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Rational Optimism

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Blaise Pascal, the French mathematician and philosopher aptly diagnosed the human condition over 300 years ago. "All of man's miseries derive from not being able to sit in a quiet room alone". This is because we hate being bored and can't stop ourselves from worrying. Boredom and worry are not the ally of the investor because they cloud rationality.

The economist John Maynard Keynes managed Cambridge's King's College Chest Fund. Between 1927 – 1946, the fund averaged a 12% annual return while the UK stock market fell by 15%. Take a moment to think about this result and all the terrible things that happened in the world during this period.

In 1929, the Great Depression started in the United States and quickly spread to the rest of the world. Between 1929 – 1933, unemployment in Britain rose to 2.5 million, about 25% of the workforce. The country was still recovering from the First World War and the worst hit areas in the north of England and Scotland suffered even more as they had not modernised after the war.

The United States was the largest economy in the world at this time. Alarmed by the depression, they called in their loans to foreign countries and put up trade barriers to limit the import of foreign goods. There was also anti-corporate rhetoric from President Roosevelt.

By 1939, the Second World War had begun, plunging major world powers into armed conflict. There were many reasons to not stay invested in the market.

Through all this, John Maynard Keynes remained rational. He didn't give into boredom and worry. How do we know this? Keynes had two parts to his investing career. In the earlier part of his career, he invested like an economist – he tried to forecast price moves, interest rates, inflation etc. His performance during this period was poor and his portfolio turnover was high at 55%. In the latter part of his career, he invested like a business owner and his performance was stellar. His portfolio turnover fell to 22%.

How did Keynes achieve such stellar results during such a turbulent period? First, he didn't allow worry to cloud his decision making. There is always something to worry about. However, sensible minds would agree that Brexit pales in comparison to a World War and the worst depression in human history.

Second, he invested like a business owner, not an economist. This meant longer holding periods and lower portfolio turnover; he did not allow himself to get bored.

Ideas need time to work out in the market. Keynes understood that investment results can be decoupled from the performance of the broader economy if you invest like a business owner. This has always, and will continue, to be our approach at Tacit.