

A few years ago on a drive to The Smoky Mountains, my wife Chichi, my children Alex and Laura and I discovered a Cracker Barrel Old Country Store. We were perfect customers: tired, edgy and hungry. We had mixed feelings about the large number of cars parked in front that meant both good food and a long wait, but the friendly hostess said “about twenty minutes,” not long enough to dissuade us.

The waiting area is not a waiting area. It is an “old country store,” filled with irresistible country trinkets, household adornments, cook books, tapes and other unnecessaries. In less than three minutes, I purchased three tapes of old radio shows, the entertainment of my youth: Jack Benny, Fibber McGee & Molly, and The Shadow. But for lack of space in our car, I would have purchased one of the wonderful rocking chairs displayed on the front porch. It is just as well. I don’t need a rocking chair.*

New Ways to Market Gasoline

Cracker Barrel started with one store in Lebanon, Tennessee. That was in 1969. Today, more than 300 stores are located in more than 31 states. Company literature describes the founding as one of those “realizations.” The founder was Dan Evins, a Shell Oil “jobber” who constantly searched for new ways to market gasoline. He asked, what would arouse enough curiosity to pull cars off the road and into a gas station? His answer: a store where travelers could relax, buy a meal, and browse through displays of authentic, local, rural artifacts of times gone by. The first store “was made of board and batten, and was chocked full with decorative items from yesteryear. It offered guests a large front

porch with rocking chairs to just ‘set a spell’. . . , if they wished.” (I still have days when I want one of those chairs.) While it might seem corny here in print, the Cracker Barrel atmosphere is genuinely appealing. The unique gift shop offers “a variety of early American reproductions of glassware, cast iron products, toys, various soaps, woodwork, candles and old-fashioned candies and jellies.” It is a perfect ambiance to browse during those five or ten minutes before a meal, and some day soon a psychologist is bound to hypothesize that browsing increases appetite. For me, the combination of being tired, bored from being in the car, the readiness to walk (browse) a bit, and the twenty-minute wait that seems like five minutes, is a perfect set up. I

buy a bigger meal than I would in any other circumstance. (The average expenditure of a Cracker Barrel customer is \$6.50. One in four customers purchases a retail item in addition to food.)

In February, 1970, Cracker Barrel Old Country Store incorporated and sold 200,000 shares at 50 cents each. By 1977, thirteen stores were located in Tennessee and Georgia, and most focused on sales of gasoline. As a result of the oil embargo, however, new stores were built without gasoline services, and today the focus is food and gifts.

A Star for Competence

Another focus of Cracker Barrel is friendly, effective service. A platitude, right? No. Good service is a result of a specific company incentive program,

possibly the only one of its kind in a national restaurant chain. Each service employee may earn between one and four stars. The stars are not awarded arbitrarily by a local manager. They are awarded for passing written tests administered by regional and national personnel. The criteria for stars vary by department. For example, kitchen personnel earn stars by displaying knowledge of the stations in the kitchen. Waiters and waitresses earn stars by acquiring detailed knowledge of the menu and the ability to answer customer questions about everything from fat content to spices. (Waiters and waitresses display their stars on aprons.) Store personnel in front, hosts and hostesses and cashiers, have similarly specific criteria to measure competence and ability to serve. Employees may not test for stars until they have worked at Cracker Barrel at least 14 months, and many earn four stars shortly thereafter. (The company-wide average time to earn four stars is 18 months.) Compensation

increases with each new star, and when four stars are earned, the employee obtains one of the most important benefits in the food service industry—comprehensive health-care insurance coverage. In food service the most important as-

set—quality personnel—is scarce and volatile. In Indianapolis, every food service outlet displays “now hiring signs,” and a fast food owner-client told me that his annual personnel turnover approaches 400 percent. Cracker Barrel believes that it has cracked this nut and has garnered the most well-trained, loyal staff in the industry. (This is a very tough nut: on average, each store has

“Some day soon a psychologist is bound to hypothesize that browsing increases appetite.”

“During the oil embargo new stores were built without gasoline services, and today the focus is food and gifts.”

*Upon reviewing this article, a Cracker Barrel company executive said, “We could have shipped it to you.”

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over 100 employees on two shifts.) Good food and good service must be reasons that Cracker Barrel ranked number one in a 1995 survey of 82,000 readers of *Consumer Reports*.

Cracker Barrel's Challenge for the Future

It is a stretch for me to recommend a food service stock and to acquire it for clients and for myself. Managing food service is very difficult. The challenges of ordering food supplies, maintaining cleanliness, delivering every meal hot and tasty, dealing with last-minute, no-show employees, satisfying the occasional impossible customer, tracking massive inventory and thousands of small cash and credit card transactions, and keeping the friendly smile require people-friendly management systems and a unique corporate culture. We admire McDonald's ability to manage, but many of its stores, particularly in the inner cities, are not pleasant, and each of us has encountered a less-than-perfect

"So far, Cracker Barrel has maintained quality, but what happens as the company expands?"

Hardees, Burger King or Denney's. So far, Cracker Barrel has maintained uniform quality, but what happens as the company expands?

Cracker Barrel wants to join the ranks of the big guys. It opened 50 stores in fiscal 1997, and it wants to do the same in 1998. Is such growth a result of management's delusion that they can run 450 stores as effectively as they can 250? Is enthusiasm exaggerated? Will we read about massive retrenchment in a few years? The possible answer to these questions is yes, but the probable answer is no, because management has shown ability to maintain quality and

to proceed cautiously. An example of caution is that Cracker Barrel does not advertise for weeks after a store has opened; it does not advertise until staff has control of the new store.

In fiscal 1995, Cracker Barrel earned \$66 million (\$1.09 per share) on sales of \$783.1 million. In 1996, the figures were \$72.3 million (\$1.19 per share) on \$943.3 million, and

Cracker Barrel Old Country Store

Symbol: CBRL
 Closing Price, January 28: 34 11/16
 Range: 23 3/4 to 35 5/6
 Dividend: .02
 PE: 23

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last year sales topped \$ 1.1 billion, with net income of \$86.6 million (\$1.41 per share). Consensus earnings forecasts are \$1.68 for fiscal 1998, and \$1.98 for 1999.

Incidentally, Alex and Laura, now 19 and 16, have become fans of Jack Benny, Rochester, Mary, Phil and every character played by Mel Blanc. As a family, we frequently bring back the good old days by playing that tape purchased at Cracker Barrel. 🍌

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