Back to Basics: Understanding Mr. Market's Behavior for Successful Investing

Dave [00:00:00]:

All right, folks, welcome to Investing for Beginners podcast. Today we are going to take a look at back to the basics. This is our continuing show that we're going to do every Thursday for about 20 episodes or so. So please come back every Thursday if you want to learn more about the stock market and become a better investor. So today's topic is we're going to talk about Mister Market and how he can help you when you're buying low. So let's talk about Mister Market. So Andrew, do you want to give everybody maybe a background on who Mister market is?

Andrew [00:00:33]:

Not really. So Benjamin Graham, who is one of Warren Buffett's mentors, he actually taught an investing course at Columbia, and Warren Buffett was a student there. So Benjamin Graham wrote a book about stock picking, 1930s or something, and then they revise it in the 1950s and then the 1970s, revised it again. But it's, if it's not like the best seller book on investing of all time, it's certainly up there. So this book, the intelligent investor, has a chapter in there about Mister market. And it's Benjamin Graham trying to describe what the stock market is and how it kind of behaves and how we can think of it. So if you think about stocks as businesses, which is what they are, a share of stock is a part ownership stake in a business. So if we think of stocks as businesses, think of Mister Market as a business broker.

Andrew [00:01:34]:

He's constantly looking to buy businesses and sell businesses. And so he shows up at your doorstep every day and he either wants to, really wants to buy your business or really wants to sell it. And so if we think of it that way, of Mister Market's this guy who can get kind of loopy sometimes. And he has some really bad days. He has a flat tire and his dog, you know, peed in his couch and everything, marketing and other days he's on sky nine. Think of it that way, it can kind of help understand the way the stock market fluctuates and has continued to fluctuate year after year after year after year. So how do you kind of look at Mister Market as far as like, how do you picture that metaphor? I feel like I played it.

Dave [00:02:21]:

You know, I think a good visualization for me is, are you familiar with those Allstate commercials and the guy that causes all the havoc and. Yeah, that to me is Mister Market is, you know, I visualize this kind of off kilter person that just is out to create chaos, whether it's on the upside or the downside. And buddy shows up every day to work, he's there every day to drive you crazy or offer you a great deal. And it's kind of like that dichotomy of like, you know, the super salesman that's got all the language and can really sell you on stuff. And then it's also kind of the manic person that is trying really, really hard to get rid of whatever it is. You know, they'll offer you any deal you want to take to, you know, buy this at a low, low price of 1999 kind of thing. And that's the mental model that I have of who Mister market is and kind of how they behave.

Andrew [00:03:26]:

Yeah, I think Warren Buffett has talked about Mister market basically saying that the market's going to come at you with different prices every single day. But if you have a business that you like Apple or Coca Cola, in Buffett's case, then just because Mister Market says, hey, I want to buy your business for pennies on the dollar, doesnt mean you have to sell it to him. But you get questions all the time from investors. Its like, oh, my stock is down 50 60%, should I sell now? Because its down. And that doesnt sound like a crazy question, but the idea of selling the business that you enjoy for pennies on the dollar because Mister Marcus shows up at your door, that does sound crazy. But were really talking about the same thing because I do find that thinking of Mister market in that way is very helpful when I see my stocks go down because it reminds you that, yeah, this is not, more times than not, its not a permanent thing. This is just the market being the market. Trey.

Dave [00:04:28]:

Yeah, and to me it helps visualize the ups and downs that you will see and the market sentiment about the core industries or companies. Because when you think about meta, a year ago, mister Market was very down on them and the sentiment around the company was very down. And so it was very easy to visualize, you know, kind of this, you know, grumpy person showing up to go, yeah, you gotta get rid of this. Get sell it now. It's trash. Get rid of this. You know, and that's like the little demon on your shoulder, right, talking in one ear like, meta is trash, you gotta get rid of it. Why you continue to hold this? This is junk.

Dave [00:05:06]:

Don't buy more of this. What are you nuts? You know, that kind of thing. And then, you know, the other side of Mister market is like, hey, this is a great opportunity, this is a great company, you should consider looking at this and you know, so you have those two dichotomies every day you're showing up to talk to you in your inside voice of what companies you should buy and sell. And it really helps me, when I think about it, when I think about those kind of illustrations, it really helps me visualize mentally what I'm trying to fight against.

Andrew [00:05:36]:

Yeah. It reminds me doing of dick sporting goods. You remember talking about that a few months ago?

