ADVISOR PERSPECTIVES

Ducks, Swans and Old People

By Mariko Gordon
February 19, 2013

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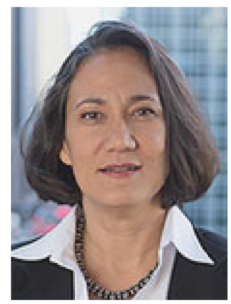

Last month we hosted two groups of students in our office: undergrads from the University of Wisconsin Milwaukee, and graduate students from the Instituto de Empresa in Madrid, Spain. All were stock jockeys, the undergrads having competed to be accepted into the Investment Management Certificate program at the Lubar School of Business, led by Dr. G. Kevin Spellman. Not only does Dr. Spellman have a Ph.D. in Behavioral Finance, he has also slogged in the investment trenches since 1993.

After presentations by several of my staff members, it was my turn to talk about stocks. Let me tell you, nothing thrills an old fart more than being asked to give advice (solicited, no less!) to fresh blood.

Over the next hour, I lobbed many advice bombs. One in particular, which I share with you today, was this: If you don't have experience, substitute history.

Experience is overrated

Regardless of where you, personally, fall on the investment experience continuum – total rookie to blowhard veteran – this particular trait isn't all that it's cracked up to be. I can think of at least four reasons why not:

1. The older we get, the easier it is to be dismissive and to rely too much on pattern recognition and heuristics as lazy shortcuts.

   "If it walks like a duck and quacks like a duck, it must be a duck." Except, of course, when upon closer examination, it turns out not to be duck (e.g., The Ugly Duckling). The world is always changing, and the market always discounts the future. If you aren't open to recognizing in what ways the future will be different from the past, you will miss opportunities.

   It's worth poking that duck hard, because most everyone else will be too lazy to do

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so. By the time they figure out it's a swan, you've made a bundle. Young people, not having built dismissive shortcuts, always poke the duck hard.

2. Lots of the same kind of experience doesn't make you any wiser.

   It cracks me up when I read firms brag about their collective "200+ years of investment experience." It could be 40 guys with five years, five guys with 40 years, or 200 spider monkeys with one year – no matter. Whatever the calculation, it's hard wired into humans to overweight what happened most recently and fight the last investment war (remember the Maginot line?).

   And with all that shared past experience at a given firm, there's probably no differentiated perspective. If people all think alike, does it matter whether it's five, 10 or 20 years' worth of shared experience making them think alike?

3. With age comes caution – but often too much.

   The adage that "bull markets are for young people and bear markets for old people" does young people a disservice. The point of the truism is that young people won't be scared to ride bull markets all the way up because they haven't learned to fear the ugly and brutal end, whereas old hands will know a bubble when they see one.

   But it cuts both ways: We old folks tend to take money off the table way too early (and then complain bitterly about a market that doesn't make sense). And while the young gunslingers may very well bury their investors, the old guys will so wallow in being right to have called the bubble that they are scared to actually deploy all that capital they preserved by being bearish in the first place. Then they miss the next market upswing.

4. Young blood isn't stupid blood.

   Early on in Daruma's history we pitched a university endowment, disastrously. I knew we were toast when I got asked "What will you do in a bear market?" in such a way that it was clear that no matter what I said, the answer the questioner (an old guy, natch) would hear would be "Why, panic of course, because I am so INEXPERIENCED."

   Never mind that I'd lived through a couple of tough markets by then, was in my thirties, and had already been part of building one billion dollar firm with good numbers. The older we get, the harder it is not to get jealous of young blood.

   But just because blood is young, it's not stupid. That's why the shrewdest thing

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we've done around here lately is hire a few smartypants in their 20s to keep us on our toes and our minds from fossilizing.

History has much to teach

There may indeed be "50 ways to leave your lover," but there are at least a thousand ways to lose money in this business. If you lack experience, you'll want to learn what those ways are, and quickly, with as little damage to your portfolio as possible and as much chance, therefore, that you'll hold onto your clients and your job.

Which is why I told our visitors to get off their butts and read up on financial history.

For a handful, I'm sure that was not the answer they wanted to hear – maybe they went into finance to avoid dealing with words. Too bad. Financials are just a story told with numbers – but it's still a story.

And the sooner you understand what drives these narratives – the motivations of the main characters, the broad cultural, political, environmental landscape in which they were played out and so on – the sooner you can see how an investment might play out differently than people expect. Hindsight may be 20/20, but by reading about the past you develop an appreciation for how the present emerges from the fog of the future.

It makes you comfortable with ambiguity; expectant of random acts of fate; knowledgeable about human folly; and a connoisseur of how sentiment changes and why. Not only do you learn to see how potentiality becomes reality, you develop a more concrete understanding of how a business actually operates in the real world. After all, if you haven't run a business and all you know is what you've been taught in books, you won't be able to take the abstraction that is investment and business jargon and translate it into day-to-day reality.

Reading about industries long gone teaches you about competitive forces and technological obsolescence. Reading company histories helps you appreciate the miracle that is a well-run enterprise. Reading memoirs of investors as diverse as Bernard Baruch, Martin Sosnoff or Jesse Livermore allows you to apply the lessons they learned without having to live through them yourself.

In short, knowing what has happened in real life will allow you to spot inflection points and exploit misunderstandings on the part of other investors. You know, those duck-spotting, trend-extrapolating types who, because they are not students of history, are doomed to repeat it.

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