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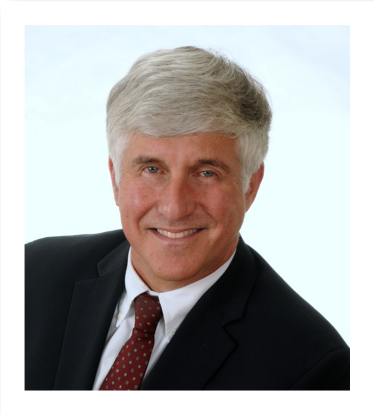
TRANSITIONS

CREATING MARKET INEFFICIENCIES

Time after time, we see a stock price immediately move 5% to 10% just after a company news release. Did the company suddenly become a different company from yesterday? Rarely is this the case. Rather, we see the effect of computers “parsing the news”, picking out a few words to trigger orders to buy or sell shares. **It seems the fastest computer wins. Or does it?**

These computer games actually help create market inefficiencies. Everyone seems too busy to actually digest the company news or listen to what management actually is saying. Of course management will try to put their best face on a weak quarter. Often they are describing events within a quarter, which is a 90 day period of time. Anyone who has run a business can attest to the difficulty of completing a large sale within a quarter, or getting earnings to properly fall within an arbitrary time frame of a quarter. Yet this is exactly what many analysts seek.



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Why isn’t this review time frame more reasonable? In the context of the next five to ten years, we all will have forgotten a weak quarter back in 2018.

When using the right perspective, the market is creating market inefficiencies for us. How do we know which is a buying opportunity? That is where very seasoned investment advisors come into play, and even we get it wrong at times. Nonetheless, since we have been watching markets as a full time occupation longer than many investors, there are times where things just stand out.

We recently saw Phillip Morris stock decline by 18% in value one morning, which was unexpected. Please note this note is not a recommendation to buy, however this is a great illustration of market

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inefficiency. What hurt the stock was not the discovery there is a risk to smoking. It was the announcement that in certain regions, cigarette sales declined. While a decline in product volumes normally would be bad news to the bottom line of a company, cigarettes always have had inelastic pricing. Price increases are met by grumbling, but the customer ends up buying the product at the higher price. This is how Phillip Morris can project a 10% earnings increase over the year even with a slight decline in products sold.

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What happens if cigarette sales decline dramatically? As with any industry, innovation comes into play as new products that claim to be less harmful than traditional cigarettes, take over large portions of sales. Maybe an investor should buy the more innovative company. What if this company is the innovator with a product that likely will take over a large portion of its cigarette sales in the next five years? Should the markets be judging innovation in a 90 day time period? If the focus in investing is five years, and the management is executing their sales strategies for both their existing products and the new innovative product, then we will likely see a case study in future business courses about opportunity.

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