The Most Important Thing

11. Contrarianism:

- Successful investors are said to spend a lot of their time being lonely.
- In dealing with the future, we must think about 2 things:
  1. What might happen?
  2. The probability that it will happen.
- Skepticism and Pessimism aren't synonymous. Skepticism calls for pessimism when optimism is excessive, but it also calls for optimism when pessimism is excessive.
- Skepticism is usually thought to consist of saying "No, that's too good to be true" at the right times. Sometimes, skepticism also requires us to say "No, that's too bad to be true".
- A hugely profitable investment that doesn't begin with discomfort is usually an oxymoron.

The Most Important Thing

12. Finding Bargains:

1. A list of potential investments
2. Estimates of their intrinsic values
3. A sense of how their prices compare with their intrinsic value, and
4. An understanding of the risks (needs to b done in the Invesible shoot) involved in each, and of the effect their inclusion would have on the portfolio being assembled.

- Investment is the discipline of relative selection
- The best opportunities are usually found among things most others won't do.
- Our goal is not to find good assets, but good buys.
- Necessary condition for the existence of bargains is that perception has to be considerably worse than reality.
- Investors can be forced into mistakes by
  - psychological weakness
  - analytical error, or
  - refusal to tread on uncertain ground

Those mistakes create bargains for 2nd level thinkers capable of seeing the errors of others.

The Most Important Thing

13. Patient Opportunism:

- The market's not a very accomodating machine; it won't provide high returns just because you need them
- Patient opportunism – waiting for bargains – is often your best strategy.
- Investing is the greatest biz. in the world because you never have to swing. There's no penalty except opportunity. All day, you wait for the pitch
- The expected returns looked good, but the range of possible outcomes included some very nasty ones.
- The key during a crisis is to be
  a) insulated from the forces that require selling
  b) positioned to be a buyer instead.

  To satisfy those criteria, an investor needs the following:
  a) Staunch reliance on value
  b) Little or no use of leverage
  c) Long-term capital, and
  d) Strong stomach

The Most Important Thing

14. Knowing What You Don't Know:

- We have 2 classes of forecasters: Those who don't know - and those who don't know they don't know
  - John Galbraith
- It's frightening to think that you might not know something, but more frightening to think that, by and large, the world is run by people who have faith that they know exactly what's going on.
  - Amos Tversky
- There are 2 kinds of people who lose money: those who know nothing and those who know everything
  - Henry Kaufman
- Know the knowable
- Investors should make an effort to figure out where they stand at a moment in time in terms of cycles and pendulums.
- I don't know
- Biggest problems tend to arise when investors forget about the difference between probability and outcome - that is, when they forget about the limits on foreknowledge.
- when they believe the shape of the probability distribution is knowable with certainty (and that they know it)
- when they assume the most likely outcomes is the one that will happen,
- when they assume the expected result accurately represents the actual result, or
- perhaps most important - when they ignore the possibility of improbable outcomes

The Most Important Thing

14. Knowing What You Don't Know :

- Over-estimating what you are capable of knowing or doing can be extremely dangerous — in brain surgery, transocean racing or investing. Acknowledging the boundaries of what you can know - and working within those limits rather than venturing beyond - can give you a great advantage.

15. Having a Sense for Where We Stand :

- We may never know where we're going, but we'd better have a good idea where we are.
- Rather than ~~disregarding~~ considering cycles (Buy-an-hold approach) it is better trying to figure out where we stand in terms of each cycle and what that implies for our actions
- Understand the present → Take the market's temperature
- Look around and ask yourself : Are investors optimistic or pessimistic ? Are novel investment ~~decisions~~ schemes readily accepted or dismissed out of hand? Is funding easily available? Are P/Es high or low in the context of history? Are yield spreads tight or generous? All of these things are important, and yet none of them entails forecasting. We can make excellent investment decisions on the basis of present observations, with no need to make guesses about the future.
- Too much money chasing too few deals
- Risk was not eliminated, it was merely transferred because of excessive trust and insufficient skepticism
- Just like the golfer adjusts his clubs depending on the wind, or we undertake an outwear decision based on weather ; similarly, shouldn't our investment actions be equally affected by the investment climate?