Dave [00:05:40]:

Yep.

Andrew [00:05:40]:

We didn't talk about on the show. We were talking about it privately. The stock crashed like 25% overnight. And at the time, the sentiment was, there was a lot of sentiment about retail in general, which is weird to me that it's not talked about six months later. Like it's just like it's old news but it's still happening.

Dave [00:06:02]:

Right.

Andrew [00:06:02]:

But you know, the shrink issue and the way it's impacting all these retailers, that was front and center and everybody was talking about it six months ago. And it definitely contributed to the stock price coming down. And so, like any investor, I panicked, right. And like, okay, I need action here. But you know, having you to kind of talk me off the ledge and think of it more rationally, the end conclusion was its possible that the stock price crash is saying something about the long term viability of this business. For example, they have this new concept called House of Sport that they're rolling out. That is an uncertain investment. We don't know how it's going to turn out.

Andrew [00:06:47]:

So it could be a signal but also could not be the mindset. Instead of, oh, the stock price went down. What is Wall street trying to tell me is, oh, if the business changes in the next 2345 years, thats going to play out in the numbers. And to me, thats a very refreshing way to think about the business because like you said, if its driven by sentiment, everybodys saying something about a stock, they could be saying it could be true or could be not, but you will see it play out in the financial statements over the years. So you dont have to play that guessing game of is the App Store going to do this or is AI going to take out Google like this and all of that? Just garbage you can throw away. If you just look more at the business itself and more importantly, not just the business but the financials of that business and how those are trending over time, its a much better way to put a stiff arm on Mister Market and say, look, I understand you want to come at me with a new price today, but Im going to just watch how things go. Its a nice mindset for me when Im hanging on to something. And it definitely helped for Dick's sporting goods.

Dave [00:07:55]:

Yeah, I think, you know, framing it that way really helps you avoid a lot of the emotional upheaval that can go on in the markets. If you watch the news at all, which you shouldn't, you will see that there's lots of sentiment. You know, they're the people talking on those shows. All are talking. I'm not saying they're talking about facts, but a lot of what you're talking about is the hype and the emotion of different things. You know, you mentioned, you know, Google going out with a, and Google certainly had some missteps recently with their rollout of their AI. But there's always, a year ago, there was talk of Bing becoming the dominant search engine and that there was all this fear that Google search was going down, and that was the sentiment around it. Then a few months later, you see reports of the market share and hadn't moved an inch.

Dave [00:08:52]:

It hadn't affected a single thing. And I admit I signed up for one of the big accounts because I wanted access to their AI to see what it was like. But I used it once or twice and I was eh, and went back to Google Search, and that was just, I think most people did the same thing. But you could see it in the numbers when you looked at the numbers for Google. And if you look at it even a year removed, it still hasn't budged. And so, like you said, there's always some noise to give you some pause for reacting a certain way. And our job is to try to be rational and look at the numbers and try to avoid what Mister market is saying just because he's trying to bully rush you into selling Google or buying Google. You don't have to listen to him.

Dave [00:09:39]:

Like you said, stiff arm him, say, nope, we're not playing today.

Andrew [00:09:42]:

Yeah. So how can we use Mister market as an opportunity? Because kind of talking about the sell side, okay, it makes sense that you don't want to knee jerk, react to a price coming down and then make you sell out of a stock, even though emotionally you might want to. But how can we use the emotions of Mister market against it and find great opportunities to buy? Robert?

Dave [00:10:07]:

Well, I think the most obvious way to me is to take advantage of that market sentiment. If youre studying a company, you understand the financials. And then some news comes along, Netflix, some news comes along that their subscriber count fell for the first time ever and it dropped 2020, 5% in a day. That could have been an opportunity to buy the company right then and there because the market is saying that Netflix is over and that Mister market is telling everybody, get rid of this. Sell it, sell it, sell it, sell it. Because they, you know, it's over now. They drop, you know, Disney has taken over and it's all over for Netflix. And if you knew Netflix well, I'm not saying I did, but if you knew Netflix well, you could have taken an opportunity from that drop of 20% and bought a good company, a 20 or 25% decrease from that particular day.

Dave [00:11:03]:

That's what I did with Dodgin when it dropped 50%. When you really know a company and the market presents you with an opportunity, that's when you can really jump on it and you can really take advantage of. Just because, because the tide is going out doesn't mean it'll drop all boats, but it doesn't mean that your boat necessarily is dropping because it's performing poorly. There's a difference. And I think that's where you can really use Mister market to your advantage.

