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The Confidence Factor - One of the Uncertainties of Investing

Investing is a relatively simple concept. Put your money to work, so that someday you won't have to work. For most investors, that comes down to:

- Purchase fractional ownership in a business by owning the stock of good companies and sharing their future increase in value as well as payouts to shareholders.

- Loan money to good companies (or government entities) that will repay their debts and allowing you to build net worth through interest payments or speculation on the future direction of interest rates.

There's lots of good advice on how to pick the right companies and when to loan money. But at times, even the best investment plan goes awry. The investment is doing everything it should, but prices lag or fall. Or they soar well above fair valuation.

It's times like these that it helps to recall Warren Buffett's quote, *"Remember that the stock market is a manic depressive."*

As much as investors would like to believe markets are efficient, efficiency tends to occur only over the long run, and even that doesn't help if one has to sell into a declining market.

Economist John Maynard Keynes was one of the foremost economists of his day and his Keynesian economic theory was common college fare up through the 1980s. In 1919, at the age of 36, he decided to become independently wealthy by speculating in currency trends using margin to leverage his investment. By April 1920, he considered himself a wealthy man. A month later he was broke and in debt when the U.S. dollar failed to rise, and the Deutschmark refused to fall. From that experience came one of Keynes' best remembered quotes, *"Markets can remain irrational longer than you can remain solvent."*

Every investment is based on an expectation of how the future will play out over time. Sometimes that future doesn't work out due to changing circumstances. But often consumer confidence is an intervening factor, influencing short-term values and market volatility. Investors may lose confidence in management, in demand for the product, in the economy, in the outcome of geopolitical events and a host of other factors. Confidence that a rising market will continue and the belief that this time is different can cause prices to keep rising well beyond fundamental expectations, driving more investor demand and excess valuation.

Source: The Conference Board. Shaded areas indicate recessions.

What often matters the most is not the reported confidence index number but the trend. Are investors and consumers growing more conservative or more exuberant? Is this trend one you want to invest in or avoid? Over the short term, great fundamentals can be overwhelmed by a loss of consumer and investor confidence.

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