

Learning from the Stoics

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A holiday by the beach is not truly complete without a good book. One of our analysts picked up 'Meditations' by the Roman Emperor and part time stoic philosopher Marcus Aurelius. Even Roman Emperors needed a side gig. He wrote about:

1. Using our minds to paint a realistic picture of the world around us
2. The importance of focusing our energy and effort on what we can control

The first point is about mastering reality. Marcus Aurelius was a realist. His view of the world was firmly grounded in reality even as the Roman Empire wrestled with several wars and plagues.

Perhaps it is no surprise that the great strides in behavioural economics by Amos Tversky and Daniel Kahneman started with a marriage of minds between an optimist and a pessimist.

Tversky was the eternal optimist. This quote sums up the way he saw the world.

"When you are a pessimist and the bad thing happens, you live it twice. Once when you worry about it, and the second time when it happens"

Contrast this with the quote from Kahneman, the perpetual pessimist.

"By expecting the worst, one is never disappointed"

Their opposing predisposition towards optimism and pessimism clashed in the middle to paint a realistic portrait of how humans actually make decisions.

This is similar to how we make decisions at Tacit. We have our in-house optimist and pessimist. Each keeps the other in check to create a realistic view of opportunities and risks in the markets. The optimist tends to focus on opportunities while the pessimist tends to focus on risks. One is not complete without the other because making sound investment decisions is all about optimising risk and reward.

The second point made by Marcus Aurelius is the importance of focusing our effort on what we can control. Today we hear of threats of war (both real and economic trade wars), rising interest rates and oil prices. There is always something to worry about but none of these are predictable or within our control.

Take rising interest rates for example. In 2016 when we increased our holding of US financial companies, the Fed's fund rate was 0.50%. Today it is 1.90%. We didn't know precisely what the Fed funds rate would be in 2018 when we made that call. All we knew was that it would probably be higher than where it was in 2016. The earning power of financial companies had been artificially suppressed by years of low interest rates and as rates rise, these companies will outperform the broader market. Our holdings of US financials has been the largest contributor to our returns since we made that call.

Adopting a stoic approach to investing prevents us from being tossed around by the highs and lows of the manic-depressive market. Having a realistic view of the world and focusing on what can be controlled worked for Marcus Aurelius when he wrestled with wars and plagues. It will certainly work for us as we wrestle with uncertainties in the markets.

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