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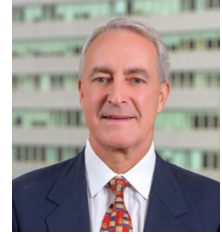
Thoughts for Investors



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The "Work" of Investing

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Data is all around us. Actually, it always has been, though lately we seem to be obsessed with it: getting it, having it, using it and now often having it stolen. But data is only a starting point. There are many other steps necessary before data is of any value to investors. Data must be collected and organized into information and then interpreted to become knowledge. With experience, knowledge becomes wisdom and with time wisdom shapes judgment. In the end we hope judgment leads to action because without action, what good is all that data? The computer has given us the ability to collect and store massive amounts of data and a proliferation of websites, blogs and "robo-advisors" are ready to share investment "wisdom" gleaned from that data for free or fee. There are even reader comments to reassess and reaffirm what was said by the websites and blogs. So, with the proliferation of these new "tools", why aren't investors benefiting more today? My thoughts are the subject of this newsletter.

One of my investment heroes is Benjamin Graham, the father of value investing. John Templeton and Warren Buffett, also investment heroes of mine, are among his disciples. Graham began teaching value investing at Columbia Business School in 1928 and along with David Dodd in 1934, wrote the seminal book on value investing, Security Analysis.

He followed that in 1949 with The Intelligent Investor, a book Buffett said is "by far the best book about investing ever written".

"There has developed the general notion that the rate of return which the investor should aim for is more or less proportionate to the degree of risk he is ready to run. Our view is different. The rate of return sought should be dependent, rather, on the amount of intelligent effort the investor is willing and able to bring to bear on his task"

– Benjamin Graham

In the Intelligent Investor, Graham advises doing a "thorough analysis" of a stock before investing. This helps an investor learn a stock's "intrinsic value", which is Graham's estimate of a stock's value. When a stock is purchased at a price below the intrinsic value, there is a perceived "margin of safety" to potentially protect the investor in the event his calculation was wrong and he overpaid for the stock. Once the intrinsic value is determined and an investment is made, Graham cautions investors not to worry about fluctuations in a stock's price (volatility). He believed that in the short run, the stock market acts like a "voting machine" (a popularity contest) whereas in the long run it becomes a "weighing machine" (weighing the intrinsic value). "Thorough analysis" is hard work and Graham believed that it was this work, or what he calls "intelligent effort", that leads to returns. This belief is counter to the idea that greater risk automatically equates to greater return. He emphatically states his disbelief of that notion and I'm sure that will startle some investors who have been taught otherwise. One of the reasons why Graham did not believe that risk necessarily equals return is because he felt risk is not a number that can be easily quantified. People view risk differently. To me, riding a motorcycle is risky whereas to you it may not be.

"Opportunity is missed by most people because it is dressed in overalls and looks like work"

– Thomas Edison

Thus, in my opinion and despite all of today's "tools", the reason that investors are not necessarily achieving their goals is that they do not spend enough time doing "thorough analysis", or the "work" of investing. For that, I believe, you can in part, curse the computer (and the software it uses). Today, with the computer you can collect massive amounts of data and then magically produce any kind of portfolio you want, such as "aggressive growth", "growth and income", "lifestyle", "target-date", "S&P500" or event "event-driven" portfolios. You can even purportedly dial-in the amount of "investment risk" you want in a portfolio by using other software to combine various types of portfolios. Some investors sincerely believe that the right software program can tell them the perfect investments and/or allocations to turn meager savings into millions of dollars of retirement wealth! I have seen television commercials touting how one can even rebalance their investment portfolio on their smartphone (hopefully not while driving). If even that is too much work, the Financial Times recently reported that Goldman Sachs is investing in Kensho, "which has been likened to a Siri-style service for investors, traders and portfolio managers". Many investors who use these services do not understand how their portfolios are built or often even what stocks they contain. Worse yet, they may be putting blind faith in the folks who build these tools or use them on their behalf. Sensing this concern, some investors switch to "macro-investing" which is a strategy of investing based on forecasts about currencies, interest rates, oil prices, politics, or the potential for certain events to occur. Graham calls this speculation.

In the end, to avoid doing work, many investors may instead spend their time choosing an "outcome", essentially picking a return they are happy with. Unfortunately, this does not necessarily make investors more successful.

"The computer is the bicycle for the mind"

– Steve Jobs

Of course, computers can do a lot of "legwork" for you. As Steve Jobs pointed out, the computer can extend your capability well beyond its normal range. In his day, Graham spent a great deal of time collecting data and doing laborious calculations even before starting his investment work. It is unlikely that many investors put in that kind of work. Today one can go to websites like Valueline, Standard & Poors, Thomson Reuters, Barron's or Yahoo Finance and collect information in minutes. However, the real work cannot be finished by the computer.

"Statistics are no substitute for judgement"

– Henry Clay, U.S. Senator

So what is the "work" of investing? I propose the real work is judgment. Though the computer may help investors collect, sort and collate lots of data, and even turn it into usable information, and even store it for generations as knowledge, there is no shortcut to acquiring judgment, which is the precursor to taking wise investment action. According to dictionary.com judgment is defined as "the formation of an opinion after consideration or deliberation". Can a computer do that? In a recent Slate Magazine article, Lee Gomes wrote that the autonomous Google (self-driving) car "may never actually happen" because (among many other factors) "…it can't tell the difference between a rock and a crumbled up piece of paper, (so) it will try to drive around both…" When investing, judgment is the ability to distinguish between volatility (the crumbled-up paper) and risk (the rock) when deciding whether you need to swerve. This is not always as easy as it sounds if you don't have a lot of experience driving your own portfolio.

"Nothing is more difficult, and therefore more precious, than to be able to decide"

– Napoleon Bonaparte

In summary, what is easy for everyone is an advantage to no one. In Benjamin Graham's day, just finding and collecting the data gave him a leg-up on other investors in the quest to uncover profitable investments. Today,

widespread access to data and the availability and low cost of computing power has negated that advantage, or rather distributed it equally to all investors thus making investing harder not easier. So if you want to be a more successful investor don't be afraid to work. Work can lead to wisdom, and wisdom combined with time, experience and thoughtful deliberation becomes judgment. I believe this is the most important trait of Graham's "The Intelligent Investor" and there probably will never be a majority of investors, amateur or professional, who possess good judgment. You will need judgment to take action when the next bout of stock market pessimism returns.

"Better a little which is done well than a great deal imperfectly"

– Plato

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