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PARTNERS

WHAT MAKES A SUCCESFUL VALUE INVESTOR?

PART VII – CURIOSITY

If you are reading this, what is, Part VII of our Multi-Part Series (published monthly), then you are already demonstrating a key trait in common with all successful investors as well as a vital link in answering the question:

What makes a successful value investor?

Curiosity…

Curiosity is one of the most important traits that all successful investor's share. I define it as the desire for truth through the constant acquisition of knowledge. This is attained by questioning, seeking answers/explanations and never taking things at face value, especially where other investors would settle for less than satisfactory answers. This idea of continuous learning is at the core of their process for all great investors. Buffett has been described as a 'learning machine' as he has never stopped learning and looking for opportunities to improve himself and his process. On the importance of reading, Munger said at the 2003 Berkshire AGM:

'I have said that in my whole life, I have known no wise person over a broad subject matter area who didn't read all the time-none, zero. Now I know all kinds of shrewd people who by staying within a narrow area can do very well without reading. But investment is a broad area. So, if you think you're going to be good at it and not read all the time, you have a very different idea than I do…You'd be amazed at how much Warren reads. You'd be amazed at how much I read.'

This thirst for knowledge explains how Munger has read hundreds of biographies, as learning through the successes and failures of others over numerous walks of life and lifetimes is the fastest way to become wiser and smarter (and in my mind without a lot of pain!). In many aspects of life, experience counts, however, in investing its effects compound over time, as experience enables greater pattern recognition which can result in better investment ideas and a better ability to spot and avoid mistakes. Again, learning from the successes but in particular the mistakes of others, is an incredibly efficient way to improve your own investment process while not coming at a significant personal cost. As was discussed in our previous publication on 'Focus'. We each have 24 hours in a day, so being as efficient learners as possible and absorbing the life lessons and accumulated wisdom of others is a surefire way maximise our time spent studying.

However, just reading about them is not enough, the mental skill of critical analysis is fundamental to successful investing. Perfecting that skill – developing the mind-set of thoughtful, careful analysis – is intimately connected to the skill of thoughtful, careful reading. Each one reinforces the other, in a kind of double feedback loop. Good readers are good thinkers; good thinkers tend to be great readers and, in the process, learn to be even better thinkers. So, the very act of reading critically improves your analytical skills. At the same time, the content of what you read adds to your accumulated knowledge, and this is enormously valuable. To put the matter more directly, learning to be a careful reader has two enormous benefits to investors; it makes you smarter, in an overall sense; and it makes you see the value of developing a critical mind-set, or not necessarily taking information at face value. The critical mind-set in turn has two aspects that relate to the reading process (1) evaluate the facts and (2) separate the facts from opinions.

Now this to some may make it sound like I am saying that all your reading should be finance/business/accounting related. That's not what I'm saying. I'm saying that if you adopt the right mindset when it comes to your own reading, then any type of reading can be used to accumulate your repository of knowledge. It is a given that a fundamental interest in business and finance is required for successful investing, along with an understanding of accounting, which is the language of business. However, as all knowledge is cumulative, expanding our minds by reading any materials be they fiction/non-fiction so long as they are related to broad swaths of human affairs, can make us more 'worldly'. Essentially the world is made up of the business of 'human affairs' and anything that can help us to understand how it works at any level will be accretive to our investment process. The more you learn about human behaviour from the past and from the present, the more you will develop your own ability to spot good/bad parallels with investment opportunities that you can evaluate today.

Professional training such as an MBA or apprenticing under one of the investment greats is not a pre-requisite nor any guarantee for success. However, an intense interest in business will lead you to grasp the basics through your own pursuit of mastery over the entire subject. To succeed in markets as we have established you have to see things that others do not, having a different education / background / perspective can all help you to sharpen your investment edge. We live in an era of profound and accelerating change. In such a world, successful performance demands flexible thinking. In an environment of rapid change, the flexible mind will always prevail over the rigid and absolute. Intelligence comes in all shapes and sizes, but for anyone worried that they are not capable of competing in today's markets, Buffett had this to say at the Berkshire Hathaway AGM in 2011:

'The good news I can tell you is that to be a great investor you don't have to have a terrific IQ. If you've got 160 IQ, sell 30 points to somebody else because you won't need it in investing. What you do need is the right temperament. You need to be able to detach yourself from the views of others or the opinions of others. You need to be able to look at the facts about a business, about an industry, and evaluate a business unaffected by what other people think. This is very difficult for most people. Most people have, sometimes, a herd mentality, which can, under certain circumstances, develop into delusional behaviour. You see that in the internet craze and so on.'

