



Howard Marks on the Human Side of Investing – Q & A

By Robert Huebscher

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Howard Marks is widely regarded for his thought-provoking essays on the discipline and process of value investing. He is the chairman and co-founder of California-based Oaktree Capital, and he delivered the keynote address at the [Value Investing Congress](#) in Pasadena last week.



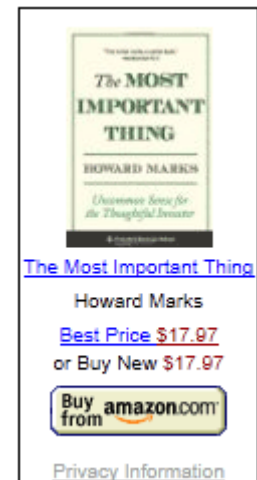
*His latest book, *The Most Important Thing: Uncommon Sense for the Thoughtful Investor*, is available from the link above.*

His remarks are presented [here](#) and below are some excerpts from the Q&A:

How much cash are you holding now?

We have all different kinds of funds – ranging from marketable securities funds, which are typically 98% invested, and today are probably 93% or 94% invested, to closed-end funds for distressed debt in controlled situations. We invest in real estate, mezzanine debt and private equity. The invested percentage of these funds largely is dependent on their vintage and how long we've been investing in them.

The most helpful thing would probably be just if I share the fact that in most areas our cash is high relative to our norms. The reason for this is because we find it challenging today to find exceptional bargains. Psychology is too positive, risk tolerance is too high for most assets to languish cheap, and thus it is a time, in my opinion, for great selectivity, caution, and discipline.



How does one go about building the temperament for successful investing?

It helps a lot to be born with a temperament that is reserved, steady, and not emotional. Reading is the most important thing. If you read about the excesses of the market and it strikes a chord with you, then you can get a lot out of this business. If you read about it and you say I don't get it, or this is not relevant to me, then you're probably in the wrong business.

A good example, one I referred to in my book, is a John Kenneth Galbraith book called *A Short History of Financial Euphoria*, in which he talks about the pendulum cycles and excesses and investor psychology. You read that book, as I did 25 years ago, and you get it. You say yes, that's right! It's probably right for you, and you are probably right for it.



The investors I know that I work with and respect are unemotional, not artistes painting great paintings. They are analytical, they are patient, and they are introspective. I don't know if the emotional person can become a successful institutional investor, or can be a successful value investor, and I don't know if he can learn to be. You must have this kind of serenity, stability, consistency.

If you think about the factors that determine investment environment – fear, greed, risk tolerance, skepticism, especially the willing suspension of disbelief that so many people practice, envy, relative benchmarking – all of these forces will bear on us. They are the forces that cause bubbles and crises, bull and bear markets. We are not immune to that. We will feel them, but we must see them for what they are and rise to the occasion rather than succumb as 95% of the investors do. Exactly how you teach yourself to do that, I don't know, and, as I say, I can't remember ever doing it as a conscious process.

The alternative is for me to say read the book. Or, I should say, buy the book.

How do you think about position sizing and using risk in positions?

Within the areas in which we work, we have always been toward the more diversified end of the spectrum. In our high-yield bond fund, we have never had a position of more than 2%. When something goes right, we don't have enough. But we follow the simplistic rule that if you don't have any big positions you can't have any big mistakes.

Part of the reason for that is that is Graham and Dodd described fixed income as a negative art, where your great contribution to your portfolio is not what you own but what you don't own. Most bonds that pay will have about the same return, so there is just no justification for concentration. If you move out from that, there is distressed debt and controlled investments in real estate. Here we can make a great contribution by holding a lot of the things that do well. So we do take positions of several percent in the ones that we think are the best, perhaps ranging up to 5, 6, 7, 8% of the portfolio.

Part of our position sizing frankly is forced upon us. We own more of things when there aren't many good things to buy. At those junctures, we may own a lot. But our tendency is to prefer diversification.

It's a stylistic and temperament thing. We tend to err on the side of diversification. But you know what? After 33 years we are still around, and many of the people who were our competitors in 1990 or 1980 are not still around. One of the great adages that I picked up from the past that I used in my book is that there are old investors and there are bold investors, but there aren't that many old, bold investors.

In the context of your longer-term illiquid investments, how do you think about dollar depreciation and risk?



This sounds like passing the buck, but we really don't think much about that. We don't attach a high enough probability to such depreciation to do anything about that, number one. Number two, our clients are looking to us for dollar returns in our dollar-denominated strategies. Number three, we don't have any superior knowledge about the likelihood of dollar depreciation relative to anybody else. I don't think we can add any value by making judgments and taking actions in that dimension.

The best thing that we can do to help our investors is to try for higher returns. If we can add value in dollars, then that's all we can do. One of the great advantages of having institutional clients is that they are fully equipped and to do hedging if they want. If they want dollar returns they come to us. If they want to hedge those against the dollar they can do that. As an institutional investor, we are given assignments. Our assignment is to make money in our strategies. The clients essentially acquit us of the responsibility to worry about the currency dimension.

You mentioned that you do not raise or lower cash for purposes of market timing, but you also said that right now you have more cash than you usually do. Can you explain the contradiction?

It is a hard one to explain. I appreciate your asking me. It's always instructive, especially for myself, when people point out my contradictions. What I meant to say is that we never say I'm worried about the market, so we are going to raise 10% cash. What we say is, we find a lot of things to sell, which produces cash, and not so much to buy, so it's hard to put the cash to work, and cash tends to flow in. I don't know if there is a legitimate difference in the two, but what I am saying is that our actions aren't the result of active portfolio management. When there aren't many bargains, we will naturally have more cash, and it isn't going to be the result of a conscious decision, but it is just what happens when you have lots of sales and not too many buys.

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