

Raisin' Hell on Bagel Street

By Mariko Gordon

July 27, 2010

Advisor Perspectives welcomes guest contributions. The views presented here do not necessarily represent those of Advisor Perspectives.



One of the joys of taking the shuttle out of La Guardia is indulging in my OJ Simpson fantasy (the one about hurdling suitcases while racing through the airport, not the one about being chased by a swarm of police cars and TV helicopters).

Because the flights to Boston and Washington are filled with experienced, day-tripping, full-fare-paying road warriors, the security lines are set apart and move swiftly. **Passengers practically begin taking their belts and shoes off at the curb**, so it's tempting to cut it close, knowing there won't be a long line. One recent morning, however, I cut it a tad *too* close and had to run just to make my flight.

I made it, but unhappily so; I had no time to even grab coffee, let alone breakfast. And as I squeezed into my seat I knew I was doomed ... doomed to eating one of those hockey-puck-impersonating bagels that pass for food on a 6 a.m. flight.

It got worse. After catching the jauntily tossed breakfast bag, **I looked inside and saw a #@%*! raisin bagel.** I like raisins. I like bagels. I hate them together.

But I was hungry. **So I glumly set about tearing small pieces of bagel, carefully inspecting for and removing the raisins**, and then slapping on some cream cheese. You'd have thought I was forced to eat poop-covered grasshoppers, I was so cranky.

With grim determination and great effort I excavated the raisins one by one. **That's how I know that there were precisely 3.5 raisins in that bagel.** Yes, I had a good laugh at my own expense: all that drama for nothing.

If you ask me, **my airborne raisin bagel experience contains a pretty good investment lesson** for what happens when anticipation (investors) collides with reality (news flow).

Here's what I mean...

The hardest part of stockpicking is knowing what's in a stock price. Ultimately, of course, the price is what one person is willing to pay and what another person is willing to



sell. But it's not that simple. The price is based on a precise calculation of the imprecise (e.g., future cash flows), together with how greedy or fearful everyone is feeling.

If you think of a stock as a dreaded raisin bagel, the price investors are willing to pay is inversely proportional to the number of raisins within. Investors assume a certain number of raisins in any given bagel and adjust the price accordingly if there are more or less than expected. You can think of news flow as the blow-by-blow commentary as each raisin is picked off the bagel.

But news is different these days. It travels fast, 24/7 and in vast quantities; there's no escaping the deluge. **The perfectly efficient market is supposed to react perfectly efficiently to the steady drumbeat of the raisin count.** Except that it doesn't.

Not all the time, anyway. And when it does react, **sometimes it doesn't do what you think it will and that's when you need to PAY ATTENTION.**

When a stock fails to go down on bad news, for example, that's the all-clear signal. Years ago we owned [United Natural Foods](#), a distributor of ... you guessed it ... natural and organic foods. **We'd bought it after a warehouse management software installation went bad and operations began to unravel** (picture Mickey Mouse and those buckets of water in [The Sorcerer's Apprentice](#)). We were pretty sure the worst was over and even went up to Connecticut to see that the trucks weren't still gridlocked in the parking lot.

The stock was humming along merrily when the CEO sold a large chunk of it, (not typical behavior for him) **AND** one of its big customers hired a new chief who came from the [Ignacio Lopez](#) school of scorched earth cost-cutting. We decided to take the money and run. **When the news hit that they'd lost the customer contract, however, the stock went UP.** Yep, the raisin tally was already in. We were asses not to buy the stock again on the spot.

When tallying raisins you also need to **be careful that the so-called "efficient market" isn't in fact being inefficiently affected by human error.** Sometimes the Street is too distracted and there's a delayed reaction.

Case in point: [Shutterfly](#) is an online photo sharing/products company, far less dependent on printing 4X6 pics than the market thinks. **Even so, a couple of years ago the Street was obsessively focused on the pricing of 4X6 prints among the big players.** News came out that [Snapfish](#) (a photo site subsidiary of Hewlett-Packard and a Shutterfly competitor) had lowered the price on prints. But Shutterfly's stock barely budged.

Hmm ... was the news priced in? It was surprising to us, given the Street's obsession, and it didn't make sense. Still, for a couple of days, nada. So we called around the sell-side to figure out how we'd gotten it so wrong. Then we found out they just hadn't seen the news - a round of panicked downgrades promptly ensued. **To butcher Sigmund Freud,**



sometimes a cigar is **NOT** just a cigar. We should have kept our mouths shut.

In still other cases, the news itself is complicated. We saw this with ARRA (the recovery act) in 2009: A cool \$50+ billion was going to be spent on health care IT. And yet, **despite being as close to a sure thing as it gets in the investment business, it took a few days for the market to parse** the Congressional Budget Office Report and the 600-page bill to do the math correctly. This bill meant a bonanza for ambulatory and clinical software providers. This time we were ahead of the crowd and loaded up on cheap stocks with bright prospects.

The point of all this? **Any time a stock doesn't react the way you think it should to news, there's an investment opportunity waiting to be uncovered.** And as with bagels, it's up to you to decide whether the price is slow to react or whether the news is already "baked" in.

** Mariko O. Gordon is founder, CEO and CIO of Daruma Asset Management, a NY-based small cap investment management firm. Subscribe to her free monthly e-newsletter On Daruma's Watch [here](#).*

www.advisorperspectives.com

For a free subscription to the Advisor Perspectives newsletter, visit:
<http://www.advisorperspectives.com/subscribers/subscribe.php>