Words To Live By

SYNOPSIS

- The best part of being a professional investor is the opportunity to learn something new every day.
- Investors are wrong far more times than they are right, so it's important to view every hit or miss as a learning exercise.
- Here are ten lesser-known quotes that have helped guide my investment philosophy and decision-making process over the years.

LEARNING FROM OTHERS

The best part of being a professional investor is the opportunity to learn something new every day. It may be cliché, but the brain truly is a muscle that must be used regularly or else it risks atrophy.

Below are ten quotes from various individuals who have shaped the way I view not just investing but also other facets of my life where logic and reasoning are critical to success. Some of the names will be quickly recognized, but most will not.

"If you can't explain it to a six-year-old, you don't understand it yourself"

- Albert Einstein

No matter how complicated and/or intimidating the world of finance and investing may seem, nearly every concept can be explained. Therefore, be extremely careful around any investor who tries to impress or confuse you with financial jargon. Best case scenario is they are showing off, but more likely than not, they have no idea what they are talking about.

"I would rather be rich than right"

- Nelson Peltz

I attended an investment workshop a while back and was privileged to hear Nelson Peltz speak to our group about his investment in DuPont. Mr. Peltz is a legendary investor who takes a long-term view in his holdings and has been incredibly successful.

This quote was so powerful to me because it sums up what this business is all about. To be successful, we must recognize that we will be wrong far more times than right. Check egos and emotions at the door, view mistakes as learning exercises, and be happy when proven wrong because it most likely just saved you from losing a lot of money.

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"There are three types of lies – lies, damned lies, and statistics"

- Mark Twain

Although statistics are powerful tools to help us recognize relationships, they mean nothing until properly vetted to ensure authenticity.

Investors often succumb to the dangers hidden within statistics because they carry very powerful psychological triggers. It's human nature to want to believe statistics on face value, and often the work required to support or disprove a relationship is either daunting or deemed irrelevant given the observed strength in the relationship.

By far, the most egregious abuser of statistics is the media. Think about how many statistics are quoted during nightly news broadcasts on television. Then think about how few of these figures are broken down to show how the data was gathered and/or analyzed.

When it comes to statistics, my rule is simple. I consider them to be guilty until proven innocent.

"Wall Street indexes predicted nine out of the last five recessions"

- Paul Samuelson

This well-regarded economist could not have summed up the true predictive nature of the stock market any better. Admittedly, the stock market has fallen prior to every recession going back to 1900, but it has been wrong more times than right.

Equities are anticipatory but they do not track the economy in lock step and often leave us with erroneous predictions. Focus on the direction of the economy rather than daily moves in the stock market. Emotions rule the short-term, and analyzing/predicting emotions is impossible.

"In my whole life, I have known no wise people (over a broad subject matter area) who didn't read all the time – none, zero."
- Charlie Munger
Google "Charlie Munger quotes" and spend some time reading through the results. His ability to sum up situations in a matter of words, albeit in a very blunt manner, is truly entertaining but more important educational.

Not too long ago, the challenge for individual investors was gaining access to information that would enable them to make informed decisions on how to invest their savings. Wall Street used to be the gatekeeper to the research that investors desperately needed, and they only sold to big institutions who paid several million dollars each year to obtain.

Fast forward the clock to today, and thanks to the advent of the internet and regulation, there is now so much content available to investors that the challenge has become knowing how to find the information that matters. But it is out there.

I dedicate the first few hours of every morning to reading from a wide gamut of sources because there are so many smart people out there these days who write for free, and I always feel a little smarter come lunchtime when I read from these experts in their respective fields.

"Be very careful when demand creates supply"
-I don't remember
I heard this from one of my instructors during a training program at the first firm to hire me on Wall Street. This quote taught me that booms and busts will exist until the end of time, and the two drivers of any cycle are always supply and demand.

For example, take a housing market that is so hot that prices are rising close to double-digits. The opportunity to profit attracts builders to this market to create a new supply of homes. The problem is that builders get too greedy and overbuild, resulting in a lot of unsold homes.

Builders need to reduce their excess inventory or else it creates a financial burden on their company. Therefore, one builder decides to cut its prices to lure demand, which subsequently causes the other builders to do the same until prices crash.

