

## CONTENTS

Following a leader  
who fumbles

-----

The value-added  
business  
relationship

-----

On the nature of  
a bear

-----

▲-----  
Visit our  
Web site at  
[www.wpam.com](http://www.wpam.com)

-----  
Telephone:  
317-228-0800

Toll-free:  
888-868-3855

Fax:  
317-334-1795

e-mail:  
[thotfull@in.net](mailto:thotfull@in.net)

-----  
▼-----

## Great Investing?

Through history—from the East India Companies of the 16th century to Microsoft—investors have been attracted to the rich, the famous, the charismatic. “Invest with Warren Buffett, Peter Lynch, Bill Gates or John W. Meriwether,”\* say books and advertisements. “You can win by doing it their way.” But, does “following the leader” work?

In late 19th-century France, investor adulation was poured on Vicomte Ferdinand de Lesseps, the founder, motivator, and point man of France's most successful public work, the Suez Canal. From 1854 to 1869, de Lesseps cajoled leaders and financiers in London, Egypt, Constantinople and Paris with such dedication and personal charm that he became the Hero of Suez, the ingenious leader who made money for thousands of investors. He was the guardian of personal fortunes, the man known to every stock market investor. His fame spread as stock of the Suez Canal Company rose in price into the 1870s. He was Buffett, Lynch and Gates combined into one indomitable personality; he was the friend of nobility, government leaders, Jules Verne and Victor Hugo.

Only what does a man do after a success? Does he retire to an estate, or imagine greater glory and achievement? De Lesseps needed a new mountain to climb. He proposed railroads to Moscow, Peking and Bombay, as well as the astonishing idea of creating an inland sea in the Sahara. In 1875, he hit upon an idea that again captured the imagination of French investors: a ca-

nal across the Isthmus of Panama. Construction was estimated to cost \$214 million, or \$240 million, including interest payable (triple the cost of Suez). The canal would be finished by 1892, or after roughly twelve years of con-

“He did it before,”  
they said. “He will  
do it again.”

struction. The project was approved at the Congres International d'Etudes du Canal Interocéanique, May 15, 1879, a gathering of scientific minds from around the world, including the US, to consider the project.

Of the 74 delegates who voted for approval, only nineteen were engineers. Of those nineteen, only one had set foot in Central America. Ominously, none of the five engineers from the French Society of Engineers voted in favor.

Within days, de Lesseps raised two million francs from 270 investors who were to receive “founders’ shares” at bargain prices. A prospectus was prepared for the Compagnie Universelle du Canal Interocéanique de Panama, but the first syndication failed. Only 60,000 of 800,000 shares were purchased. Following this failure, de Lesseps traveled to Panama, reduced the estimated cost of construction, then

*continued on page 2*

## Great Investing?, continued from page 1

toured New York, Washington and a good part of France. He was received everywhere as a world business leader, a man for the front page.

De Lesseps organized a new stock sale to raise \$60 million (far too little) by selling 600,000 shares at 500 francs each (\$100), a significant investment because 500 francs was nearly a year's wages for about half the working population of France. As in modern speculative offerings, the terms were attractive: "Pay 25 percent now, the rest over 6 years; interest of 5 percent on paid installments and 80 percent of the profits when the canal is finished." In the background, investors knew that Suez stock, originally offered at 500 francs, was selling at 2,000 francs with a 17 percent dividend. "He did it before," they said. "He will do it again." Between December 7 and 10, 1880, this "IPO" (initial public offering) attracted more than 100,000 people who wanted twice the number of available shares. Eighty thousand people purchased only one to five shares each. Sixteen thousand were women. By the end of 1881, more than 800 Frenchmen were at work at Panama.

Yellow fever, cave-ins, fires, wash-outs, underestimation and poor planning led to pessimism and doubt. By mid-1885, talk of failure was in the air. More money was needed. De Lesseps, now almost 80 years old, proposed selling bonds with lottery tickets attached,

a device which saved the Suez Canal when a conventional bond syndication failed. By 1887, Canal Company stock was selling at a new low of 282 francs. Three conventional bond sales brought capital, but not enough. As a financial crisis loomed, de Lesseps had one last hope: the lottery bond. The Chamber and the Senate approved the bond in April and June of 1888.

Investment bankers agreed on a single, mammoth bond sale: two million bonds redeemable in 1987 at 400 francs (\$80), but priced at 360 francs (\$72), and offering a lottery drawing every two months. Lottery prizes were to be between 500,000 francs (\$100,000) and 1,000 francs (\$200). Over 7 million francs were spent on advertising. This bond sale was the talk of France. The sale should have been a success, but on the morning that the bond sale commenced, a person still unknown sent a telegram to every provincial city as well as to New York and London announcing the death of Ferdinand de Lesseps. Though false, the news was powerful. Only 800,000 of the 2 million bonds were sold. The company received less than a third of what it wanted and what it needed to survive. However, de Lesseps was not finished. He organized committees and rallies in favor of the bond issue. He visited 26 cities in two months. He reduced the price of unsold bonds. Nothing worked. By mid-December, three receivers were operating the Company. The Great Hero had failed.