Andrew [00:11:30]:

Yeah, I felt like FISA was a good example of that. Maybe what, 2021? 2022?

Dave [00:11:37]:

Yep.

Andrew [00:11:37]:

You bought some at that time?

Dave [00:11:39]:

I did. You know, I, I took my first bite during the pandemic when I dropped 30, 40%, and that was a huge opportunity. But there's been a few other times since then that the market has turned negative on the company for a period of time and it dropped. But if you looked at the financials of the company versus what the market sentiment was telling you, those two didn't line up. You knew. Yes, the cross border payments, which is a very profitable segment for visa, is down during the pandemic when people arent traveling. So you know that when travel comes back, thats going to rebound hard and thats exactly what it did. But the market was being short sighted and looking at, were seeing this now and im going to react to this now because maybe they feel that visa is expensive or overpriced or its a bubble or whatever.

Dave [00:12:36]:

And if you understood the company, you knew that, that once the pandemic was over, people were going to get back on airplanes and go fly and go on vacations and take trips and all that stuff, which is exactly what happened. And it would rebound. And it has. And now it's beyond the sales it was doing in 2019 before the pandemic. So those are all indications that these are opportunities you can take advantage of when mister market presents them to you.

Andrew [00:13:03]:

Yeah, I think I remember visa trading at like a 25 pe or something like that. At some point.

Dave [00:13:09]:

Yeah.

Andrew [00:13:09]:

And it usually trades at a 30, 35.

Dave [00:13:12]:

Right.

Andrew [00:13:12]:

So it, it was, I mean, a 25 pe for a high, I don't want to say high growth company, but let's say above average growth company. It's been a good deal the last few years for a lot of the time with the low interest rates.

Dave [00:13:26]:

Yes. Yeah, exactly. And that's how we can take advantage is by doing our work and doing our due diligence and understanding the companies. And then when mister market shows up, which he will every single week, you can take advantage. What about you? How do you think about that?

Andrew [00:13:39]:

Yeah, I agree with all of that. I think you can definitely find those opportunities if you can be disciplined about the way youre identifying if a stocks a bargain or not. You want to be careful of the stocks down 50%, but its PE, still like 100. You might want to be careful there doesnt mean its cheap just because its down 50%. So you do want to ground yourself the way youre looking at how expensive a stock is based on some financial data. But the other thing, I think IM trying to incorporate it more and more. And its really hard. Its really hard.

Andrew [00:14:15]:

I dont know how to get around it consistently, but its something IM trying to do more and more. But its this idea of not letting the narrative guide the way youre thinking about the company. And I know that sounds kind of obvious, but as an example, for a while I was really bearish on China and not trying to say I had a crystal ball or anything, but it was a good move for a long time. And now that sentiment is starting to affect a lot of the stocks that sell into China. And so now the question becomes, you look at a great business that's selling into China right now, do you believe that narrative or not? It's hard because you have to go against the grain and people don't think you're right, but you have to, even if you believe, like I believe, that China was a bad place to be in for a while, that doesn't mean I should believe that for the rest of my investing career. And so if I were to stick to an idea I had three years ago and continue to use that forever, then I would miss stock opportunities that presented itself if that reality ever changed. And so that's kind of something I've been trying to implement more lately, is not coming up with excuses for buying a great company because you have this bias that everybody else at the time has, too. Like if I were to look at, I don't know who's like an August 1.

Andrew [00:15:37]:

Like Amazon right now, Amazon is one of those companies. I'm like, man, if that ever gets to a 35 PE or 30 PE, it's like, man, yeah, just pull the trigger. That'll be just no brainer, right? But people were saying that about Starbucks and Apple really not too long ago. I don't think there's a single answer for that. But it's sometime in the future, there's going to be some narrative around Amazon. If we're ever fortunate for it to come down, for the PE to come down a reasonable price, there will be some narrative. And it's going to take a lot of conviction to bet against that narrative. But that's what you have to do to buy companies that are trading at a discount.

Dave [00:16:16]:

It is. You have to be contrarian, right? And I think that's what makes it hard, is swimming, being like a salmon swimming upstream, swimming against the tide, going against. And the hard part about the narrative is that it is so prevalent. It's everywhere you look. And it shades the news, it shades the investor reports, it can shade the earnings reports, in that the analysts may be asking questions about a particular narrative and really focusing on that narrative. They will ask different questions, hopefully, but you'll still have this kind of a narrative that really feeds how they're reacting to news of a particular company, whichever it may be. And sometimes that can last for more than just a quarter. Sometimes it can last for a year or two or longer.

