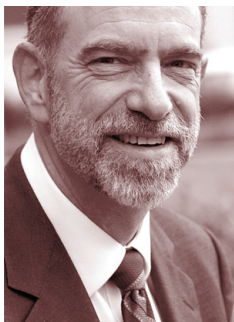


NUMBERS



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What time is it? How much does this cost? How many calories are in that dessert? We are awash in a sea of numbers. They may be favorable: How much is our portfolio up this year? Or disturbing: How many people were killed today in Iraq?

For investors, the profusion of numbers is daunting. What's the current economic growth rate? What's going on with interest rates? What's our current asset allocation? The amount of data that confronts us can be overwhelming. At the same time, as participants in the marketplace, we are called upon not only to try and make sense of it all, but to make good investment decisions.

There are many numbers these days that people in the investment world are particularly concerned about. We are concerned about budget and trade deficits. Skyrocketing oil prices. Demographics. Will the government have enough money to meet Social Security and Medicare expenses of retiring baby boomers? What about prospectively low returns that may be generated on investments over the next several years?

One especially hot topic right now concerns the global financial system. In the face of low expectations and investors' demand for high returns, we have witnessed an explosion of hedge funds, private equity transactions and other "alternative" investments. Many of these investment vehicles involve significant

"financial engineering" – leverage and complicated derivative securities. Some economists see these trends as sources of great benefit to our global society; that we have found new ways to reduce risk and increase wealth and liquidity throughout the system. Others see signs of impending trouble – that these vehicles and securities are untested. That we are in over our heads, and are on the edge of a global financial meltdown. In truth, there are potential blow-ups on the horizon that could create significant disruption in the markets. At the same time, devastating as such an event might be, we need to keep in mind: it's all just numbers.

In the world of business and finance there has always been a focus on the numbers, particularly the bottom line. What are a company's revenues this quarter? What's the net profit margin? What are the company's earnings? Similarly, for investors: What is the stock's P/E ratio? How has it performed?

Over the past several decades, the world has become increasingly attentive to this focus on capital markets and numbers. We have witnessed remarkable growth in global trade and emerging foreign markets. Similarly, in other areas, such as government and our community organizations, we see a trend towards operating in a more "business-like" fashion. To develop metrics by which we can measure performance. To operate efficiently. To focus on the numbers.

Oddly enough, in the world of investments, I see today an opposite trend away from this focus on the numbers. For example, when evaluating risk, we have traditionally measured it on the basis of volatility. At a recent investment conference, however, Peter Bernstein, who has been described as a “leading philosopher of risk,” cautioned us that it is dangerous to think about risk as a number. When we are talking about risk, what are we really trying to get at?

At the same conference, David Swensen, who oversees Yale University’s endowment portfolio, which has achieved extraordinarily high returns over the past several decades, was asked how he selects the investment managers who generate those astonishing returns. “Three criteria,” he replied. “(1) People; (2) people; (3) people.”

In a similar vein, according to a recent Wall Street Journal article, accounting rule makers are currently looking at eliminating net income, the bottom line figure on financial accounting statements. They recognize that businesses are complex and entail many uncertainties. Figures such as net income are overly simplistic and too easy to manipulate.

In the marketplace, we have a responsibility to play by the rules – to act fairly and ethically. Within that context, however, we also have the responsibility to act in our own best interests: to try to maximize our returns. That’s how it works. Sometimes we win, sometimes we lose. Anyone who enters the market should be prepared to compete. The numbers are important.

And yet, their meaning is limited. In another recent newspaper article, I noted that a certain hedge fund manager earned

compensation of \$1.5 billion in 2005. Then last year, in 2006, the same manager earned \$1.7 billion. I find such numbers staggering. Is this a sign of success, I wondered? Or of failure? In all honesty, I think they indicate a system that has somehow gone awry.

In and of themselves, however, such numbers don’t really mean anything. What matters is what those numbers represent. Where did all that money come from? How was it earned? To what purpose will it ultimately be applied?

Granted, it is a subtle difference – yet a profound one. The numbers are useful. They help us with our analysis, keep track of our progress, and measure our success. But they are merely abstractions. It’s easy to get swept up in the numbers, and lose sight of the substance behind them.

As we seek to find our way in this wilderness, what is most important, I believe, is that we keep our focus on what the numbers are really all about.



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