

Tortoise Capital Management

The Equity Marketplace is not a Political Machine or a Moral Entity

By Ken Long, President, Tortoise Capital

In the days following the World Trade Center attack, IITM hosted a teleconference for traders concerned about the physical and psychological impacts of such an event on themselves and their trading systems. The two-hour discussion included important insights on volatility trading, market psychology, risk management and even some fundamental discussions about the appropriateness of trading at times like these. Participant feedback was gratifying and positive, because we integrate these tragic events into our personal and professional lives. This article reviews some key points that I believe are still relevant today and in the future.

Immediately after the attack, various pundits asserted that it targeted our economy and by extension, our very way of life. Many recommended that one way we could "show them" would be to buy 100 shares of stock in our great companies and send the market higher through sheer force of will. I personally observed this idea trumpeted and relayed throughout the market, on TV, in chat rooms and on e-mail lists. It was a topic of water cooler discussions in the halls of business and government.

Imagine this call to arms circulating throughout the country, and imagine the tens of thousands of good Americans answering this patriotic call to action. Now, picture professional money managers in their offices weighing the risks and threats to their capital, planning to protect themselves against the tremendous uncertainty that had just been released into the world. When the market finally opened, we saw the interplay of these two competing forces in the weeks immediately following. Predictably, a dramatic sell-off that certainly left many citizens holding the bag, while those who had sold to them to raise cash were poised to take advantage of the backlash from the emotional crisis.

During the teleconference, the questions arose: Should patriotism be a reason for buying? Ought we "make a statement" with our trading activities? Should we refuse to take short positions? Is there a moral component to trading? These are fundamental and important questions and I will summarize my commentary and observations from the teleconference. I preface my remarks by pointing out that I am a professional soldier, an investor, a trader, a father, and someone who lost friends in the Pentagon. These are simply my beliefs, positions that I have internalized. They make sense to me based on who I am and how they work for me.

I believe the equity marketplace is not a political machine or a moral entity. It exists simply to efficiently and effectively price the relative value of assets throughout the world based on the dynamic interplay of many variables. I believe that bringing politics and patriotism into the equation is to misunderstand the role of the market and is not only dangerous, but foolhardy, for traders who risk changing the dynamics of their risk management calculations.

The appropriate discussion of morality for traders, I believe, is appropriately directed to the trader's purpose for generating her profits, and for the method by which she ethically operates. I believe shorting is not immoral, but serves a useful function by providing liquidity to the market and helps buyers who

Tortoise Capital Management

want to go long. It is certainly as moral as buying at the bottom of the market after a fear-induced sell-off. This vital process is both moral and necessary for the market to function. That's good for the economy, the market and the world.

I believe a one-time stock purchase by tens of thousands of retail investors cannot move the market for any significant period of time, since fundamental strength in the market must be related to the production of goods and services that customers are willing to buy, and an expectation that market conditions going forward reflect the continued likelihood of increasing value and profitability. Any other blips in the market are anomalies which will sooner or later revert to the mean. We saw this play out with professionals selling quickly to citizens when the markets opened after 9/11, and then buying after a 20-30% drawdown and reaping the benefits of the countertrend rally that ensued when emotions had calmed down and world events showed evidence that the administration would vigorously and effectively prosecute the war and act to bolster the markets.

I believe that an appropriate way to express concern for fellow citizens and demonstrate patriotism would be to volunteer time and money to casualties and their families. I believe expressing patriotism through stock purchases was ill advised and counterproductive and an unfortunate event for many who heeded that call to arms.

Conclusions: I believe that to be an effective trader and manage risk, I must resist external influences that divert me from my system. I believe that by keeping my "trading part" segregated, I can be effective and disciplined, produce profits morally, and then apply those profits to those projects and activities that express my other values. I believe trading is an honorable profession and that taking the short side as occasions indicate is part of my responsibility as a trader and helps to provide liquidity to the market and other traders who want to take the other side of the trade.

The events of 9-11 and the weeks and months afterwards have reinforced these core beliefs of mine and proved very helpful to me as I navigated these recent turbulent market waters.