The Three Stooges

Reducing both the frequency and cost of errors is a key objective of rational capital allocation.

I have been reflecting on my mistakes of which there are many. This note looks at a few that I have christened *The Three Stooges*.

It's Too Late Larry

While it is often said that the four most dangerous words in investment are; "*this time is different*", perhaps the three most expensive words (in terms of opportunity cost) are; "*I missed it*".

Why is it so psychologically hard for some investors to buy more of something that has gone up in price, if the increase is justified?

Personally, I find it much easier to add at falling prices than to buy at increasing prices. There seems to be some psychological regret at play as I berate myself for missing the opportunity to buy at lower prices. Not adding to a great compounder is an error of omission, the opportunity cost of which is large but rarely visible.

The same "it's too late" prevarication can cause us to be too slow to sell holdings, especially after large single day falls.

To fight this tendency to anchor on past prices it is helpful to remind oneself that in a liquid market every day is a new day that is discounting a new future. The market ignores the psychological path dependency of our prior price points, and so should we.

Cashed-up Curley

I have previously written more comprehensively about the nature of cash (link). Over the long-term, cash is a terrible investment but at times it provides valuable insurance and optionality.

There are many factors that influence the amount of cash that one holds (assuming the investment mandate allows such flexibility). Historically I have held high cash levels and I suspect that may be a mistake for someone that is managing a modest amount of capital. I suggest that continually hoarding large amounts of cash may be a mistake to acknowledge the optionality that cash brings. If the security of holding cash allows one to keep one's head in a down market, then cash clearly has value.

The modest capital caveat is an important one. I think the bar should be higher for someone who is managing small amounts of capital as the excuse that there are not enough attractive investment opportunities seems to me an admission that I am not working hard enough or smart enough to find them. Perhaps the question is whether the cash holding is a security blanket or a comfort blanket?

With large amounts of capital to deploy (i.e. billions rather than hundreds of millions), the decision to hold cash is more defensible. But even then, it should be recognised that such a decision is a market timing call. Two problems spring to mind. Firstly, market timing is hard. Very few people have demonstrated market timing competence. Secondly, the subsequent market fall needs to be big enough to compensate for the opportunity cost of being invested.

Lest I alert Capstrive's shareholders, the pre-requisite that every investment must make sense remains a firm pre-condition. This note is simply a question to myself on whether cash holdings have been predominately for justifiable portfolio security or reflect insufficient endeavour in rooting out compelling investments given Capstrive's modest size. And I fully appreciate the potential irony of the timing of this note in a year where the optionality of cash is higher than it has been for some time. A down market will provide the real test.

Moe the Merrier

There are several investors with both excellent long term track records and investment philosophies that I respect or aspire to. Using their portfolios as a first screen for investment opportunities is an efficient and logical use of time.

"Coat-tail investing" is unusual in the degree to which it is easy to copy the greats. I don't know of any other professional endeavour where someone with minimal skill can simply copy a peer.

The problem with this "more the merrier" approach is when it substitutes for one's own investment analysis. If an investment has a random price fall, will one have the fortitude to hold or add? And there are other problems with coat tailing. The stock acquisition that we have attributed to our famed investor may not have been picked by them at all, but instead by someone who is being trained in. We don't know the portfolio context, the stock may a hedge for another long position rather than an outright high conviction long.

Respected investor portfolios are an efficient screen. But the dictum "do your own work" remains.

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