"Following the leader" is a dangerous game. Last year's winner is unlikely to be this year's victor. Bill Gates (founder of Microsoft) was the brains behind the most widely used operating system. Does his first success guarantee a second and a third? Should we invest in a company because Bill Gates invested in a company? The concept, not the man, makes a successful stock. The Suez Canal was feasible. As designed in France, the Panama Canal was not. (It took another twenty years of

engineering to make it so.)

*\*John Meriwether created a hedge fund. According to the New York Times, Meriwether "was viewed as a bond trader with a Midas touch, a mathematician of genius who saw gold nuggets in markets where others saw only sand." His picture was on the cover of business magazines. Investors and lenders became so enamored with Meriwether that his fund, Long-Term Capital Management, achieved a total market value of \$200 billion. Last month, when trends reversed, the Federal Reserve Bank asked financial companies to bail out the fund on the hypothesis that its demise threatened the financial system.*

*Information about the French Panama Canal Company comes from The Path Between the Seas, by David McCullough, Simon & Schuster, New York, 1977.*

### Thoughtful Wealth Planning&Management

is published six times per year by Wealth Planning&Management, LLC. All rights reserved. Reproduction in whole or in part is strictly forbidden. News services may quote from this periodical with proper attribution. This issue was completed October 1, 1998. The DJIA was 7632.53. The S&P 500 was 1017.10.

Publisher: John W. Guy  
Editor: Lois Sherman  
Design: The Art Room

### FOLLOW THE LEADER?

- Thomas Edison notwithstanding, most great entrepreneurs and investors create only one success in a lifetime.
- Investors learn of financial and inventive genius after the fact. Profit from the original ideas of a genius might continue many years. Profit from his/her new ideas might not occur at all.
- When a countenance appears on the cover of magazines, the relevant success is past.
- If a countenance appears frequently over many months or years, a paid PR firm is at work. Sell the stock.
- Follow the concept. Dummies with the right concept make money.

# SHOW ME THE VALUE

The introspective investment advisor must occasionally ask: "What value do I add?"

The easiest answer (and therefore most suspect) is "I make money for clients." This answer fits the impression that professional investment advisors have unusual capabilities to select profitable investments and to time purchases (to buy low and to sell high). Another way to state this impression is that professionals have superior abilities to predict the future and that they therefore will make more money for clients than clients can make acting alone.

My view is that personal professional advisors provide a more comprehensive service. They "make money" for clients by bringing a broad perspective to the table, an understanding and awareness both of markets and of the countless ways individuals relate to markets. A corollary view is that advisors do not perform a valuable service every day. They do not acquire securities that appreciate every day, and every few years professionally managed portfolios might decline because the weight of market action dominates over selection of individual investments. Instead of providing measurably valuable advice every day, financial advisors provide one or two important suggestions over the life of a business relationship. Though infrequent, these suggestions have immense long-term value.

To illustrate, let us look at specific occurrences in which an investment advisor rendered immensely valuable advice. Some of these experiences are mine; some are from others:

In 1974, a utility executive called his advisor to sell shares of his company's common stock. The advisor looked back at the trading record

and asked the client, "Didn't you acquire shares two months ago?" Being aware of the rules, but having temporarily forgotten a transaction, the client instantly understood that a sale would have violated the then-existent "short-swing profit rule," which said that profit recorded from any combination of a purchase and sale within six months would be forfeited

"Over the course of a long-term relationship, a financial advisor is likely to render at least one piece of immensely valuable advice."

to the company (and would result in considerable personal embarrassment). The client did not place the order to sell. He thanked the advisor, and the two remained friends and business associates until the client passed away 15 years later. The advisor could not recall any other incident of rendering immensely valuable advice to this client. Nevertheless, both parties recognized that the advisor's experience with SEC rules pertaining to insiders saved the client hours of explanations and personal pain, as well as a handsome sum of money.

Awareness of the laws of estate settlement also result in immensely valuable advice. Here is an example. About 1980, a recent widow became the client of an experienced advisor. From 1980 to 1995, the advisor provided routine service, such as acquiring certificates of deposit and opening a basic individual retirement account. The relationship was good, and the client began to trust the advisor to a degree that surprised the

advisor, for, in 1995, the client asked the advisor to be her trustee. Commission-based advisors seldom accept the role of trustee, but this situation was unique because the closest living relative was a niece residing in another state. Therefore, the advisor accepted the role of trustee, and, under the rules of his firm, gave up the investment account to a colleague. He then preceded to organize the estate by obtaining help from an attorney and an accountant. When the client became terminally ill, the advisor took over all administration of the client's affairs, including paying bills. As the client's health deteriorated, the advisor recommended that she make lifetime gifts using the \$10,000 estate and gift tax exemption. He also noticed—just one week before her death—that a large checking account was not properly titled for efficient estate administration. This account was immediately changed to the name of the client's trust. When the client passed away, the advisor/trustee administered the estate. Reflecting on this experience, the advisor concluded that he had saved the estate over \$50,000 in potential taxes and had reduced settlement time from several years to under four months. He felt that he had rendered immensely valuable advice and service, but only during the last 18 months of an 18-year relationship.

