This is How Cash is Supposed to Work

Few would argue with the premise that the most basic principle of successful investing is buying low and selling high. Yet the actual execution of this most basic principle is far more challenging than many realize.

The concept seems obvious, doesn't it? Buy low. Sell high. To most, that means buy when prices are their least expensive and sell when prices are at their peak, just before they fall. The problem with this notion of what it means to buy low and to sell high is that, absent a crystal ball, a bit of guesswork is required.

How low is low? If prices are falling, are they likely to keep falling? And how high is high? If you sell today and prices go higher tomorrow, did you sell too soon? Timing, reading tea leaves and on-the-fly market analysis can enter into the decision-making process. More often than not, human emotion plays a role as well.

Too frequently, the average investor actually ends up buying high and selling low - the exact opposite of the obvious goal. When prices are falling, it can be very scary. Most aren't thinking about the opportunity that is unfolding. Instead, they are thinking about the money they are losing. They decide they can't afford to lose any more and so they sell - when prices are low.

It can be very exciting when prices are rising. Investors are making money, and they want to make even more. So they continue to buy stocks (or at least hold on to them) as prices rise. This strategy may work for awhile, but ultimately buying stocks as they get more expensive can result in...you guessed it - buying high. So you see, buying high and selling low is actually very easy. It is practically second nature for the average investor. Buying low and selling high is more complicated.

Judgement can be unduly influenced by recent experience. If prices are falling, aren't they likely to continue falling? And if prices are rising, that recent experience may convince an investor that they will continue to rise. In fact, buying low and selling high requires the discipline to look forward, not backward. To do so successfully, one must remove sentiment from the process and focus on what is knowable. Tandem's investment discipline does precisely that.

Buying low should not mean buying at the absolute low. Similarly, selling high doesn't require knowing the absolute high. High is high. Even if prices go higher. There are many acceptable tools for valuation analysis. The most common is PE, or Price/Earnings ratio. Tandem utilizes its own proprietary ratio: The Tandem Ratio, which is a multi-factor model that we use as both a stock screen and a valuation measure. We think it is important to not only have a process, but also to have the discipline to stick to that process regardless of the market environment.

From our perspective, when a company is trading at an historically low valuation, and the fundamentals of the company remain appealing, the stock is cheap and should be bought. Can it get cheaper? Of course it can. Undervalued things often become even more undervalued until order is restored. Buying low does not require buying lowest. Low is okay. Paying a reasonable price increases the likelihood of a profitable return as the market cycle turns higher.

While buying low requires discipline, selling high might actually be harder. It certainly requires discipline. It can also require patience.

Castle Tandem Fund

TANDX :: Institutional Shares

We do not invest your money simply for the sake of being invested. We take seriously our commitment to buy low and sell high, and to have the patience and discipline in between. The best opportunities to buy and sell do not occur simultaneously. When there are more things to sell than buy, cash levels in client portfolios rise. Conversely, when there are more things to buy than sell, cash levels will decline. To us, this is the way it is supposed to be.

Most of our peers tend to believe that their job is to remain fully invested at all times, leaving the decision of when stocks are cheap and when they are expensive to others. We simply cannot operate this way. It is not in our DNA to hold without taking some profit, or even worse buy, overvalued securities. We work hard to make profitable investments on behalf of our clients. It is our responsibility to sell and lock in a gain on an investment when appropriate. We follow our investment process regardless of the market environment (bull market, bear market, or trading range).