IRRATIONAL PESSIMISM – THE BLUESCOPE STORY

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This month marks the 20th anniversary of US Fed Chairman Alan Greenspan warning us of "irrational exuberance" in reference to lofty stock prices. Back in 1996, his warning sparked major market volatility yet the tech bubble resumed its rally and went on for four more years, showing that irrational behaviour can persist for some time.

Over those 20 years the work of behavioural economists like Amos Tversky, Daniel Kahneman and Richard Thaler has highlighted one reason why this happens – humans are prone to deep-seated biases that help us defy the evidence before us.

Interestingly, much of our discussion of emotion-driven investing is about Dr Greenspan's irrational **exuberance**. Yet people become irrationally negative just as they become irrationally euphoric. In 2016 no stock story better illustrates this than Bluescope Steel.

ON ITS METTLE

Bluescope is an independent steel company that was spun out of BHP back in 2002. Like many steel producers, in recent years it has suffered from the presumption that it would be outcompeted by Chinese steel mills. It started 2016 worth around $4.50 per share, having fallen below $3 in the middle of 2015.

How quickly sentiment can change. When we looked at Bluescope, we saw things the rest of the market wasn't seeing – whilst its Port Kembla steel business lost money it owned profitable steel-making joint ventures in the US and Asia. It also continued to make significant margins on its leading COLORBOND roofing business in Australia.

COST-CUTTING, PRICE RISING

Just as importantly, we believe Bluescope is now a very well-managed business. It had taken steps to strengthen its balance sheet as far back as 2012 through a joint venture with Nippon Steel. In late 2015 management were able to take around $200 million of cost out of the business. That focus – and a recovery in steel prices - has helped the business deliver multiple profit upgrades over recent months. That's driven the share price well over $9, nearly trebling the price we paid for our original holdings a year ago. We have taken some profits through the year.

The Bluescope story is a reminder that investors can be wrongly pessimistic as well as foolishly overoptimistic. The lesson here – as with so many other investments – is not to be swayed by the latest news and big-picture theories but to constantly assess the price of a business, the quality of its management and the strength of its underlying assets.