Charlie Munger followed up on this by saying:

'The biggest problem with intelligence is complicating things more than they need to be. Occam's Razor. A successful investment usually hinges on only one or at most several critical factors, if you cannot boil it down to these and isolate them out of the myriad of things that could affect the business then you cannot make a balanced investment decision. This is the art of investing, an 8-hour presentation on a stock is the polar opposite of this ability and thankfully where most people in the industry thinks the gold lies...Intelligent people are easily seduced by complexity while underestimating the importance of simple ideas that carry tremendous weight.'

As long as you have a good mind and use it wisely, you will have no problems in the investment business. It is not a game where the person with the highest IQ wins, but where the smartest person wins. The person who is curious, who knows how to value a business and how to think about its value relative to the market.

We have previously discussed the importance of personal humility in the investment process, and it also applies here, when it comes to intellectual honesty. Recognising our own limitations and therefore safeguarding ourselves against potential mistakes is extremely important. When we make an investment mistake it is obvious as the outcome will not be what we predicted at best and at worst we will have lost some of our capital. It is important to acknowledge errors when they occur, examine how and why they happened, to learn from them and to implement any necessary changes in our portfolio/investment process to ensure they do not recur. This is a positive process, it is one of continuous learning and personal growth that will make us better investors, there is no time to wallow in regret. Now you can clearly see why learning vicariously from the mistakes of others can accelerate your investment process and is also significantly cheaper!

To me the greatest aspect of investing is the fact that it is a never-ending game. You can never truly 'win' as the game is constantly changing and evolving. As an investor, no matter what your report cards say, there is always room for improvement. You can only improve by embracing your mistakes and the rewards for doing so in terms of performance, are significant. This is the opposite of most careers where people seek to bury their mistakes, as the old saying goes 'success has many fathers, but failure was an orphan.' This degree of intellectual honesty is only really found in academia through peer review papers, where 'breakthroughs' which usually means proving something that everyone previously thought was correct, to be wrong, are celebrated. This is intellectual honesty at its purest and a refreshing approach to error correction that we should all embrace.

Personal integrity in how you conduct yourself and how you deal with others is in my view, a core pillar of every successful investor's personality. If ever in doubt (an immediate red flag) I advocate Buffett's newspaper test, which is to think how you would feel if the details of what you are thinking of doing were published on the front page of a national newspaper for all your friends, family and business partners to read, if it makes you even slightly uneasy, do not do it. As the saying goes 'it takes a lifetime to build a reputation and a single second to demolish it.' When it comes to friends and business partners in particular (you get to choose them, your family you do not), make sure to surround yourself with people that you admire and that seek to make you a better person. Again, if there is ever any doubt, cut them loose, as life is far too short to be dragged down by people lacking in integrity.

Wisdom in markets comes through experience, but to use it, you must also have and be able to apply common sense and good judgement. I agree that in markets there is no substitute for experience, whether learned directly or learned vicariously through the teachings of others. As long-term value investors we aim to be here for the long-term. To do so we must maintain our intellectual honesty which in turn allows our knowledge to compound over time. Human beings are not entirely objective or rational and can be highly emotional when we 'believe' something to be true or have a vested interest in a certain outcome. This is why we usually predict events will work out in our favour and that we are smarter than average (note not everyone can be smarter than average!). In investing, we have to be objective and counterbalance our inherent personal biases through our investment process. As our knowledge compounds, so does our ability to recognise and evaluate potential investment opportunities.

I'll leave the last comment on this subject to one of the worlds most intellectually curious and honest men, whose contributions to human progress cannot be understated and that is Charles Darwin. In his book On the Origin of Species (1859) he wrote:

'It is not the strongest of the species that survive, nor the most intelligent, but those most adaptable to change'.

In a constantly changing and what feels like an ever-accelerating world, embracing lifelong learning through intellectual curiosity may be the single most important factor in achieving success in life and in financial markets today. Lifelong learning is closely associated with humility, an open mind, a willingness to take risks, a capacity to listen, and honest self-reflection. To shrink this lifelong aspiration down into a repeatable action for today, if you can go to bed each evening a little wiser than when you woke up, then the effects of compounding over many years will be even more spectacular on your life, than on just your financial returns.

I trust you have enjoyed our journey together so far however, if our paths diverge from here, then as the investing legend, Charlie Munger says, 'In the investment business, all knowledge is cumulative' and in this spirit, we wish you continued success on your journey!

Yours sincerely

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