(strategic) Lethargy

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Scientist and philosopher, Blaise Pascal, extoled in the year 1654 what a majority of investment management professionals still can't understand:

> *'All of humanity's problems stem from man's inability to sit quietly in a room alone.'*

As an individual investor, the single greatest edge you can possible have is that you can invest for the long term – perhaps the last of the structural advantages. While asset managers in the money management business are constantly under pressure to deploy capital at their disposal, the smartest of investors consider inactivity to be their best friend. Take Warren Buffett for example (he might know a thing or two about investing):

The stock market is a no-called-strike game. You don't have to swing at everything — you can wait for your pitch. The problem when you're a money manager is that your fans keep yelling, "Swing, you bum!"

Checking your portfolio daily, making decisions out of fear caused due to a sudden fall in security prices or resorting to trading in the name of investing are sure shot ways to lose money. The key to successful investing is buying wonderful companies at fair valuations with competitive advantages (moats) run by a management team with unquestionable integrity. It's what Charlie Munger, Vice Chairman of Berkshire Hathaway calls sit on your ass investing. Buy right, sit tight, evaluate periodically and if need be, act.

Identifying a process that works for you is of utmost importance. Take Stan Druckenmiller for example. He was managing money for the legendary George Soros at the time. Despite sensing the inevitable bursting of the tech bubble, this is what happened (in his own words):

> *'I bought the top of the tech market in March of 2000 [after quickly making money in the same space in mid-late 1999] in an emotional fit I had because I couldn't stand the fact that it was going up so much and it violated every rule I learned in 25 years. I bought the tech market very well in mid-1999 and sold everything out in January and was sitting pretty; and I had two internal managers who were making about 5% a day and I just couldn't stand it. And I put billions of dollars in within hours of the top. And, boy, did I get killed the next couple of months.'*

Keeping your emotions at bay while investing is paramount to generating healthy returns. Temperament matters. While the idea of doing nothing can seem counter intuitive, that is what is needed to outperform over a long term. Researchers from Israel concluded after researching thousands of penalty shootouts that a goalkeeper had more chances of stopping the ball if they were to stand in the centre rather than diving to their left or right. But the idea is, that what appears as "doing nothing" is what prevents them from performing well.

Seth Klarman has in the past, at several times, had ~30-40% of his assets in cash, sometimes going as high as 50%. Think – can you stomach someone earning double digit returns during the dot com bubble while you underperform the market for 6 years flat? Klarman was vindicated when the bubble burst, sending a shockwave to global financial markets. He used this opportunity to buy fundamentally sound businesses which were battered down due to the meltdown. He has since delivered returns in excess of 17% over 30 years – making him one of the most successful long-term investors out there.

GROWTH OF AN ASSUMED \$50,000 INVESTMENT (1) IN THE BAUPOST FUND FROM 4/30/1991 THROUGH 4/30/2001

	THE BAUPOST FUND	S&P
12/14/90	\$50,000.00	\$50,000.00
04/30/91	\$50,000.00	\$50,000.00
04/30/92	\$54,757.07	\$57,018.44
04/30/93	\$65,132.71	\$62,282.25
04/30/94	\$73,877.69	\$65,594.76
04/30/95	\$79,846.02	\$77,050.60
04/30/96	\$90,320.94	\$100,330.12
04/30/97	\$112,676.72	\$125,546.87
04/30/98	\$146,526.23	\$177,105.14
04/30/99	\$119,738.49	\$215,753.50
04/30/00	\$131,635.70	\$237,605.28
04/30/01	[redacted]	\$206,783.48

(1) Assumes reinvestment of all dividends.

Table 2
The Baupost Fund
Portfolio Allocation at April 30, 2001

Cash	48.6%
U.S. Public Equities	18.4%
Western Europe Public Equities	4.7%
Other Public Equities	1.5%
Performing and Non-Performing Debt	23.4%
Private Equities and Partnerships	1.7%
Securities in Liquidation	1.3%
Market Hedges and Other	0.4%
Total	100.0%

Source: Baupost Group Letters

In his 2004 year-end letter to investors, Klarman covered the decision to move to cash.

> *'The alternative is to remain liquid, defy the steady drumbeat of performance pressures, and wait for the prices of at least some securities to drop. (One doesn't need the entire market to become inexpensive to put significant money to work, just a limited number of securities.) This path also involves risk in that there is no certainty whether or when this will occur; indeed, securities prices could rise further from today's lofty levels, making the decision to hold cash even more painful. Meanwhile, holding out for better returns involves a (potentially lengthy) period of very low (albeit certain) positive returns available from today's short-term U.S. Treasury instruments.'*

Warren Buffett doesn't buy securities day in and day out. All throughout 2007/08, he refrained from investing in mortgage backed securities and related investments – and when the world came crashing down, he was busy plowing billions into companies which were in dire need of capital at fantastic prices – namely Goldman Sachs. At a time when the financial industry was in a freefall, Buffett stepped in with his vote of confidence eight days after Lehman's collapse and filing for bankruptcy. The investment – which gave Buffett \$5 billion worth of perpetual preferred shares with a dividend of 10% and warrants for 43,5 million additional shares – gave him a solid return.

Prem Watsa doesn't make decisions based on short term fluctuations in the market. They wait, wait, and wait till they get a juicy opportunity to sink their teeth into. And they bite – deep, like sharks. What investors need to understand is, **<u>less is more</u>**. Inactivity is the dear friend of an investor. Make a few, big infrequent bets.

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