

Blinded by the Light (of Data)

By Mariko Gordon

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Today when the world thinks of Japan, it sees nothing but apocalyptic devastation: tanker ships stranded in cabbage fields, logs balancing on rooftops, mile upon mile of rubble and clouds of radioactive steam billowing from damaged reactors.

That's the downside to globalization and relentless 24/7 media coverage; it's hard to shake such searing images.

But it's not fair to think of Japan as broken, pathetic and toxic, and my friends in the Japanese diplomatic corps bristle at this notion. It does a proud people a disservice, as the media circus will have moved on before the world registers the **strength of Japanese character in the face of adversity** - one of stoicism, courage and perseverance.

So let me give you a different picture of Japan, one based on a happy memory.

Over 3,000 islands dot the inland sea of Japan. Often shrouded in fog, they rise up from placid water in picturesque clumps, the ancestral home of ogres in Japanese folktales. Some are too small to be inhabited, others contain surprising bits of industry.

One of these islands is called [Naoshima](#), and it is one of my favorite places on earth. Except for a smelter perched at one end and a traditional village of Tokugawa vintage on the other, it is otherwise an island covered with site-specific art installations and fabulous concrete confections designed by the legendary [Tadao Ando](#).

This "island of art" is the brainchild of Mr. Soichiro Fukutake, whose [Benesse Corporation](#) owns [Berlitz](#), among many other lines of business. He is a billionaire of James Bond-ish proportions. As part of a delegation of Japanese American leaders, I had the chance to meet him once. He was perfectly affable as far as billionaires go, but he did have one flaw. **He liked to keep his island guests in the dark...**

I hesitated as I stood on the threshold of a single-story rectangular building whose wood exterior was black and charred, as if made of charcoal. **Walking in meant plunging into a vast darkness so complete it was like being shut into a box;** I couldn't even see the hand in front of my face.



Some people in the group flipped out and had to leave, it was such a freaky experience to be so suddenly and utterly stripped of sight. We slowly walked into the room, arms extended in front of us like zombies, silenced by the novel sensation of being able to seeing nothing at all.

After a few minutes there emerged a glow from the gloom, so faint as to seem a hallucination. A few minutes more and, as our eyes adjusted to the dark, we saw that the entire back wall of the room was in fact a giant, daffodil-yellow, light-filled box.

The light had been there all along, of course, we just couldn't see it. There were no shortcuts either; we needed to wait the 15 minutes for our eyes to adjust.

That moment of literally "seeing the light" rocked my world and confirmed in my mind the genius that is artist [James Turrell](#), whose creation this was. **It was a life lesson in having patience and trusting a process that could not, under any circumstances, be hurried,** in order to experience a stunning moment of discovery.

That is what art is all about. **Often, it's what finance is all about, too.**

I was thinking about this moment of illumination when, in answer to my [penultimate newsletter](#) about statistics and Kaiser Fung's book, [Numbers Rule Your World](#), reader **Robert Braun asked a question so good, I found myself once again groping in the dark.** I ended up sending an S.O.S. flare to Kaiser.

Robert asked: "Let's say [there's] a 2.1% standard deviation on a 0.6% average monthly outperformance for 199 months. Is this 'just right' or 'too much'? Any objective way to evaluate this?"

This is important in our business, as **the measuring stick of standard deviation is wielded faithfully to differentiate among managers.** While no investment process and its long-term history can be reduced to a single putative measure of risk, it's seductive to hone in on a tidy number like standard deviation.

But there's a problem: It's that simple rules of thumb that use standard deviation assume that the data set is shaped in a perfect bell curve, with a symmetrical distribution on either end. In real life, as we know too well in this business, returns are asymmetric and the tails are often fatter than expected.

In response to my S.O.S., **Kaiser suggested forgetting about standard deviation and focusing on percentile ranges of returns instead:**

"The idea is to make statements like this: 'historically, the average return is 0.6% and 90% of the time, investors lose no more than 5%.' There are infinite variations: you can use any



percentile. You can even make a statement like; '50% of the time, the return was between X and Y.' This method is wonderful because it does not make normal distribution assumptions or symmetric distribution assumptions."

When comparing the returns of two managers over time, **thinking in percentiles and giving yourself time to see the insights that are temporarily hidden allows you to make a more informed decision regarding relative performance.**

In short, the only path to the light-box of enlightenment at the back of the wall is to trust the process of wallowing in the data. It's a process that can't be rushed, but the qualitative analysis of the quantitative data set will result in an a-ha moment. No travel to the land of ogres and Japanese billionaires necessary.

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