Sometimes the best thing an investor can do is rise above it all. **Robin Cowcher**

by **Roger Montgomery**

The extensive but brief dislocations in global sharemarkets following the UK's decision to leave the European Union were a timely reminder of the fleeting nature of many crises.

Jumping at shadows is the stockmarket's specialty and for an industry that is paid a percentage of activity, it relishes such events. But the Greek philosophers had it right when they said: "This too will pass."

And pass it does.

In the 66 years since 1950, there have been 57 market moves downward of 20 per cent or more in either of the US S&P 500, the UK's FTSE, Germany's DAX and Japan's Nikkei.

Think about that statistic – it means a "crash" in a major market every 1.15 years. I would describe that as frequent and regular. As markets become more interconnected and investors more aware, anything form slowing Chinese growth to a rising oil price can trigger panic.

Weathering the storms

When asked about whether he was worried about a big drop in the market, Warren Buffet's colleague Charlie Munger replied: "In fact you can argue that if you're not willing to react with equanimity to a market price decline of 50 per cent two or three times a century you're not fit to be a common shareholder and you deserve the mediocre result you're going to get compared to the people who do have the temperament, who can be more philosophical about these market fluctuations."

Munger's comments beg the question, why would an investor be willing to invest in any market that could halve? The answer is that the stockmarket is the greatest concentration of financially irrational people in any one place.

Here's an allegory used by Buffett that I like: think about a farmer in Orange, Dubbo or Parkes who has inherited a farm from a generous ancestor, and on which there is no debt. The farmer is under no pressure to sell the farm. Clearly there will be a few bad years, but there will also be a few good years.

Buffett suggests you think of the stockmarket and its distracting and noisy volatility as the emotionally immature farm neighbour who: "Yells out a price every day to me at which he would either buy my farm or sell me his — and those prices varied widely over short periods of time depending on his mental state ... If his daily shout-out was ridiculously low, and I had some spare cash, I would buy his farm. If the number he yelled was absurdly high, I could either sell to him or just go on farming."

Noisy neighbour

Despite their apparent significance, events such as Brexit represent little more than the noisy neighbour panicking that his farm might fall further in price. The constant stream of discussion, prediction and introspection about interest rates, unemployment, inflation and the economy is nothing more than a distraction from the main game of investing.

Now, it is true that prices may indeed fall but should we care? Is the value of a portfolio of pieces of extraordinary businesses determined by daily gyrating prices? We know that a company increases in value by adding retained earnings to its equity capital and maintaining its return on the now larger equity.

If I can find a business that is able to grow its equity tenfold while maintaining its return on the growing equity, I know that I will be able to sell it for far more in the future than I paid for it today. I don't need to worry about China, the US Federal Reserve or Brexit.

Stockmarket investors forget the valuation mechanics of compounding returns and allow the emotional behaviour of their fellow investors to infect their decision-making, causing them to respond emotionally too.

If you didn't rush to sell your home, your hobby farm, your holiday house or your caravan during the tech wreck or the GFC, then there is no reason you should behave differently when it comes to your share portfolio.

The only difference is that one is priced daily and the other assets are not.

Remember, price is what you pay, value is what you receive. If that is true, then the value of the portfolio changes much more slowly than prices.

Don't let the daily liquidity of shares combined with the noise of Brexit and other macro events dissuade you from taking advantage of bargains or influence you to sell extraordinary companies when their shares are temporarily depressed.

Roger Montgomery is the founder and chief investment officer of Montgomery Investment Management