Another 21 great investment quotes

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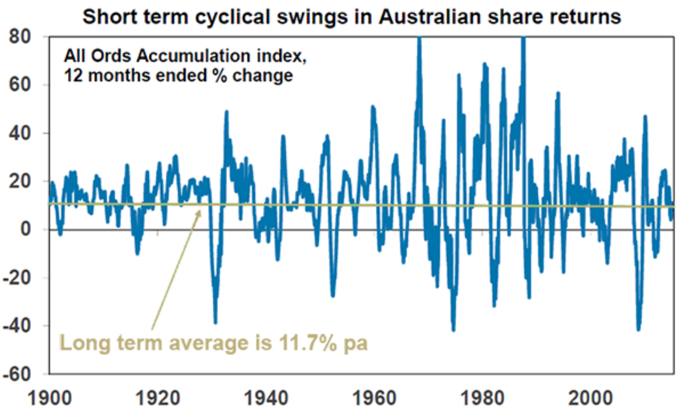
Introduction

Investing can be profitable as well as fun, but it can also be unnerving and unprofitable if you don't understand markets and don't have the right mindset. The basics of successful investing are timeless and some experts have a knack of encapsulating these in a way that's insightful. A year ago I wrote on 21 investment quotes I find useful (see 21 great investment quotes, Oliver's Insights, April 2014). Here are some more.

The market and cycles

"The stock market is the story of cycles and of the human behaviour that is responsible for overreactions in both directions." Seth Klarman

Cycles are an investing reality. Not just shares – but also bonds, property, infrastructure, term deposits, whatever. They all go through cyclical phases of good times and bad which are driven by the combination of fundamental economic & financial developments invariably magnified by investor behaviour that has a habit of extrapolating current conditions into the future. Some cycles are short term, such as those that relate to the 3 to 5 year business cycle. Some are longer, such as the secular swings seen over 10 to 20 year periods in shares.



Source: Global Financial Data, AMP Capital

"In the old legend the wise men finally boiled down the history of mortal affairs into a single phrase: 'This too will pass.'" Benjamin Graham

Just as historical experience tells us there are investment cycles, it also tells us that they pass. Despite all the "new eras", "new paradigms" and "new normal" commentators wheel out at cycle extremes, all cycles contain the seeds of their own reversal. When someone tells you about a new whatever, it's probably already run its course. So when, after a major share market collapse in the midst of recession, it seems there is no hope, just remember "this too will pass."

"It's so good it's bad, it's so bad it's good". Anon

In every cycle there comes a point where fundamental conditions are so good that they are bad: economic growth is so strong that its causing inflation to rise and central banks to run ever tighter monetary policies; shares have become overvalued; and investors have piled in at such a rate that there is no one left to invest. This then sets up a market top and a new bear market. And the reverse applies during economic and market downturns. Which brings us to contrarian investing.

Contrarian investing

"The way to make money is to buy when blood is running in the streets." John D Rockefeller

This is a bit extreme, but it illustrates a key point. The best time to buy shares and other growth assets is after a sharp fall and a good guide is the economic and financial pain around you. When it is at an extreme and it all looks hopeless then that's usually a good sign that there is long term value to be found!

"Markets are in a constant state of uncertainty and flux and money is to be made by discounting the obvious and betting on the unexpected." George Soros

There are two insights in this. First, markets are always bouncing around – minute by minute, day by day, year by year – because they are trying to discount the future. We just have to get used to it. Second, investment markets can be perverse. If the economy and profits are obviously bad then that is likely already reflected in the share prices and you are better off betting on what is not, eg an economic recovery. And vice versa when things are obviously good.

"In investing, what is comfortable is rarely profitable." Rob Arnott

The problem with contrarian investing is that in going against the crowd you lose that warm fuzzy feeling that comes with safety in numbers. You have to go against what you are hearing at BBQ's or from the media and that can be very uncomfortable.

"The share market's role is to make the majority of investors wrong" Ned Davis

This sounds rather bleak and is a bit simplistic, but it reflects the fact that most don't invest on a contrarian basis – by definition markets top out when most investors are long and they bottom when most are short or underweight. Hence the comment about the market proving the majority of investors wrong. There are two ways around it: either adopt a contrarian approach which takes positions counter to the crowd at extremes or take a long term approach that looks through cyclical fluctuations. But whatever you do don't get sucked in (or out) when everyone else is.

Pessimism

"More than any other time in history, mankind faces a crossroads. One path leads to despair and utter hopelessness. The other to total extinction. Let us pray we have the wisdom to choose." Woody Allen

I love this quote. Because often the financial commentary around investment markets can only see disaster. Eg, we have been inundated with commentary over the last five years to the effect that the Eurozone will soon blow itself apart or that if it stays together it is doomed to a horrible outlook. And yet not only has it stayed together but it has got bigger!