The Most Important Thing

16. Appreciating the Role of Luck:

- Randomness or luck plays a huge part in life's results, and outcomes that hinge on random events should be viewed as different from those that do not.
- USD 10 million earned through Russian roulette does not have the same value as USD 10 mln. earned through the diligent and artful practice of dentistry. They are the same, can buy the same goods, except that one's dependence on randomness is greater than the other. To your accountant, though, they should be identical. Yet, deep down, they are qualitatively different.
- Every record should be considered in light of other outcomes - Taleb calls them "alternative histories" - that could have happened just as easily as the "visible histories" that did.
- Every once in a while, someone makes a risky bet on an improbable or uncertain outcome and ends up looking like a genius. But we should recognize that it happened because of luck and boldness, not skill.
- Randomness contributes to (or wrecks) investment records to a degree that few people appreciate fully. As a result, the dangers that lurk in thus-far-successful strategies often are under-rated.
- Investors are right (and wrong) all the times

The Most Important Thing

16. Appreciating the Roles of Luck:

- for the "wrong reason". someone buys a stock because he is expecting a certain development; it doesn't occur; the market takes the stock up anyway; the investor looks good (and invariably accepts credit)
- The correctness of a decision can't be judged from the outcome. Nevertheless, that's how people assess it. A good decision is one that's optimal at the time it's made, when the future is by definition unknown. Thus, correct decisions are often unsuccessful, and vice versa.
- Randomness alone can produce just about any outcome in the short run.
- Investors often receive credit they don't deserve; few of these "geniuses" are right more than once or twice in a row.
- It's essential to have a large no. of observations - lots of years of data - before judging a given manager's ability.
- Things that happened are only a small subset of the things that could have happened.
- How much credit should a decision maker receive for having bet on a highly uncertain outcome that unfolded luckily?
- Quality of a decision is not determined by the outcome
- Investors invariably lose track of the fact that both short-term gains / losses can be imposters.

The Most Important Thing.

16. Appreciating The Role of Luck :
and of the importance of digging deep to understand what underlies them.

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17. Investing Defensively :

- There are old investors and there are bold investors, but there are no old bold investors.
- Pursuit of winners in the mainstream stock markets is unlikely to pay off for the investor. Instead, you should try to avoid hitting losers.
- Defense - significant emphasis on keeping things from going wrong - is an important part of every great investor's game.
- Defensive Investing : Rather than doing the right thing, defensive investor's main emphasis is on not doing the wrong thing. 2 principal elements in Investment defense :
  1. Exclusion of losers from portfolios : This is best accompanied by conducting extensive due diligence, applying high standards and being less willing to bet on continued prosperity, rosy forecasts and developments that may seem uncertain.
  2. Avoidance of poor years, and especially, exposure to meltdown in crashes. This aspect of investment defense requires thoughtful portfolio diversification, limits on the overall riskiness borne, and a general tilt towards safety.
  - concentration and leverage are two examples of offense.
  - The amount of safety you build into your

The Most Important Thing

17. Investing Defensively:

portfolio should be based on how much potential return you are willing to forego. There is no right answer, just trade-offs.

- Critical element in defensive investing - Margin of Safety.
- Exclusion makes fixed income investing a negative art.
- Many investment managers' careers end not because they fail to hit home runs. Rather, they end up out of the game because they strike out too often - not because they don't have enough winners, but because they have too many losers. And yet, lots of managers keep swinging for the fences.
- If we avoid the losers, the winners will take care of themselves.
- The cautious seldom err or write great poetry.
- The choice between offense and defence is important and challenging.

