

## Is a Picture Worth a Thousand Basis Points?

By Mariko Gordon

February 14, 2012

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I've been seeing double lately. No, not from taking blows to the head in the boxing ring and not because I've been hitting the sauce (I don't drink).

Rather, it's the result of being around twins a whole lot more than ever before.

First, there's Matthew and Michael, identical twins of Daruma COO David Gerber. These two 13-year olds, though they like swapping places from time to time, are otherwise so suspiciously well-behaved that I wonder what they put in the water in Bergen County, NJ.

In contrast, my great nieces Gwen and Ellery are fraternal twins and conclusive proof that nature trumps nurture every time. One can recite Shakespeare and the other grunts like a caveman; one will conquer through charm and the other through brute force. In short, they squabble constantly.

All this twin action has brought me back to elementary school, remembering two classmates who were not only identical twins but [mirror image twins](#). While technically "identical," one was right-handed and the other was left-handed. As a result, watching them at the blackboard in matching red plaid school uniforms was like having a mirror image hallucination.

But it's not just children - lately I'm seeing twins (mirror image ones, no less) in my business as well. In this case, it has to do with our buy and sell execution.

Here's what I mean...

As you may recall, our last [newsletter](#) introduced Daruma's "investment process auditor" Dan S. My hope was that Dan could show us where we had spinach in our investment process teeth. (Trust me, NO investment firm is 100% spinach-free, no matter what their marketing bilge says.)

So what did Dan discover? First the good news: He confirmed what the behavioral finance mavens at [Cabot Research](#) quantified - that we add a lot of value through our sell



discipline.

In particular, we did a great job selling stocks that had been big winners after there was a sharp break in the price (of the sort that suggested something big had changed in the company's prospects). We were right not to hang on, since these stocks went on to underperform. In short, we didn't fall in love with our big winners, and knew trouble when we saw it.

Now for the bad news and my tendency of late to see twins. Dan revealed that our population of losers included a cluster of good companies coming off of great stock price runs that we bought when some kind of trouble made them cheaper.

I was stunned.

"Do you mean to tell me that from a place of knowledge we sell the first break, but sometimes from a place of ignorance we buy the first break?" I asked. "Yup. Pretty much," said Dan.

If you don't live in the stock picking trenches as we do, you have to understand that no matter how much due diligence you do before you buy a stock, you will never know a company as well as after you've owned it for a while.

In our case, buying good companies after a long run and at the first sign of trouble turned out to be a losing proposition. In effect, we were sometimes buying the types of stocks that were our most successful sales.

This was in stark contrast to our biggest winners, which were stocks we also bought after a decline, but - and here's the important distinction - after enough time had passed to allow management to cure what ailed the company and get the business back on track.

Our biggest winners were those where the fix was in when we bought them - but nobody cared or believed it - and the stock had been given up for dead.

Some of our losers, on the other hand, were those that we bought too early, so eager were we to buy good businesses at what we thought was a good price. It's the stock market equivalent of buying a dress marked down 20%, only to discover it marked down 40% three weeks later.

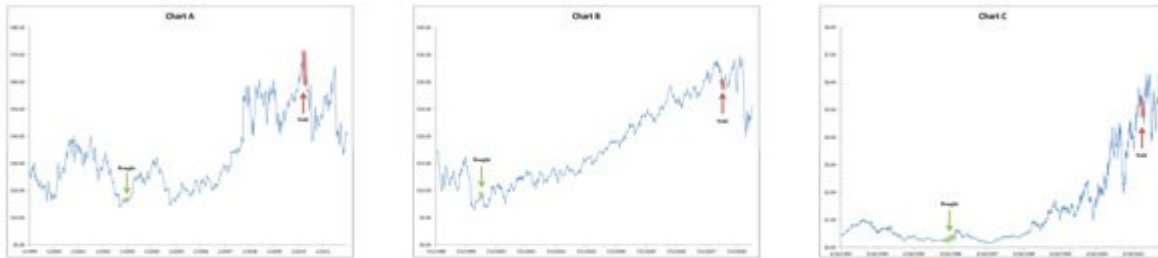
In the end, Dan and I pored over close to 17 years' worth of stock charts. If a picture tells a thousand words, a stock chart is the equivalent of War and Peace.

But there was no denying it: the charts between the good sales of our big winners and the bad buys of other people's big winners were IDENTICAL. The results, however, were a

MIRROR IMAGE - identical twins moving in opposite directions.

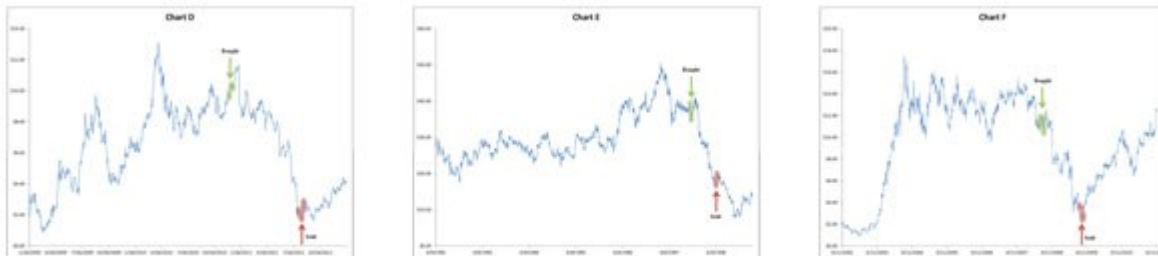
### War and Peace in Six Charts

Charts A,B,C: three very different companies, three very different market environments, yet three similar pictures. Stocks bought after a long period of decline or consolidation tripled, quadrupled or octupled.



[click to enlarge](#)

Charts D,E,F show the opposite result. When we bought the first significant break after a long upswing that other shareholders had benefited from, we were left holding the bag. There hadn't been time to heal what ailed the company, nor for investors to give up hope. We do better buying what no one cares about anymore rather than buying after the first big disappointment.



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*Mariko O. Gordon is founder, CEO and CIO of Daruma Asset Management, a NY-based small cap investment management firm. Subscribe to her free monthly e-newsletter On Daruma's Watch [here](#).*

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