Process

"A great company is not a great investment if you pay too much for the stock." Benjamin Graham

The key to successful investing is not to buy great companies or investments, but to invest well. Shares can give you horrible returns if when you buy they are overvalued and overloved. So you need an investment process that avoids this.

"When the facts change I change my mind. What do you do sir?" John Maynard Keynes

This is the classic economists' defence for when their forecasts don't pan out! But it also highlights that any investment process needs to have a bit of flexibility for when the facts change.

"Don't look for the needle in the haystack, just buy the haystack!" John C Bogle

The key insight here is that trying to beat the market by stock picking can be hard and so if you want to grow wealth over time the key is to get a broad exposure to the market and letting compound interest do its job.

"There seems to be a perverse human characteristic that makes easy things difficult." Warren Buffett

Whatever you do, don't overcomplicate your investments. Avoid investments you don't understand and try and keep your investment process relatively simple and commensurate with the amount of effort you want to put in. You need to be able to see the wood for the trees and understand what's happening.

"There are two kinds of forecasters: those who don't know, and those who don't know they don't know." J.K. Galbraith

While that may be a bit harsh – you might say I would say that being an economist – the reality is that forecasts as to where the share market, currencies, etc, will be at a particular time have a dismal track record. Hence the jokes about economists! Good experts will help illuminate and point you in the right direction, but don't over rely on expert forecasts.

"Stop trying to predict…" Warren Buffett

Basically, the same point. If you are going to actively move your investments around the key is to have a process that helps identify extremes – when assets are undervalued, underloved and oversold and vice versa. Or if you don't have the time or inclination to put the effort in, it's best to take a long term approach and let others manage cyclical market fluctuations.

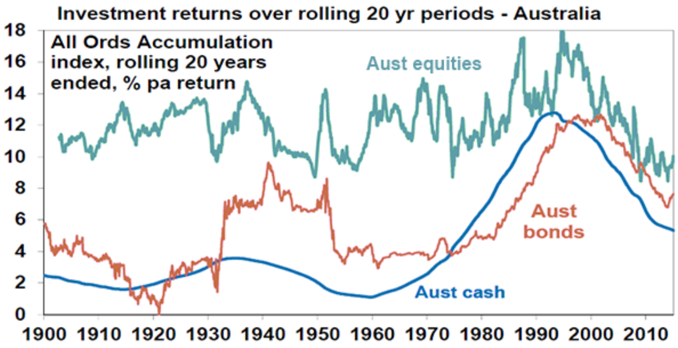
Cash flow and time

"Do you know, the only thing that gives me pleasure? It's to see my dividends coming." John D Rockefeller

There have been lots of investments over the decades that have been sold on promises of high returns or low risk but were underpinned by hope based on hot air (the tech boom) or financial alchemy (AAA rated sub-prime trash). By contrast, assets that generate sustainable cash flows (dividends, rents, interest payments) and don't rely on excessive gearing or financial engineering are more likely to deliver.

"Our favourite holding period is forever." Warren Buffett

In investing time is on your side and the more you have of it the better. So while short term market fluctuations can take you away from your objectives – think the first chart in this note, the longer the perspective you take the great the chance you have of achieving them – as per the next chart.



Source: Global Financial Data, AMP Capital

Right mindset

"In the business world, the rear view mirror is always clearer than the windshield." Warren Buffett

We are all subject to behavioural biases, the most serious perhaps being a tendency to extrapolate recent developments off into the future regarding investment returns. So if the recent past has been poor you assume this will continue and want to get out and vice versa. But this just causes us to get wrong footed by the cycle. Just as spending too much time focussed on the rear view mirror will get you wrong footed by the road.

"You get recessions, you have stock market declines. If you don't understand that's going to happen then you're not ready, you won't do well in the markets." Peter Lynch

If you can't handle volatility associated with investment markets then either they are not for you or you should just take a long term approach and leave it to someone else.

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

This is all about knowing yourself. The reality is that we all suffer from the behavioural biases that give too much weight to recent developments in forming expectations regarding future returns, seek safety in the crowd and give too much weight to loss relative to gain. But smart investors have an awareness of their weaknesses and seek to manage them. One way to do this is to take a long term approach to investing. But this is also about knowing what you want to do. If you want to take a day to day role in managing your investments then regular trading may work, but you need to recognise that this requires a lot of effort to get right and will need a rigorous process.

Reality

"There is no free lunch." Anon

If an investment looks too good to be true in terms of return or risk, then it probably is. Rather, focus on investments offering sustainable cash flows (dividends, rents, interest) that don't rely on excessive gearing or financial engineering.

"Money can't buy me love." The Beatles

And finally, just remember that money isn't everything. Numerous studies show that people with good wealth and incomes are happier than those without, but beyond a certain level more money won't necessarily make you any happier.

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