The Most Important Thing

18. Avoiding Pitfalls :

- An investor needs to do very few things right as long as he avoids big mistakes.
- Analytical error : "Failure of imagination" - either being unable to conceive of full range of possible outcomes or not fully understanding the consequences of the more extreme occurrences.
- Another pitfall : Failure to recognize market cycles and manias and move in the opp. direction. Extremes in cycles and trends don't occur often, and thus they're not a frequent source of error, but they give rise to the largest errors. The power of herd psychology + Capitulation → Difficult for investors to resist.
- Failure of imagination:
  1. Most investors extrapolate the past into future, and in particular, the recent past, because the financial memory tends to be extremely short.
  - Also, any chance of remembering tends to be erased by the promise of easy money that's inevitably a part of the latest investment fad.
  - Most of the time, future is indeed like the past, so extrapolation doesn't do any harm. But at the important turning points, when the future stops being like the past, extrapolation fails and large amounts of money are either lost or not made.
  - Things that aren't supposed to happen do happen

The Most Important Thing

18. Avoiding Pitfalls :

- Short-run outcomes can diverge from the long-run probabilities, and occurrences can cluster.
- Another aspect of 'Failure of imagination' - Asset correlation. How one asset will react to a change in another, or that 2 assets will react similarly to a change in a third. Understanding and anticipating the power of correlation - and thus the limitations of diversification - is a principal aspect of risk control and portfolio mgmt., but it's very hard to accomplish.
- Psychological errors :
  1. Greed : Desire to make money causes you to buy even though the price is too high.
  2. Error of not noticing : Participating, even unknowingly, in a market that has become elevated because of undisciplined buying by others has serious implications for you.
  3. 3rd error : doesn't consist of doing the wrong thing, but rather failing to do the right thing. Committing the 3rd form of error is a different kind of mistake (e.g. failing to short an over-valued stock) is an error of omission, but probably most investors would be willing to live with.
- Too much capital availability makes money flow to the wrong places.
- When capital goes where it shouldn't, bad things happen.

The Most Important Thing

18. Avoiding Pitfalls :

- When capital is in oversupply, investors compete for deals by accepting low returns and a slender margin for error.
- Widespread disregard for risk creates great risk
- Inadequate due diligence leads to investment losses.
- In heady times, capital is devoted to innovative investments, many of which fail the test of time
- Hidden fault lines running through portfolios can make the prices of seemingly unrelated assets move in tandem.
- Psychological and technical factors can swamp fundamentals.
- Markets change, invalidating models
- Leverage magnifies outcomes, but doesn't add value.
- Excesses correct. :
- One way to think and apply and improve investment results,- think about what "today's mistake" might be and try to avoid it. Likely mistakes ~~could~~ consist of :

- Not buying	- Buying
- Not buying enough	- " too much
- Not making 1 more bid in auction	- Making bid too many
- Holding too much cash	- ~~Running so~~ Fully invested
- Not using enough leverage	- Using too much leverage
- Not taking enough risk	- Taking too much risk

- There are times when the investing errors are

The Most Important Thing

18. Avoiding Pitfalls.

of omission : the things you should have done but didn't. Errors of commission : The things you shouldn't have done but did.

- Errors of commission (Buying)
- " " Omission (failing to buy)

19. Adding Value :

- Performance of investors who add value is Asymmetrical. % of market's gain they capture > % of loss they suffer.
- In good years, it's good enough to be average. However, it is essential to beat the market in the bad years.

The Most Important Thing

20. Pulling it all Together:

- Best foundation for successful investment - Value.
- To achieve superior investment results, your insight into value has to be superior. Thus, you must learn things others don't, see things differently or do a better job of analyzing them - ideally, all 3.
- Your view of value has to be based on a solid factual and analytical foundation, and has to be held firmly. Only then will you know when to buy or sell.
- Outstanding buying opportunities exist because perception understates reality.
- The goal is to find good buys, not good assets.
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