Dave [00:17:13]:

And that can really shade how you think about the company, because even though you may not feel that way, if you listen to it enough and you hear it enough, it starts to seep into our consciousness that we start to think the way other people do. And that's a big reason why I think Warren Buffet removed himself from the whole financial apparatus and set himself up in Omaha, Nebraska, because that's as far away from the finance world as you can possibly get. And I think that allows him to focus more on the companies themselves and his thoughts about the company, as opposed to the narrative that's out there about a particular company. And I think that could be really helpful if you can figure out a way to cut yourself off, or I guess reduce the exposure to some of that can be really helpful. But it's really, really, really hard to. It's very difficult to remove yourself from that because we can all get influenced by that very easily. I know I've fallen under that spell many times.

Andrew [00:18:15]:

Yeah, me too. All the time. It's hard. I feel like I've said this so many times on the show. But when Buffett bought Coca Cola in 1987, everybody was saying that he was buying and the company was too big, the stocks too big. You can't make money when it's too big. And there were a narrative. If you picked up, like a magazine from, I don't know if it was a Fortune magazine or Forbes magazine, they had written that investors year after year after year said about Coca Cola stock, it's too big.

Andrew [00:18:48]:

The company's too big. Its best days are behind it. It's over. And those words were written in 1920 ish 19, something like that. So it's like that snare. They've had been following that company for three, four decades before Buffett even bought the company, right. And then it went on to return 25% a year for however long it did. So I find that so interesting that, like, when the average common investor believes something about a stock, maybe that's a signal that you should believe the opposite, right? A company that big like Coca Cola, everybody had opinion about it.

Andrew [00:19:26]:

And Buffett was, to my knowledge, the only investor took a huge swing and took advantage of that opportunity fully, at least became famous for at least, right?

Dave [00:19:36]:

Exactly. Well, he did the same thing with American Express. Maybe the sentiment was very negative on the company because of that salad oil scandal. And he did his own research and discovered that even because the narrative was that they were going bankrupt, that this was the end of that company. And he did his research not only with looking at the financials and realizing that even if they had to sell that particular asset at a loss, complete zero, they still had enough cash on the balance sheet to cover all their other costs and not including their operations, are continuing to go. So he knew that they were in a good position financially to absorb the potential for that big loss. And then he saw customer behavior. He saw people using their American Express cards, and he was asking them, you know, does this scandal scare you about using their card? And most people were responding.

Dave [00:20:34]:

They didn't even know what the scandal was. So confirmed to him that, you know, this isn't going to affect the customer's behavior, you know, that use American Express, and so that can really help form your opinion on what you're doing. But again, he was going against the grain, just like he did with Coca Cola and albeit different circumstances, it's still the same concept of hes learning what he needs to know about the company and determining whats really driving the business and how much of this news cycle is more noise than actual potential reality or a killer of the company. And thats another bet that he made that turned out very, very well for him. Still owns the companies. He owns 18% of American Express now, you know, easily the largest shareholder of the company.

Andrew [00:21:25]:

Yeah, we're in good company.

Dave [00:21:27]:

Yeah, yeah. We don't quite fly to that same level. We don't have to report it on a 13 f or anything like that. So we got a little ways to go for that.

Andrew [00:21:38]:

It is amazing how you can find nuggets like that in a place that has so many people looking for deals. I was listening to a podcast still. Ackman was on Lex Friedman's show.

Dave [00:21:49]:

It's a super interview. Oh yeah, yeah, super interview.

Andrew [00:21:53]:

And uh, he talked about he invested in a stock that was going through bankruptcy, but they had their lawyers and stuff, and he was able to read the documents and found a way to make money on that. Even though most bankruptcies end up with the shareholders getting completely wiped out.

Dave [00:22:09]:

Right.

Andrew [00:22:10]:

So the values can be there if you're willing to do the work. And then the other side of that is to have the chutzpah to just swing away. Even though there might be so many other people who are directly opposing your thoughts and ideas. It's definitely not for the faint of heart. I don't think I'd ever go for a company as doing something as extreme as bankruptcy. But that said, there can be opportunities like that and they continue to show themselves day after day after day in the market. And that's kind of the beauty of it.

