

“WARREN BUFFETT’S RULE #1”

September 2023

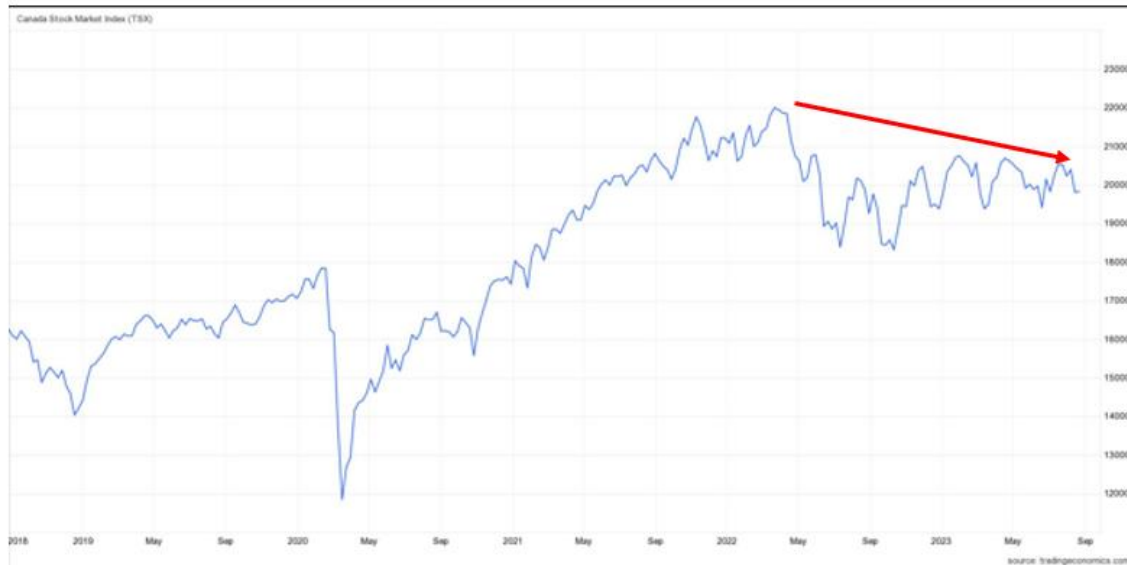
By Brahm Satov

Warren Buffett is renowned for his ability to make money, but his rule number one may surprise some who are unfamiliar. Buffett is one of the top ten wealthiest in the world, he is the CEO of Berkshire Hathaway and his reputation is that he buys stocks that are undervalued and holds them, usually for long periods, sometimes indefinitely. Buffett started investing just after the Great Depression when stocks were cheap so he certainly had a tailwind in terms of timing. In addition, Buffett learned from his Columbia University professor, Benjamin Graham (author of the Intelligent Investor), that the key to making money grow was the compounding of interest. I would like to dedicate this newsletter to a good friend of my dad's and a friend of my family, Roy Wayment, an honorable man, he will be missed. After my dad passed in 1999, not many of his friends came to see our family, I understood this, but Roy took it upon himself to regularly check-in and visit.

So what is Warren's rule number one, believe it or not, it is “don't lose money”. By the way, his rule number two, is “never forget rule number one”. Nonetheless, when it comes to the markets many emphasize that is important to be in the markets on the best days, but I would postulate that it is actually more important to be largely out of the markets on the down days. The reason for this is simple, if an investor loses 50% of their investment, they need to recoup 100% to get back to break-even. (Let's say an investor has \$1M and loses 50%, or \$500K, if the remaining \$500K recovers by 50%, they are only at \$750K ($\$500K \times 1.5\%$), they need to double the \$500K to get back to breakeven, or rise by 100%. It is true however that the stock markets over time have gone up on more days than they go down. But sometimes, when the markets are tremendously overvalued or a recession is likely the probability that the stock markets go down rises substantially, it is in these times that I would suggest a defensive posture. As I have been recommending for quite some time now.

One of my good friends, called me not long ago and said, the markets have been, in his words, “ripping”. In essence calling me wrong, as he is right, I have been quite cautious for some time. Whilst it is true that I remain cautious, I have been calling this the “kangaroo” market, meaning I expect it to bounce up and down for a while (look at the chart for the TSX, you can see the hopping), until momentum starts to wane as evidence of a slowing economy takes hold, it is at that point that I expect stock markets to have difficulty. Nonetheless, some may not realize that although unusual, it has been quite a while since most equity markets have made new highs, in fact for the S&P500 it has been more than 17 months, or about a year and a half. Even the TSX has not made a new high since early 2022. That’s right, so for well over a year, markets have been down, not up. Sorry my friend, but these markets that you say are “ripping”, they may be up for the day, the month, etc., but since 2021, they are still...lower. So, if investing has been difficult of late for you, you are not alone, as this has been the case for most investors. Whilst, we have seen few stocks trade higher, most stocks are still well off of their 2021 peaks. Yes, that means that most investors’ portfolios are down from their peak in 2021. However, some good news, if you own GIC’s, than chances are that your portfolios have seen growth and that rate of growth has been increasing if you are rolling GIC’s, since GIC rates have been trending higher. Albeit, you may not see the interest until the GIC’s mature, but enjoy the build-up and the knowledge that GICs are far safer than the stock markets and in my opinion, a very good place to be when the risk of correction is high. Especially, if we should see a significant equity market correction. And for those keeping score, the TSX was down approx. 9% in 2022 and as I write this is up only about 2% or so, so far for 2023.

Chart on the TSX



Source: [Tradingeconomics](https://tradingeconomics.com), Aug 28/2023

I agree with Warren in terms of his rule number one, of course he, like every investor he has seen down years. Nonetheless, by limiting losses one can improve overall performance and certainly lower exposure to risk. In my opinion, by taking on less risk when the possibility of correction is high, the ride for investors can be less volatile, more comfortable if you will, and then readjusting when the coast is clearer. This always made sense to me and in my opinion, still does. In other words, don't forget Warren's rule number one!

Thank you for taking the time to read this, please feel free to e-mail me any feedback or comments.

Sincerely,
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