A DIFFERENT APPROACH TO INVESTING (PART 3)

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This is the third of a three-part series of quarterly client letters intended to explain how our investment approach is different than most.

Part one, subtitled *We Don't Gamble*, revealed how many market participants think they're investing, when in fact what they are actually doing is nothing more than gambling with their hard-earned investment dollars. Rule #1: We don't gamble.

For the second letter, subtitled *We Think Long Term*, we discussed how most investors treat investing (a long-term proposition, by definition) like it's a sprint instead of the marathon that it really is. The data routinely shows an inverse relationship between trading frequency (i.e. short-term thinking) and returns; the more you trade, the lower your returns. **Rule #2: We think long term.**

And now finally for this third installment, I will explain how we are also different in that **we adhere to the timeless wisdom of the world's greatest investors.**

Before we begin, here is what Investopedia has to say about this elite group:

> **"Great money managers are like the rock stars of the financial world. The greatest investors have all made a fortune off their success and in many cases,they've helped millions of others achieve similar returns."**

So who are the world's greatest investors? I can't dispute Investopedia's take on this either. Among their list they include the likes of Benjamin Graham, John Templeton, and of course – Warren Buffett.

Let's briefly take a closer look at each of these "rock stars" of the investment world, in the interest of adhering to their timeless wisdom for the betterment of your own investment success.

Benjamin Graham: "The Father of Value Investing"

Although Graham was born in London England in 1894, he and his family moved to the United States when he was just a year old. He went on to write the investment classics *Security Analysis* (along with David L. Dodd) and *The Intelligent Investor*, known as the definitive book on value investing.

Graham's investment firm achieved returns of approximately 20% per year from 1936 to 1956, widely outperforming the 12.2% average return for the broader stock market over the same period. In terms of helping others succeed, I believe his most significant contribution may have been his keen insights into investor behaviour. According to Benjamin Graham,

"The investor's chief problem – and even the worst enemy – is likely to be himself."

Almost a century after Graham introduced the subject; the study of behavioral finance is now commonplace among academics.

So how is our approach different? How can we gain from this wisdom, to ensure that we do not become our own worst enemy? Graham went on to say that,

"Individuals who cannot master their emotions are ill-suited to profit from the investment process."

Throughout my career I've seen countless examples of investors, my industry peers among them, who clearly cannot master their emotions. Rather, they make their investment decisions based on how they feel, or on the current market sentiment as dictated by the media or the investing 'herd'. This often results in short-term, knee-jerk reactions that serve only to capitulate from an otherwise well-thought-out long-term investment strategy.

Here's the issue with investing as based on one's current emotions. When you feel pessimistic about the outlook for stocks or the economy, chances are most other market participants are feeling the same way (…unless of course you somehow believe that you alone have some uncanny insight that not even Benjamin Graham professed to have?). If most investors are feeling gloomy about the outlook for stocks, this is generally already 'priced in', making stocks 'cheap'. When stocks are available at attractive prices (cheap), risk is low and therefore it should go without saying that they should be bought – not sold.

Of course, the converse also holds true. When the folks I talk to are euphoric about the outlook for stocks, that view is almost always the widely held opinion. In other words, it is already the consensus point of view. When the investing herd, the media, market strategists, analysts, and the talking heads on BNN/CNBC are all singing off of the same song sheet – as they so often do - once again, this euphoric state is inevitably already reflected in stock prices. Such optimism makes equities very expensive, and therefor also very risky - right when most investors are piling in. Clearly it is easy to see how many investors can in fact become their 'own worst enemy'.

It should go without saying that we choose not to play this game. We will not let our emotions drive our investment decisions, and we will not seek the false comfort of running with the herd.

Warren Buffett: "The Oracle of Omaha"

Warren Buffett is widely considered the greatest investor of all time. According to his latest annual letter to Berkshire Hathaway shareholders, he has now achieved a fifty-one year track record (1965 to 2016) of a remarkable 20.8% per year. Over the same period the S&P500 has grown at a very respectable rate of 9.7% per year (*with dividends*). While this represents an overall gain of 12,717% for the S&P500, an investment in Berkshire Hathaway in 1965 would be up an almost unfathomable 1,972,595% today.

Despite Buffett's incredible long term track record, many seem to have a "what has he done for me lately" attitude toward the Oracle of Omaha. Here is some recent data: Berkshire Hathaway has outperformed the S&P500 in seven out of the last ten years, and in 2016 his propensity to double the benchmark was intact, with shares of Berkshire up 23.4% vs. the S&P500 up 12%. Most money managers would be happy to simply beat the index, let alone double it!

So what can we learn from Warren Buffett, who so happened to be a student of the aforementioned Benjamin Graham. According to Buffett, in order to achieve investment success we must,

"Be fearful when others are greedy, and be greedy when others are fearful."

I believe this is simply another way of saying that we must control, and not succumb to, our emotions – as already discussed above. As such, I'd like to briefly focus here on another tenet of Buffett's: **Think of stocks as a business.**

Buffett believes investors should think of themselves as part owners of the underlying business in which they are investing. We touched on this line of thought in my We Think Long Term letter. Here's a direct quote from that commentary: *"Others (not us!) seem to view a stock as merely a piece of paper, rather than focusing on what they really own – an investment in an actual, underlying business. Perhaps one of the fundamentals to Warren Buffett's success is the fact that he takes a very 'business-like' approach to investing in stocks. As a business owner, he isn't swayed by the latest (typically negative) media headlines of the day. Further, he knows that the shorter you hold a stock the more likely you are to lose money. As such, he typically invests in these businesses for a very long time, and is not prone to trading them like pieces of paper."*

How are we different? By taking a 'business-like' approach toward investing we completely change the way we make our buy/sell decisions, our reaction to the headlines, and our time horizon. Perhaps most important, this allows us to remove (or at least temper) our emotions from the decision making framework.

Sir. John Templeton: "The Greatest Global Stock Picker of the 20th Century"

(*as per Money magazine, 1999*)

John Templeton was an American investor, fund manager, and philanthropist. Through his Templeton Growth Fund, he achieved an annual return of close to 16% per year from the fund's inception in 1954 to his retirement in 1992.

He became a billionaire by taking his uncanny stock picking skills across the globe. According to Wikipedia, *"Templeton became known for his 'avoiding the herd' and 'buy when there's blood in the streets' philosophy. He also was known for taking profits when values and expectations were high."*

To reiterate, the purpose of these missives is to explain how our approach is different than that of most investors. Fittingly, here is one of Templeton's most famous quotes;

"If you want to have a better performance than the crowd, you must do things differently from the crowd."

Why is being different so important? Year after year industry data reveals a large disconnect between investment returns and investor returns. In other words, even when stocks show a material long term advance, stock investors find a way to drastically underperform the very market they're investing in.

According to Dalbar Inc., for the twenty year period from 1994 to 2014, the S&P500 averaged 9.8% per year while the average investor achieved returns of just 2.8% per year, barely beating inflation! The cause of this huge discrepancy can be explained above, and throughout my previous quarterly client letters.

In adherence to Sir. John Templeton's quote above, clearly a different approach toward investing is required.

To wrap up this three-part series, here is a summary of how we will differentiate ourselves:

1. **We don't gamble**
2. **We think long term**
3. **We will follow the timeless wisdom of the world's greatest investors**

Onward and upward!

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