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THREE NEW YEAR'S RESOLUTIONS

Having a sound and consistent investment philosophy is crucial to achieving superior long-term results. The noted investment counselor, David L. Babson, first proposed the following resolutions more than fifty years ago and they are every bit as valid today as they were then. Except for a few minor updates, this newsletter was originally written by Mr. Babson in 1969.

In these final days of December, we would like to propose three New Year's resolutions. They constitute what we have observed over the years to be the foundation of a sensible philosophy which, if followed, is the surest and safest way to attain successful results:

***I Resolve*:** To pay no attention to my own or anyone else's predictions as to what the stock market is going to do over the next few weeks or months.

***I Resolve*:** To adhere faithfully to my long-term investment plan which I have drawn up on the basis of predictable rather than unpredictable trends.

I Resolve: To think of myself as a part-owner of the companies in which I invest and not as a buyer of pieces of paper I hope later to sell to someone else at higher prices.

One investment myth which never seems to die is that stock market swings can successfully be predicted. It is amazing that so much attention is devoted to what is nothing but a pointless guessing game.

In recent weeks, the financial pages have been full of forecasts of the trend of stock prices next year. Whenever we hear people remark that "so-and-so says the market will move much higher" or "such-and-such firm is looking for a big decline," we wonder why anyone bothers to read all this nonsense.

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The accuracy of previous predictions can hardly be the reason. This is obvious to those who have made a point of noting the market forecasts made at the beginning of any of the past 5, 10 or even 25 years. The fact is that these annual prognostications are so quickly forgotten that "market seers" can make them year after year without risk of damaging their reputations.

By some quirk of investor psychology, the only type of stock market prediction people remember is a bearish one made prior to an historic decline. This is the case even though it may have been made over and over for years while stock prices were rising sharply.

In contrast, few people recall bullish forecasts which are later proved either right or wrong. For example, it is now almost forgotten that in mid-1929 Bernard Baruch urged the purchase of common stocks because "the economic condition of the world seems on the verge of a great forward movement."

What we wish to emphasize, though, is not that Mr. Baruch should have known better. Throughout his lifetime, this talented financier had a much greater insight into the future than all but a handful of his peers. Rather, the point is simply that *no one can accurately and consistently predict the stock market*.

Over the years, we have observed that the most successful investors have been the ones who pay the least attention to short-term forecasts. On the other hand, those who are always trying to outguess the market nearly always end up with a long string of unnecessary losses and missed opportunities.

Many learn from their bitter experience. But others never do. They remain confirmed addicts of basing their strategy on which way they think stocks are temporarily headed. Accordingly, we suggest as Investment Resolution Number One:

> ***I resolve to pay no attention to my own or anyone else's predictions as to what the stock market is going to do over the next few weeks or months.***

Another reason why some investors have unsatisfactory results is their failure to establish a long-range strategy. Having a sound plan, and holding to it, is just as essential to building a list of suitable investments as it is to constructing a house. Yet only a small percentage of people ever draw up a financial plan and follow it faithfully through recurrent periods of optimism and pessimism.

Too many investors accumulate their holdings on the basis of tips, rumors or the casual comments of friends. Their portfolios become illogical mixtures of securities, scattered at random among industries with widely varying characteristics. Only relatively few shareowners have a clear idea of their long-range objective -- i.e. what they hope to accomplish with their capital.

Those who do have a definite goal frequently abandon it somewhere along the line. Some are lured into speculating in unseasoned issues which are totally alien to their needs. Others become panicky and sell out all their holdings at depressed prices.

The trouble is that setting up and adhering to a basic plan is not easy. It requires great self-discipline to stick to the original guidelines under all types of conditions and it calls for a more cold-blooded, unemotional attitude towards one's capital than most people can maintain.

Some investors also allow their judgment to be swayed from time to time by too much obsession with future uncertainties. Yet this obstacle can be avoided if the major economic and investment trends which can be predicted are weighed against those which cannot. A reasonably complete balance sheet is the following:

The Unpredictables

- *What stock prices will do next week, next month or next year.*
- *How and when investor moods will change from optimism to pessimism, or vice versa.*
- *Which group(s) of stocks will become the next fad.*
- *Whether international developments will bring war or peace.*
- *How the political winds will blow.*
- *When business activity will swing up or down.*

The Predictables

- *The population of the U.S. and the rest of the world will keep on growing.*
- *More people will need more goods and services.*
- *Research will develop new products and techniques, leading to more demand and greater productivity.*
- *The burden of taxation will become even heavier.*
- *The dollar's buying power will continue to decline.*
- *Well-managed corporations will, as a group, maintain their long-term progress of earnings and dividends.*

The above list could have been drawn up at any time during the last two decades. Yet throughout this period the *predictables* have had a far greater influence on most investors' portfolios than the *unpredictables*. For this reason, we submit as Investment Resolution Number Two:

I resolve to adhere faithfully to my long-term investment plan which I have drawn up on the basis of predictable rather than unpredictable trends.

A third pitfall is the widely held belief that the only way to have good investment results is to "buy low and sell high." This approach -- which is as old as the stock market itself -- has lately become more popular than ever due to all the publicity given to "performance investing" (a modern euphemism for short-term trading).

The current scramble for "instant results" has fostered the idea that common stocks are just pieces of paper to be bought and sold like commodities. Consequently, many investors consider the in-and-out approach synonymous with having an "aggressive" policy. With this goes the notion that the higher a portfolio's turnover rate (i.e. the faster its holdings are churned), the more likely it is to do well.

Unfortunately, all the new emphasis on trading is misleading the public as to what investing is all about. It lures those least able to afford losses into thinking that the "performance" cultists have some new technique at their command when they are only doing what in-and-outers have done for decades. It was also responsible for the dangerous appraisal levels to which many lower-quality stocks soared in the past few years.

Today, many new investors may be drawn into speculation because they think the "buy low, sell high" approach is the only way to build up their capital. In these Letters over the years, we have advocated an aggressive investment policy that is much *more certain* and far *less risky*.

Briefly stated, this better course is to invest in those industries and companies which -- because of the nature of their business, the capability of management, their emphasis on research and other favorable characteristics -- are almost certain *as a group* to achieve strong future growth of earnings and dividends.

The investor in such stocks should adopt the same attitude as that held by the typical owner of a private business. The latter is committing his capital to an enterprise he believes will do well over a long period of time. If sales and earnings should run into some temporary difficulty, he sees no reason to rush out and sell the business.

It is because of this frame of mind that many investors today own the shares of Automatic Data Processing, Colgate-Palmolive, MasterCard or similar companies at a cost basis of only a small fraction of current market value. And they are now receiving annual dividends equal to 20%, 50%, even 100% of their original investment.

In contrast, a much larger number of investors have never owned the shares of these or comparably successful companies. During the past 5 years, for example, MasterCard has been a stock which nearly all knowledgeable investors have known they ought to own. Yet during this whole period only a small portion of stockholders has actually added it to his or her portfolio.

Others may have owned MasterCard or similar outstanding issues in the past, but they later sold out because of their own or someone else's concern over short-term developments. Therefore, we put forth as Investment Resolution Number Three:

> ***I resolve to think of myself as a part-owner of the companies in which I invest and not as a buyer of pieces of paper I hope later to sell to someone else at higher prices.***

These three resolutions, taken together, constitute the foundation of a sensible philosophy for investors to follow in the coming year as well as in future years.