The lesson learned here is to always have an idea where we are in any cycle, whether it be housing, stocks, energy, etc. Once supply begins to rise as it meets the beckoning call of excess demand, it's time to start planning an exit strategy.

"Something that everyone knows isn't worth knowing"
- Bernard Baruch
Financial markets are comprised of assets whose prices are also driven by supply and demand. Prices rise when demand increases, and demand is fueled by information and analysis used by investors.

If thousands of professional investors are taking this information and using it to buy/sell stocks, then we must assume that all available information has already been incorporated into asset prices in one way or the other.

Hence, the next time you read the Wall Street Journal over morning coffee or thumb through a three-month-old copy of Fortune Magazine while waiting to get your hair cut, just remember that this information is already baked into stock prices. It's ok to still read them, but they should not be used as the reason to purchase whatever stock is being discussed.

For an investor to believe that they have an information "edge" versus the competition, it must truly be something that other investors cannot access or else it will have already been considered.

"Three simple rules will explain 99% of human behavior: (1) Most people don't think, (2) Some people are just jerks, and (3) Everyone is selling something"
- Brett Arends, Columnist for MarketWatch
Rarely do I come across something so simple yet so powerful (particularly the third point). Since fear mongers never manage any real amount of money, they have chosen to get rich by getting people to sign up for their newsletter, buy their book, and pay for whatever other garbage they are trying to sell to those who need real financial advice.

Recessions happen, stocks lose investors' money, and economies collapse under too much debt. But they don't happen that often, and those who make such predictions carry no weight with me unless they can show me a time in the past where they made a bullish call and was ultimately correct. Only then can I consider them to be impartial.

What makes matters worse is that eventually one of these clowns will get lucky. The market will drop for some reason, and they will take their requisite "victory lap" around the media circuit to tell you why their system worked once again (even if the market decline occurred for reasons exogenous to their thesis). As the saying goes, "A broken clock is right twice a day."

The world does not end all that often, and those who preach it are predators that have only one objective in mind, and that is to grow the size of their wallet.

"The real value of historical record is as a gauge of risk, not return"
- William Bernstein
Mr. Bernstein is without a doubt one of the best writers and financial minds of our time, and his seminal masterpiece, The Four Pillars of Investing, is a mandatory read for any aspiring investor.

History may not repeat itself exactly, but often it gives us a pretty good idea of how bad it can get. Knowing how to spot bubbles and when asset prices detach from reality can save investors from life-altering mistakes.

In April 2000, right around the time the dot-com bubble burst, here are just a few of the companies that were trading at valuations that look like typos:

- Terra Networks selling at 1,200 times sales
- Akamai Technologies selling at 3,700 times sales
- Telocity selling at 5,200 times sales

For scale, even the most egregiously expensive growth stock in today's market sells for 20x or maybe 30x sales. A more realistic valuation for a growth company is closer to 3x-5x sales, and even this range could be debated amongst conservative investors. Oh, and none of these companies had any earnings.

We all know how this story ended, so the next time you look to history as a guide, focus more on what it can tell you about the risk rather than the return. As Sir John Templeton famously said, "The four most expensive words in the English language are, 'This time it's different.'"

"The stock market is a giant distraction to the business of investing"
- John C. Bogle
I constantly get asked the same two questions by both the media looking for a story and day traders looking for an edge. The first is what I think is driving the market at any given moment, and the second is what I think the market is going to do over the next 6-12 months.

My answer is always the same to both, which is I have no clue, and if I did, I would not be answering questions from reporters. Instead, I would be shopping for an island because what's the point of having a crystal ball if you can't use it to make enough money to establish residency in your own utopian state?

Think about the stock market this way. If emotions dominate the short-term movements in stock prices, and emotions are viruses to investing, then trying to understand what is driving the stock market on a daily, weekly, or monthly basis only adds unnecessary risk. There is simply no upside because any decisions based off such analysis will result in being either lucky or wrong.

That being said, I still watch the market closely because stocks go on sale all the time, and I love a bargain. A stock will often fall for unknown reasons while the fundamentals stay intact. Emotions cannot be analyzed but fundamentals can, and when these opportunities present themselves, it's fun to profit on the fear and panic of others.

The bottom line is that this business is about managing risk rather than taking risk, and spending time agonizing over why the market is doing whatever it is doing or where it is going adds zero value.

Sincerely,

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