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Character Premium or Discount

In their credit training program banks used to (I'm not sure if they still do) teach the famous Four C's of Credit, which seem to have evolved a bit from the traditional: Character, Capacity, Capital, and Collateral, the last is now being called "Conditions:, which include matters like saturation of supply, technology change, or the effect of lower margins on the service. Maybe the last "C" was changed due to the blow-up of presumably safe collaterals, given the highest grade by the rating agencies, in the 2008 meltdown. "Connection" was never one of the C's of credit even if it was a part of the evaluation process then as now.

Buying stocks is a more critical relationship than extending credit since it is buying into a company, so the four C's are even more relevant. The only difference between credit and equities is that the "first way out" is easier for the latter as there is a market for selling the stock, even at a loss, if one is not happy with the company's performance. Collecting from a credit default is definitely more challenging.

As can be gleaned from our title, we will delve only on one C, which is Character as it affects the price of a particular stock. It has already been mentioned in this corner that mergers and acquisitions drive market frenzy, translating into the rise in the PSE volume and value. There are only a few names that come up when possible acquirers and their targets are mentioned. We can also include character analysis in the issuance of newly listed shares or IPO's.

Do stocks merit a premium or discount in connection with the characters behind them? Do analysts need to go beyond financial ratios, industry structure, market shares, and historical performance and delve into personality traits?

There is a case to be made for paying attention to the track record and reputation of the principal behind a company. With the media coverage of business players now at par with their political and entertainment counterparts, reputation has become more of a public issue. In the new discipline of behavioral economics, emotions in decision-making, as well as the value of character in a corporation, is becoming relevant in making financial decisions.

Thomas Schelling, a 2005 Nobel laureate in economics, given for his conflict-collaboration game theory, has used the term "egonomics" to refer to self-management in personal matters, weighing costs and benefits as in acquiring status symbols or being rid of addictions.

The role of character and personal feelings in determining the price of an item to purchase, including stocks, is now considered a factor affecting the value of a stock. One way to look at the effect of ego on prices is to observe an art auction. Certain players bid irrationally for an artwork because they "have to have that painting at all cost" perhaps to complete a collection. Art is a metaphor for the effect of character on purchase price which has little relation to the cost of the product (like paint, canvass, artist's time, and frame) or even its resale value.

The character and emotion in the case of the art auction is on the demand side, as it is the buyer driving up the price or bringing it down. On the supply side, character plays a part too. Some positives drive up the premium in pricing. These include a quantifiable track record like increasing the market cap of the stock through efficiencies and a strong management line-up or an aggressive cash dividend policy. A character discount may arise from fuzzy accounting, weak second-tier management, or perhaps a luxurious personal lifestyle funded by the company.

The aggregate version of character analysis is captured in "market sentiment", an abstract, emotional factor which cannot be ignored as it affects demand and stock prices. Market sentiment is a phrase securities analysts use to explain price fluctuations that statistics and financial ratios cannot account for. Investor mood is described as bearish, bullish, or that in-between outlook of wait-and-see (cautious optimism) and staying in the sidelines, waiting for developments.

Sometimes, characters as stock pickers (demand side) affect market sentiment. A market maker like Warren Buffet "betting all-in on the future of the American recovery" with the purchase of railroad stocks, like the Burlington Northern Santa Fe (BNSF) three years ago, can make the bears take flight and turn market sentiment around.

In our local market, characters reign. Stocks are described by their principals and lumped together as a cluster, say the "XYZ" group, if that combination of letters is a person or family. Rumors of a takeover by a particular character is enough to lift a sleepy stock into the stratosphere, then fall back in a hard landing when nothing happens—we are not even talking.

The valuation of character in the value of the stock is a tricky one. Isn't corporate reputation now driven by word of mouth or social media? Stories of intimates or those claiming to be so, fill up a character's reputation with tales of a lavish lifestyle with yachts and private jets, being a man of his word, charismatic with employees, fair and honest with partners, or shrewd and opportunistic and late-payers with suppliers—these are random stories told of corporate characters.

The question of character and how it affects the stock price is a matter of whether or not it increases the stock pickers' appetite for the stock. In a small economy, change in management and ownership and who is behind it matters a lot.

Ours is a moody economy with only a few personalities dominating the financial space. Buying into a company through its shares can be considered a declaration of faith in its principals. This character analysis however is not static as the personalities change and the next generation takes over. New names come up and quickly grow into conglomerates. Still, it is their track record, sometimes a very short one even made shorter by some scandal, and character that determine whether it deserves a premium or discount on character.

In a small market like ours it is easy to see how a small group of players needs to be watched as closely as the ticker tape on stock prices. It’s tricky for the character observers to track the few players to watch. Even when they are together in the same company board, they don’t necessarily talk to each other, and certainly do not coordinate their moves. In such cases, which character does an analyst watch out for in determining the stock premium or discount?