3 Quotes to Live By

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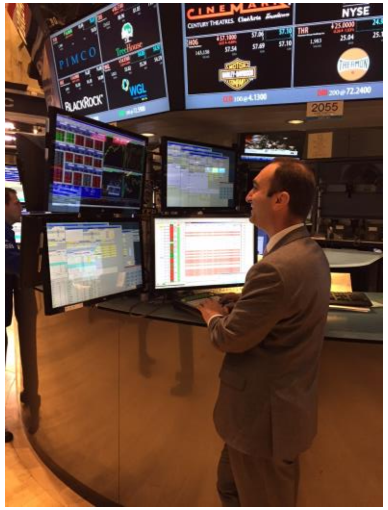
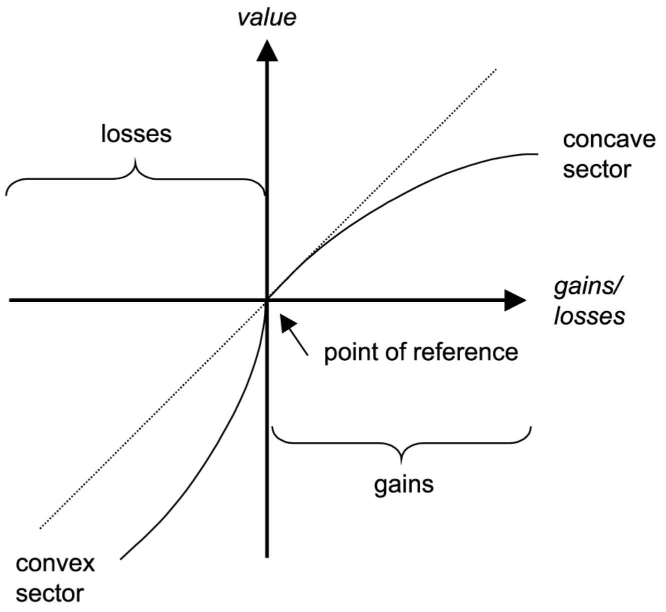


3 quotes to live by:

- **Warren Buffett**: "Investing is simple but not easy."
- **Peter Lynch**: "There's no shame in losing money on a stock. Everybody does it. What is shameful is to hold on to a stock, or worse, to buy more of it when the fundamentals are deteriorating." Peter Lynch
- **Peter Lynch**: “In this business, if you're good, you're right six times out of ten. You're never going to be right nine times out of ten."

“Simple but not easy”

“Simple but not easy”



Kahneman and Tversky

- Pain of loss = 2-3× joy of gain
- Ratio varies across individuals
- If winning – take **less** risk
- If losing – take **more** risk

Prospect Theory – A Beginner’s Guide https://marketfox.org/2017/01/04/prospect-theory-a-beginners-guide/

