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Financial Dive Reflex

“Mammalian dive reflex” is an involuntary physiological response to sudden submersion. Its specific trigger? Cold water in the face.

This is more than that sensation familiar to any of us who have jumped into a high mountain lake, had February mud hosed off us by our mothers, or stepped under the shower too soon. It's the mechanism by which cold water drowning victims can survive to be revived after long periods under the ice.

A few years ago I came across a description of the dive reflex posted on a scuba message board. It caught my eye even then, in cheerier times, as an apt metaphor for one set of survival responses in times of extreme financial duress, so I copied it:

Bradycardia, or slowing of the heart rate to conserve energy;

Vasoconstriction, to increase blood available to the lungs;

Preferential shunting, to direct blood to only the most critical body areas;

Elevation of red blood cell count, to extract and carry more oxygen;

Thoracic filling with plasma, to prevent lungs and chest from collapse as pressure increases.

For months now the markets have delivered bucket after bucket of cold water in the face. I don't want to torture the metaphor by specifying financial analogs for lungs, red blood cells, oxygen, plasma etc., but let me try to extend its lesson as follows:

Pace matters: Calm down and don't rush your decisions. Keep the long run in mind, and don't hurry into the hardest hit sectors until they've stabilized. Trading for activity's sake can deplete

wealth; waiting for the right price opportunities may be hard but it's necessary.

The periphery can wait: In times like this, businesses, consumers, and governments refocus away from what's merely desirable to what's necessary. As investors, so should we (and indeed we had already largely done so).

Feed the Core: Core portfolio qualities such as liquidity, income and stability are being stress-tested; where they are the critical priorities, they must be ensured. At the same time, for long-horizon portfolios with a growth priority, latent energy in the form of equities must be nourished.

Efficiency matters: Each dollar must be made to work its hardest. In part this means avoiding waste (unnecessary taxes, fees, commissions), but also it means optimizing cash flows and compounding them.

Reinforce internally: Within your existing allocation structure, be willing to substitute different asset types to take on roles previously played by others. For instance, in recent prices we've seen opportunity in senior convertible bonds as equity surrogates – higher in the capital structure and thus less likely to get squeezed into oblivion, yet with an embedded option to participate should stocks rally.

Of course, we don't plan to hibernate the rest of our days at the bottom of an icy lake, and portfolio management needs to be more than just reflexive.

A seeming irony – really just the math of lower prices – is that each dollar buys more now than it used to, both in terms of income and assets. The greater irony is that those who eagerly bought at higher prices (lower investment yields) are loathe now to do so at lower prices (higher prospective yields); indeed, many have resolved never to invest again – or more likely, not until the top of the next bubble.

We continue to participate in the markets, though at measured pace, and with a focus on preserving vitality at the core.

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