On occasion, immensely valuable advice is rendered, but not taken. In early 1987, an advisor and her manager asked for a meeting with a client who was engaging in sale of naked puts and margin transactions. They asked the client to stop these activities. The client did not modify his behavior, and his net worth was eliminated in the 1987 October crash. A heart attack and other personal difficulties followed. Two similar situations arose this year, one happy, the other sad. In the first circumstance,

*continued on page 4*

# ON THE NATURE OF A BEAR

A confluence of unanticipated negative events causes bear markets. The confluence always is unimagined. For example, as recently as June, who could have predicted or even envisioned the Asian weakness, Japan in recession, the Russian government and economy in chaos, and talk of impeaching the President of the United States with his potential successor under investigation for violation of campaign finance laws? "There oughta be a law" against presenting so many different plays on the same stage at the same time.

While investors contemplate these events, they also must deal with declining net worths, at first an easy task, later a significant personal challenge. During the early stages of a bear market, investors are philosophical. They state that they are long-term investors who are not concerned about day-to-day stock market results. If the decline continues more than two or three

months, investors become stoic. They put on blinders and build emotional barriers. "I can handle this," they say. "It will end soon." Unfortunately, if it does not end soon, stoicism slowly gives way to helplessness, fear, and a feeling that "I cannot stand this anymore." Some market theoreticians believe that bear markets end when "everyone" declares "I gotta get out of here," and the market experiences a decisive sell-off on high volume when "everyone" abandons ship. (The terms "everyone" and "everyone else" are used frequently in interviews with professional investors. An example is, "I buy when everyone else is selling." Unfortunately, no one has statistically defined the terms, and I have wondered whether I belong to "everyone" or to "everyone else.")

Perspective is the only defense against irrational action. Answering these questions helps to gain perspective:

- Where is my net worth today compared to a previous date?
- How am I doing compared to others? (In a bear market, all equity portfolios decline. Knowledge that we all are in the same boat tends to calm nerves.)
- Will my personal life change as a result of market declines? (Usually, anxiety over potential consequences exceeds the reality of potential personal difficulties.)
- What is the history of bear markets? How long to they last, on average? How do advisors act during bear markets? How do journalists act? Do journalists tend to spread pessimism?
- Do my personal hypotheses and points of view make sense? (Example, a common view among older persons is that "I do not have enough life time left to experience a recovery?" Does a belief such as this survive logic based on stock market history?)

## SHOW ME THE VALUE, continued from page 3

a client began utilizing margin borrowing privileges to finance the construction of a new house. Upon observing this activity, the advisor called the client's attention to experiences of 1987 when some clients found themselves with substantial losses because they had borrowed against portfolios for reasons other than acquiring new securities. (Purchasing a home or car or financing trips are examples.) The client responded immediately by selling securities to cover the margin debit. Unfortunately, another person did not follow the same advice. In late July and early August, an amateur investor began

sharing personal investment information with a professional investor. The relationship was informal because the investor was not paying a fee to the advisor. The information, displayed in a complicated 15-column spreadsheet, described a program of purchasing stocks on roughly 30 percent margin and simultaneously selling covered calls. Upon reflection, the professional called the client to ask if the client had analyzed the probable effect of a down market. (A minor decline turns into a major disaster when investors have utilized margin borrowing.) The investor said that he was not concerned. A

month later, with the market down over ten percent, the advisor learned that this investor might seek protection using the laws of bankruptcy.

My guess is that over the course of a long-term relationship, a financial advisor is likely to render at least one piece of immensely valuable advice. The advice arises from coincidence when the advisor understands both the investment markets and the client's personal situation. Usually, the value of advice is not recognized at the time it is delivered. Instead, it is recognized months or years later.

PLEASE READ THIS DISCLAIMER: Clients and principals of Wealth Planning&Management, LLC, may own securities mentioned in this newsletter. This newsletter is designed to stimulate thought, to help readers to formulate investment philosophies, and to encourage the assumption of risk. However, WP&M does not in any way warrant results from the use of information in this newsletter. WP&M does not guarantee the accuracy of this information. The information is not an offer to sell, or a solicitation of an offer to buy, any security. Readers should not assume that recommendations herein will be profitable or will equal past performance. The possibility of loss is inherent in making any investment, and no information source, including this one, can present all facts and all risks.