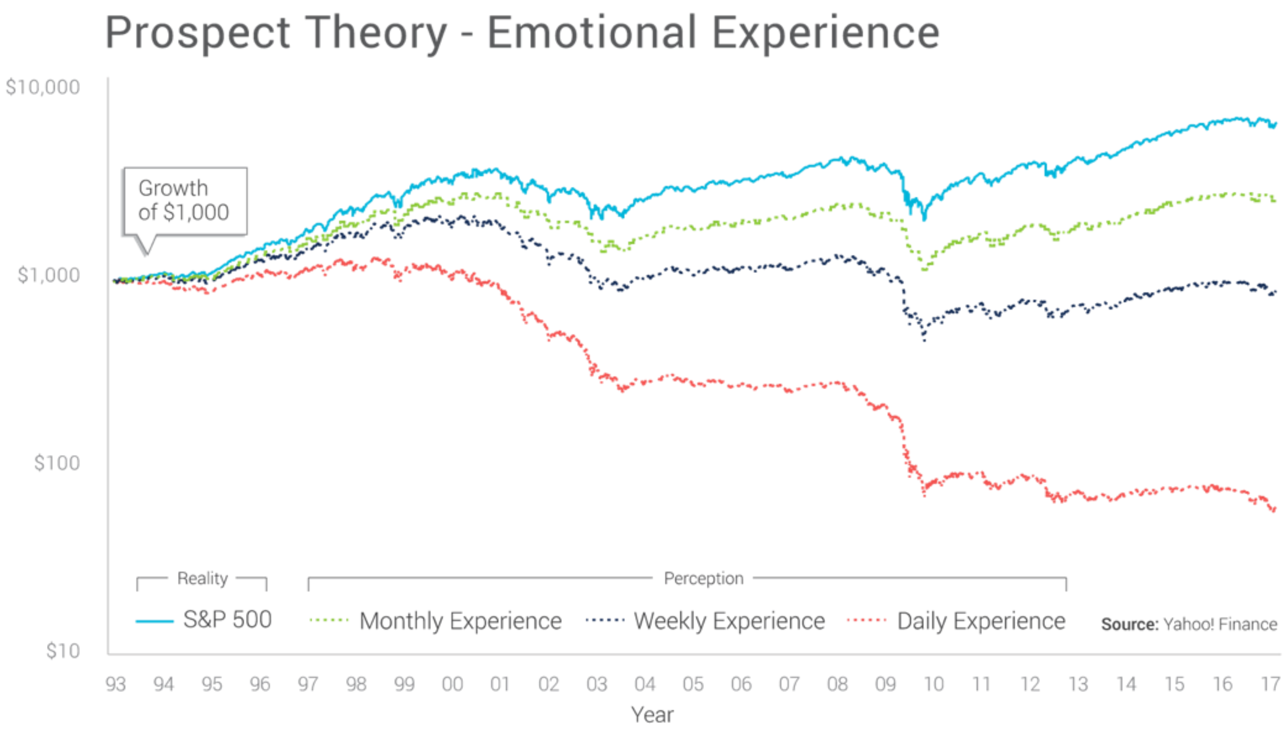
“Simple but not easy”

Probability that you will see a gain on your stock portfolio if you wait:

- 1hr ≈ 50%
- 1d ≈ 51%
- 1w ≈ 53%
- 1y ≈ 73%
- 10y ≈ 100%

Source: Michael Mauboussin, Credit Suisse

“Simple but not easy"



Q: Want to avoid pointless stress and anxiety in your life?

A: Don’t check the value of your portfolio daily!

“Simple but not easy"

Peter Lynch: “Before buying a stock, I like to be able to give a two-minute monologue that covers the reasons I’m interested in it, what has to happen for the company to succeed, and the pitfalls that stand its path… Once you’re able to tell the story of a stock to your family, your friends… and so that even a child could understand it, then you have a proper grasp of the situation.”

“Simple but not easy"

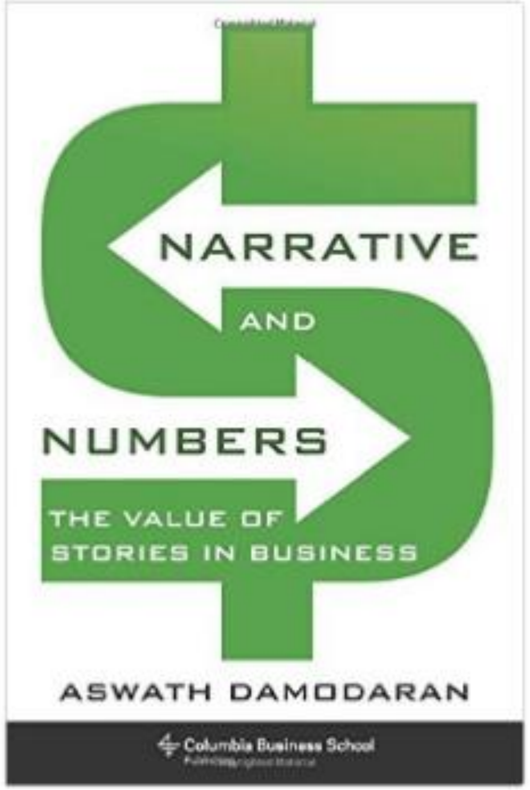
Step 1: Develop a narrative for the business that you are valuing
In the narrative, you tell your story about how you see the business evolving over time.

