

The Outlook: Feb. 17, 2017

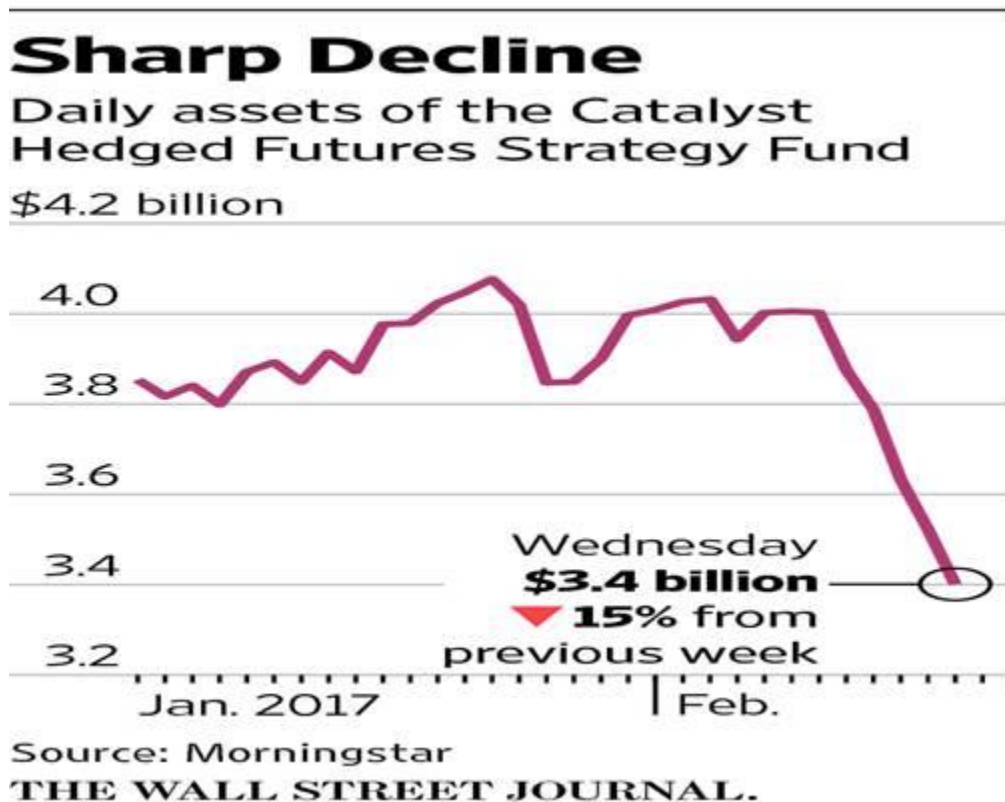
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That’s one of the truly “Big Questions:” big for all of us in our roles as investors; just as big, or even bigger, for all of us in the rest of our lives, as we try to figure out how to deal with tough decisions in business, family, politics, and so on.

It’s been Outlook’s observation that a lot of grief for investors comes from failure to sit ourselves down and actually *think* about that Big Question: “What is the nature of this?” It’s terribly easy, instead, to go along with “the accepted wisdom,” which really means believing a vague general impression about “the nature of this” which we absorb from the media and the popular culture. Understanding the nature of the market, of course, is the foundation for all good investment decisions . . . but Outlook suspects even this vital step rarely gets the “sit down and think about it” treatment it needs so badly.

This morning’s Wall Street Journal told us about “the talk of the Street” lately, which is the plummeting value of a certain hedge fund. Here’s the chart, showing a 15% loss in a week, totaling around \$600 million, which apparently is enough money for “the Street” to gossip about. More interesting than the big loss, though, were the details of the story and the remarks from an assortment of people: the fund’s managers themselves, their competitors, and a professor or two, of course.



The hedge fund “employed complex derivatives” in the options and futures markets. Its aim was to make money in every kind of market except a strongly-rising market . . . yes, like the one that arrived Election Day. Like a great many of Wall Street’s finest minds, the fund thought a strongly-rising post-Election market was too far-fetched to happen—so its “complex derivatives” strategy amounted to creating a short-selling position against the market.

“The nature of the market” is that it’s a vast crowd of people, all mighty concerned about their money, none knowing what tomorrow will bring, all badly wishing to know that . . . hence all paying acute attention to what the rest of the vast crowd appears to be doing or thinking. There are, in this crowd, plenty of calm individuals who aren’t worried about what tomorrow will bring, but are fairly sure what next year or next decade will bring . . . and who invest accordingly. (That’s us, of course.) But the calm and patient ones are drops in the ocean next to the staggering numbers of the impatient and anxious, and the dollars they wager every day. The \$4.3 billion hedge fund in this morning’s story was perfectly typical of this giant crowd.

“We took our (short sale) positions off the books over the past few days,” said the fund’s boss. “We weren’t forced to sell. We have certain tolerances for losses and we decided to take off the positions.”

Notice what that remark sounds like? Yes—like a gambler with a “system.” Roulette, poker, blackjack, you name it . . . gamblers who stay solvent always talk about the supreme importance of a set of personal rules which order them to cut losses and leave the table at predetermined levels of pain. And of course, the hedge fund manager sounded like a gambler because he is one . . . like that vast crowd of his impatient, anxious peers, all acting the same way.

The “profound thought” which came to Outlook from this story was no surprise at all. It was that those clever people—impatient and anxious—all see the market as a “thing” which acts in peculiar, complicated ways . . . and thereby gives really clever people like themselves a chance to make big money, by understanding and outsmarting the market. Those people will never—repeat, never—see the nature of the market as we patient ones do. They will not, because seeing themselves as terribly clever people is how they define themselves. But clever or not, they are wrong—as history shows so very many clever people are so terribly wrong, so often. The market is not Wall Street. It’s Main Street—where determined people work hard and long to build things which endure, and which improve on the past. The anxious crowd will never stop looking for a quick edge, while scrutinizing each other to see if someone else might have stumbled on the edge, first. Main Street, thank goodness, pays very little attention to the fits of anxiety sweeping that crowd. It’s too busy building or repairing companies which actually create long-term prosperity the hard, slogging way. At Outlook we’ll keep betting on those people, and ignoring the clever gamblers.

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