WHITE PAPER

INVESTMENT MAXIMS

What did you learn in school today?

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After 43 years in the investment business, I realize that I (and most others) don't really know very much. But, here are twenty-five things I have learned. I have arbitrarily divided them into four major categories. By way of introduction, it is important to understand that capital markets represent a collection of individual decision makers who are driven by emotions such as greed and fear. Therefore, markets are constantly changing which means they cannot be mastered by equations, ratios, rules of thumb, and simple extrapolation of historical data.

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Capital Markets

- It is important to understand that cycles are inevitable because that understanding will decrease the likelihood of excessive exuberance or pessimism.
- No one really knows what will happen to the economy and markets including the "experts."
- The market is smarter than you think. By the time you have a great insight or react to news, the market has probably already priced it in.
- Markets can stay seemingly out of whack for long periods.
- It is hard to tell the difference between temporary blips and paradigm shifts.
- Most financial news is basically "noise" with little impact on long term results.

Investor Behavior

- Emotions are the worst enemy of investors. And, this curse applies to both amateurs and professionals.
- All investors make mistakes so it is critical not to be paralyzed by them.
- Snap decisions are usually bad decisions.
- Another enemy of long term success is the continuous and powerful urge "to do something." Most activity in the investment world is both expensive and non-productive.
- Committees generally strive for consensus which results in middle of the road, comfortable, investment strategies and commensurate performance.

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Managing Money

- Most investors don't spend enough time thinking about their objectives and don't properly evaluate their progress toward achieving them.
- Risk is the most difficult topic in investing and most investors' risk tolerance rises and falls in lockstep with the stock market. (The opposite of what should happen)
- Portfolio volatility can be particularly damaging to investors who rely on their portfolios for current support.
- The best returns are earned by those willing to be an early adopter and/or to do something truly different from the pack.
- The one thing you do control in the financial world is the going-in price you pay for an investment.
- Momentum is a more powerful predictor of short term returns but value wins in the long run.
- If all of your investments are performing well, you haven't done a good job of diversification. Most investors have a very difficult time comprehending diversification and portfolio construction.
- Similarly, most investors focus on the individual components of their portfolio rather than the behavior of the entirety.
- Markets are highly competitive which suggests that most investors should opt for passive strategies.
- Cost is the enemy of returns.

The Investment World

- The investment world is characterized by sophisticated math and complex models. But, these models are highly fallible and we shouldn't be seduced by the "illusion of precision."
- Wall Street is very good at marketing, and statistics are frequently misused- caveat emptor.
- Short time horizons are highly destructive for investors, corporations, and the economy as a whole.
- Performance data has little predictive value, and overly frequent performance evaluation often results in unnecessary activity and poor decisions.

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So What?

Given these maxims, our approach to managing money is as follows:

- Spend a lot of time thinking about investment objectives and risk tolerance.
- Structure diversified portfolios that offer a reasonable chance of achieving the desired return while also withstanding any kind of investment environment.
- Use a blend of active and passive strategies. In the active segment, select top flight investment managers that have the courage to move against the prevailing wind.
- Try to find investment strategies that are out of the mainstream in order to enhance diversification, and potentially, return.
- Make moderate shifts in asset allocation based on a blend of quantitative data and judgement derived from considerable experience.
- Use economies of scale to minimize cost.
- Focus performance evaluation first and foremost on achieving goals.

This approach to investing may not give you bragging rights at cocktail parties but it is the most sensible way to preserve and grow wealth.