How to Develop Unsinkable Conviction

By Mariko Gordon
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Hands down, my favorite part of this job is getting to see how things are made.

Don't get me wrong... data, billing and design centers all have their virtues. But they lack the unexpected poetry found on the factory floor: a gentle rain of salt falling on cracker dough; the glow of a blast furnace; or, in the case of our last visit, the molds for fiberglass boats, as eerie as horseshoe crab or cicada molts.

Out there on the factory floor is the reality that our spreadsheets struggle to capture.

The week before last we were in Florida, visiting two of Brunswick's manufacturing plants - one makes Boston Whalers, the other, Sea-Ray yachts. The Boston Whaler is the more well-known brand, famous for its "unsinkable boats."

Not "unsinkable" as in the empty promise that was the Titanic, either. These boats are *literally* unsinkable, as in "saw it in half and it still floats." Or ride it over rapids (even, legend has it, Niagara Falls) and it still floats. All thanks to its unique construction of a double hull filled with foam.

All of this newly acquired knowledge on boating unsinkability had me wondering if there is some magic foam we can inject into our investment process, something along the lines of creating "unsinkable conviction." That's because conviction is necessary to ensure clear decision making and success in our business.

After all, investing is part facts and figures (where debates are fairly easy to settle), and part squishy things, like trying to predict the future and trying to quantify how much fear or greed is already reflected in a stock price (lots of controversy, unsettleable by facts). Without conviction, emotions trample decision making - and there you are, stupidly selling fear (cheap) and buying popularity (expensive), rather than buying hatred (low) and selling euphoria (high).

Today, and even though the VIX (a measure of volatility) is down a lot this year - meaning that markets in aggregate have whipsawed much less than last year - individual stock names can still be plenty volatile. There are a number of reasons for this, from the large number of short-term investors who dominate the investment landscape today, to the fact that news simply gets discounted faster (some argue more precisely) than before.

Whatever the reason, when you combine that with data suggesting that low volatility stocks, the winner of the long-term performance sweepstakes, are hideously expensive (another newsletter topic, perhaps) it means that to find value you have to seek out stocks with high volatility.

[Translated into English: Stocks that don't go down and up a lot, but are instead very steady in the long run, have historically ended up outperforming those that have violent rises up (typical of expensive high-growth darlings) and down (when growth disappoints, valuation gets crushed and sometimes both never recover). The point is, if you want to find value today, it's probably going to be accompanied by a large dose of seasickness.]

Since pursuing value means we have to deal with more volatile, mess-with-your-head types of stocks, I've been seeking ways to boost our conviction levels, above and beyond the usual things that we do: bottom-up analysis of fundamentals, company visits, conversations up and down the food chain, and Excel models complex enough to launch a spaceship.

There are two techniques that I've been playing with to boost conviction. They are very different from each other - almost diametrically opposed - and it's the reason we employ both.

One is checklists. The other is mindmapping.

Checklists

While I've been a huge fan of surgeon and New Yorker writer Atul Gawande for years, I finally got around to reading his book, The Checklist Manifesto, in which he makes a compelling case for checklists. Not only have they been proven to save many lives when adhered to in hospitals, they are also a reason for the success of the Hudson river landing by pilot Chesley "Sully" Sullenberger.

Checklists do a couple of things. First, they help reduce the cognitive load of having to make many small decisions during repetitive workflows and processes (our brains can handle only so many decisions, especially with the overwhelming information flow typical of our business).

Far better to make the big decisions once in the *creation* of a checklist, and then let the checklist ensure that all steps are done when evaluating a new stock (e.g., Do we check on the quality of the board now or after examining stock compensation?). A checklist prompts you to get everything done in the order you've decided is optimal. You waste no time with each new idea.

For us as investors, checklists take a load off the brain, in addition to helping make sure that all windows and doors of our investment process are locked, and that we haven't forgotten to put the alarm on, so to speak.

Mindmapping

Very different from the way checklists provide peace of mind is the technique known as mindmapping. I began using this approach in earnest when I started writing this newsletter in 2008.

Diagramming my ideas around a topic helps me clarify and organize my thoughts, which makes the writing easier. I've become such a fan of mindmapping, in fact, that I've taken to using our office walls (painted with IdeaPaint, which transforms them into whiteboards) to do so. I now mindmap our investment cases as well.

If checklists help the "facts and figures" part of the process, mindmaps work on the "sentiment and future predicting" side. Thinking "out loud," visually, allows me to consider all the angles that affect how investors see a stock today - and how they may see it tomorrow. It allows me to flush out key assumptions, see where they may be wrong, or come up with ways to test them.

The more we can move from the "conjecture" bucket into the "proven" bucket, the better. Mindmapping allows for expansive, ruminative and creative thought, the kind that can be scarce in our business, where there is always more information than time.

Our brains, under constant informational assault, have been shown to shut down and deliver suboptimal decisions. Mindmapping creates the space necessary for good decisions.

Conviction is one of those hard-to-quantify states of being - that of evidence-based judgment tempered by experience - necessary to successful investing. It is, however, rooted in neurobiology and thus easily hijacked. Why not give ourselves the unsinkable conviction that comes from being sandwiched between the outer hull of checklists and the inner hull of mindmaps?

Mariko O. Gordon is founder, CEO and CIO of Daruma Asset Management, a NY-based small cap investment management firm. Subscribe to her free monthly e-newsletter On Daruma's Watch here.