Step 2: Test the narrative to see if it is possible, plausible and probable
There are lots of possible narratives, not all of them are plausible and only a few of them are probable.

Step 3: Convert the narrative into drivers of value
Take the narrative apart and look at how you will bring it into valuaton inputs starting with potential market size down to cash flows and risk. By the time you are done, each part of the narrative should have a place in your numbers and each number should be backed up by a portion of your story.

Step 4: Connect the drivers of value to a valuation
Create an intrinsic valuation model that connects the inputs to an end-value for the business.

Step 5: Keep the feedback loop open
Listen to people who know the business better than you do and use their suggestions to fine tune your narrative and perhaps even alter it. Work out the effects on value of alternative narratives for the company.



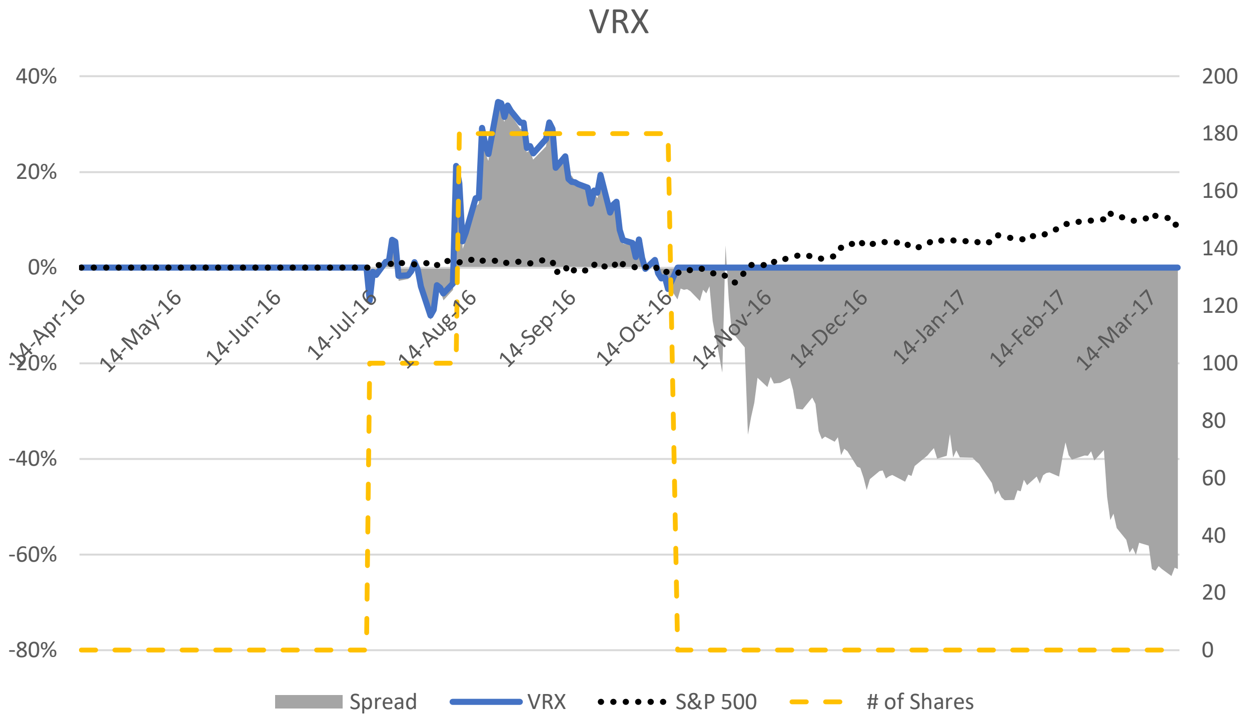
“There's no shame in losing money”

