

Eads & Heald Investment Counsel

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Equity Investing

By: R. Stewart Eads, CFA

President

Eads & Heald Investment Counsel

www.EadsHeald.com

Chapter 2: Simplicity and the Big Picture

We are all products of our upbringing, experience and environment. While working as a summer intern at NASA's George C. Marshall Space Flight Center during the summers of 1964 and 1965, I had several contacts with the Center's director, Dr. Wernher von Braun. He was one of the German rocket scientists sent to the United States at the end of World War II as lands and scientific talent were being divided up between the U.S. and the U.S.S.R. To my mind, the charismatic Dr. von Braun was the key individual behind the United States' success in putting a man on the moon by 1969. The entire Marshall Center exuded his confidence in the halcyon days of the 1960's.

One of Dr. von Braun's beliefs that made a lifelong impression on me was that "simplicity is the ultimate in sophistication." While his Saturn class rockets had complicated intricacies by necessity of the task at hand, the overall concept of the three-stage rocket with gimbaled (movable) engines was quite simple and profound. The mark of true intelligence and an understanding of a matter is being able to distill it down to the primary rudimentary factors and then explain it so that most people can understand what is being said. In many facets of life, people simply do not have a good foundation and understanding of what they are attempting to explain. That is often why they cannot present it clearly.

If you think about it, almost anyone can make a problem more complicated than it needs to be. Some people complicate things because they truly know no better -- they then become part of the problem they are trying to solve. Other people seem to purposely complicate problems so as to glorify their contributions to solving such a complex matter. It is a special skill to be able to distill a complex issue down to the key necessary components and discard all extraneous factors.

Regarding Wall Street wisdom, I firmly believe that history has a lot to teach us in order to best prepare us to predict the future. "Empirical analysis" is a good term to describe the process. This is not to be confused with so-called "technical analysis." History presents several dramatic relationships between key variables that are essential to examine in any rational attempt to predict the future for, say, the stock market.

After receiving my M.B.A. at Wharton, I spent the next three years in the Office of the Director of the U.S. Central Intelligence Agency in Langley, Virginia. Among other myriad tasks and assignments, I was given a satellite. More specifically, I was asked to do a systematic study of the data collected by this particular electronics satellite. My satellite did not take pictures. Its mission was to collect electronic signals from USSR radar. I created a computer model of "normal" ambient electronic signals by radar type and even tracked deviation from this norm. In the late 1960's, the U.S. was very interested in the Anti-Ballistic Missile (ABM) capabilities of the U.S.S.R. to better gauge how rapidly we needed to build our own ABM system. The U.S. was

very interested in signals emitted by various U.S.S.R. radar installations believed to be integral to their ABM system. Intelligence on these Soviet ABM systems (actually, the lack of any such systems) eventually supported President Reagan's Star Wars bluff. This was one key factor in the ultimate downfall of the U.S.S.R. They simply could not afford to build a sophisticated ABM system.

My satellite had an expected life of three months and encircled the earth at approximately 100 miles altitude and had a collection swath of a few hundred miles across the earth. It flew at a northernmost latitude of approximately 80 degrees. It completed each trip around the world every 1.5 hours and made about 16 circles around the globe a day. This satellite, while it flew across virtually all of the U.S.S.R. over its life span, always tended to fly over the U.S.S.R. at approximately the same two times each day over its three months life. It sampled a lot of the terrain, but it sampled very little in the way of different times of the day. This phenomenon is simply governed by the relative position of a satellite's track relative to the sun. After all, position on the earth relative to the sun is what determines the time of day. Data sampling at different times of the day were dependent on the earth moving around the sun and the fact that the orbit precessed (moved) albeit slowly in galactic space because the orbit latitude was other than 90 degrees. In short, this satellite accomplished only a portion of round the clock local time sampling of the U.S.S.R. terrain, and it seemed that very few people realized this. Myriad details had been covered, but the understanding of the bigger picture key to the success of the mission seemed to be lacking. I presented the conclusions of my study to a packed room of admirals, generals and others in a basement conference room in the Pentagon in the late 1960's.

If you carefully read (and, possibly, reread) these articles and understand what you read, you will likely be in the top few percentile of people who understand the workings of the overall stock market and common stocks in general. You will be much better informed on what variables you should focus your attention on, what investment time frame makes sense and how to go about putting a rational investment program into place.

If we have discovered some basic truths of securities investing and tell all we know, does that not put us out of business? Quite the contrary, our best prospective clients are well educated in the realistic process of creating wealth using common stocks so they can avoid myriad advisors pursuing false horizons. In the final analysis, our best long-term clients are very successful people who understand the rudiments of successful long-term investing but simply do not want to tend to the nuts and bolts of day-to-day information gathering and following the successes and failures of numerous securities. They are simply too busy making money in other endeavors or have no interest in portfolio management. Further, they realize that successful stockbrokers are generally "salesmen" by necessity (gathering assets) and not analytical portfolio managers. They want someone who is totally focused on growing assets using prudent investment vehicles.