Dave [00:22:44]:

Yeah, it really is. And I remember I listened to an interview with Professor Aswas Demoder recently, and he was talking about Nvidia. And right now it's on top of the world. It's second or third largest company in the United States or in the world. And it's dominated. You know, what did somebody say? It's Jensen Wong's world. We're all just living in it right now and it's on top of the world. But you know, as he pointed out in the interview, in the last five to ten years, there's been three or four occasions where it was on desk door and market sentiment was very much against the company and they were going out.

Dave [00:23:21]:

And that has obviously proven not to be true. But I think it just goes to show that Mister Market can show up at any time in any company, and even a company is as awesome as Nvidia is now. The sentiment is obviously very positive about the company now, but not that long ago it wasn't. And so it just shows you how quickly it can turn on a dime. And it really comes down to trying to understand the company as best you can and the customers and the people that buy their products and how that narrative may be impacting it positively or negatively. And I think if you can get your arms around that concept, I think it can help you stiff arm Mister market a little bit and try to avoid feeding into the narrative, because it can be a powerful force and it can really make you act in ways that you may not consciously know you're acting.

Andrew [00:24:16]:

Yeah. So, so true.

Dave [00:24:19]:

Yeah. The Ackman interview was amazing. One of my favorites. I kind of liked him, I admit, after the interview.

Andrew [00:24:25]:

Yeah, yeah.

Dave [00:24:26]:

Well, I mean, this is a perfect example, right, is that it's not a stock we can buy, but the market sentiment about Bill Ackman has been fairly negative, right. You know, for the last few years. But after listening to him talk in the interview, you know, I didn't have an opinion one way or the other. But after listening to the interview, I liked him. I thought he was, you know, pretty fair, you know, a reasonable person. You know, he's portrayed in the media as maybe not so reasonable. And so I think that was, you know, Mister Market is showing up and, you know, showing the crazy stuff and not the other side of the story.

Andrew [00:24:58]:

Yeah. Being an activist investor can be really a thankless job with a lot of crap thrown your way, you know, but they do transform a lot of companies for good in a lot of cases.

Dave [00:25:08]:

Again. So I guess, to wrap up, what would you tell investors? How would you tell them to like, give them a couple pointers to help them kind of use mister market to their advantage?

Andrew [00:25:21]:

Yeah, good question. How do, how do we organize our thoughts? Let's see. I would start with separate the stock from the business. And so if you can look at a situation where the stock price has moved and separate the idea that just because the prices move means somethings moved with the business, I think that can be a huge step. Now, obviously, there will be times where a stock will move because something bad has happened in the business and thats called for, but a lot of the times, its just noise and its just mister market.

So starting by separating those two and being diligent and doing that every time you react to it, I think is a great place to start. And then I think the next thing would be to probably form independent thinking. One of the ideas that, like you mentioned, Dave, that Buffett and Munger have really taken hold to is they try to get as close to the source information as possible.

Andrew [00:26:26]:

And so for them. That means only reading the annual reports and other related things. I might not be that extreme, but I try to shave myself more that way rather than the other way. And so that can help you form independent thoughts on businesses. And then the last thing I would say is pay attention to the financial data and also use that to paint pictures of what's going on. Because it's really easy, especially in today's Internet connectivity, swapping of emotions and opinions and controversies. It's really, really easy to get wrapped up in some story or some narrative. But the numbers are the numbers.

Andrew [00:27:07]:

We can interpret them differently, but they're still there. So the more you can go back to those numbers, I think the better you'll be in making independent thoughts that are not as swayed. Maybe if I add one last thing, I would say, be okay with being wrong, because nobody's going to get this 100%. We're all going to get swayed. We're all going to make mistakes. We're all going to fall to the narrative. And that's just, that's part of the cost of doing business as well. So those would be my thoughts.

Andrew [00:27:38]:

Anything to add on that?

Dave [00:27:40]:

No. I think that was like a perfect summation of what we talked about today and what people can use to help them get better.

Andrew [00:27:49]:

Okay, sweet.

Dave [00:27:50]:

Yeah. Awesome. All right, well, with that, we will go ahead and wrap up our show for today. I hope you're enjoying our back to the basics series. If you are, please give us a notice. So let us know at newsletter investing four beginners.com. And with that, I will go ahead and sign us off. You guys go out there and invest with a margin of safety.

Dave [00:28:11]:

Emphasis on the safety. Have a great week, and we'll talk to you all next week.