Loss	Corrisponding Gain	Ratio (gain:loss)	Years
-5%	5.30%	1.05	0.5
-10%	11.10%	1.11	1.1
-15%	17.60%	1.18	1.7
-20%	25.00%	1.25	2.4
-25%	33.30%	1.33	3.2
-30%	42.90%	1.43	4.1
-35%	53.80%	1.54	5.1
-40%	66.70%	1.67	6.4
-45%	81.80%	1.82	7.8
-50%	100.00%	2	9.5
-55%	122.20%	2.22	11.6
-60%	150.00%	2.5	14.3
-65%	185.70%	2.86	17.7
-70%	233.30%	3.33	22.2
-75%	300.00%	4	28.6
-80%	400.00%	5	38.1
-85%	566.70%	6.67	54.0
-90%	900.00%	10	85.7
-95%	1900.00%	20	181.0

Losses greater than 20-30% are difficult to regain and can quickly spiral out of control.

Jesse Livermore: “Profits always take care of themselves, but losses never do.”

“There's no shame in losing money”



One of my recent losers.

Lesson: Cutting a loss when the story’s changed can save you a lot of money!

“There's no shame in losing money”

The Disposition Effect – Why it Matters

https://marketfox.org/2017/01/12/the-disposition-effect-why-it-matters/

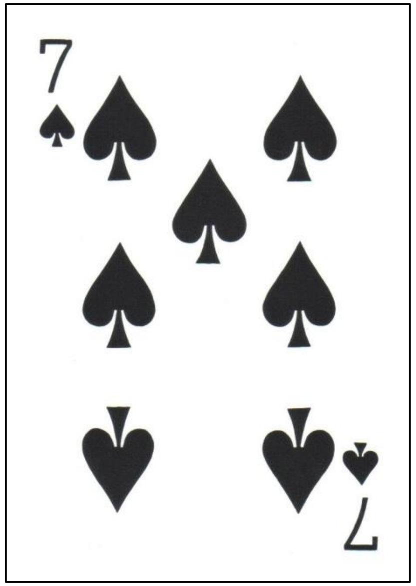
Managing the Disposition Effect

https://marketfox.org/2017/02/05/managing-the-disposition-effect/

Are Markets Driven by Fear, Greed or Regret?

https://marketfox.org/2017/03/12/are-markets-driven-by-fear-greed-or-regret/

“You're never going to be right 9/10”



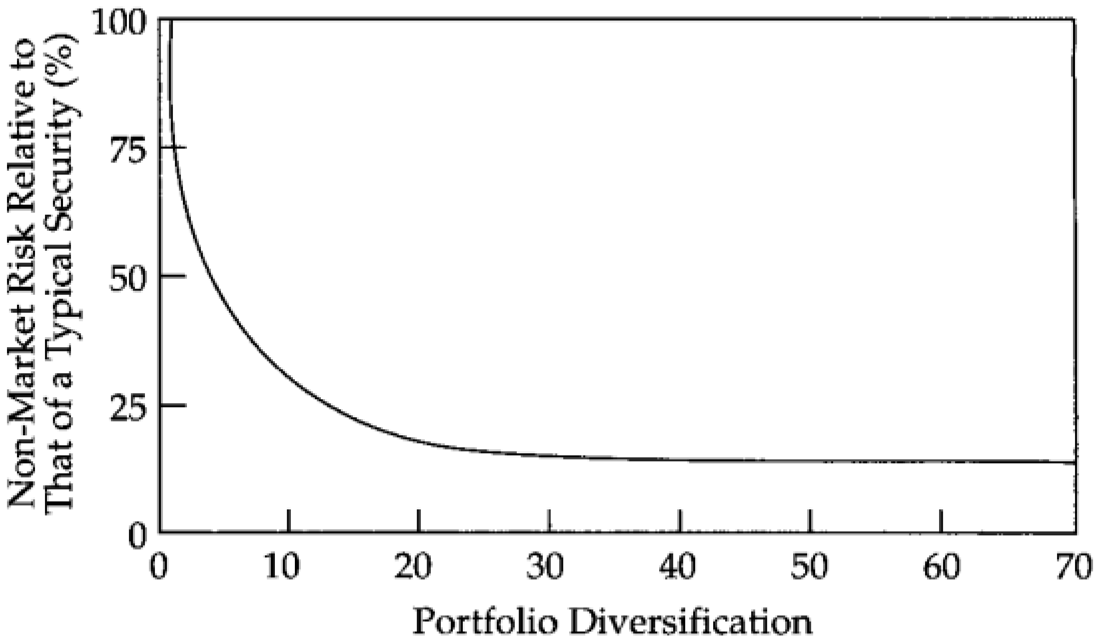
Should you:

1. Stay
2. Call

“You're never going to be right 9/10”

Right decision Good outcome	Wrong decision Good outcome
Right decision Bad outcome	Wrong decision Bad outcome

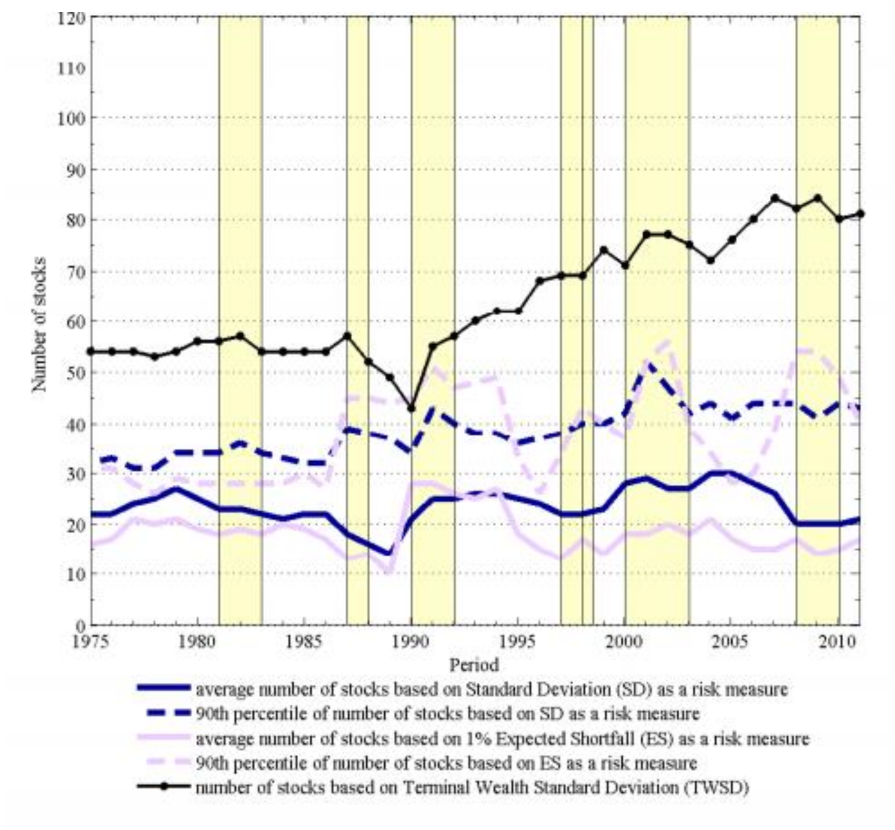
“You're never going to be right 9/10”



Owning 10 stocks eliminates ≈ 75% of the risk of holding a single stock.

Peter Lynch: “The part-time stockpicker probably has time to follow 8-12 companies… there don’t have to be more than 5 companies in the portfolio at any one time.”

“You're never going to be right 9/10”



In Australia, **on average** owning 20 stocks eliminates ≈ 90% of the risk of holding a single stock.

90% of the risk is eliminated 90% of the time if you hold ≈ 40 stocks.

Suggestions for better Investing

- **Indexing** – Consider if its right for you
- Check **stories**, not **performance**
- **Focus** on what you can **control**
- Don't be a sore **loser**
- **Learn** by creating **feedback**
- **Portfolios** matter, not **stocks**
- **Diversification** - depends on **objectives**
- **Objectives** – know yourself

References

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