Insanity Investing. Ramblings From The Barstool.

Market pundits did say that 2016 would be a difficult year for investing. However, they did say the same thing in 2015, 2014, 2013, not to mention 2010, 2011 and 2012. One can only conclude that it is always a difficult year for investing. 2009 was easy. You either couldn’t or wouldn’t exit in which case you made some money in the recovery but lost all your clients, or you could exit, did, missed the recovery, and lost all your clients. All the investors who experienced 1997, 1998, 2001, and said they were waiting for a crisis to invest, all fled, and missed the boat. These same investors are awaiting a market crash sometime in the near future when they say they will pile in, but will probably flee again when push comes to shove.

The two most important things in investing are courage and luck. Fundamentals and analysis are excellent at shoring up courage and providing very general direction. Too much a focus on fundamentals and your profit and loss will be volatile. Focus on profit and loss, and you will lose faith in your analysis. Markets are moved by the average marginal buyer or seller, and therefore by the average interpretation of the facts. The average person is by definition smarter than 50% of the population and dumber than 50% of the population, and has therefore a 50% chance of being right. Markets are therefore a coin toss. A series of coin tosses is a drunken walk (random walk is a technical term and I cannot afford precision here). To successfully trade a drunken walk, one needs courage or one will never act, and luck, or one will never win. The only other thing is discipline and risk management to ensure that one is able to replicate one’s good or bad luck day in day out. As long as you can stay in the game, you are successful. Don’t be overambitious or delusional.

In markets, perception drives reality. It’s has a parallel in quantum mechanics.

Once in a while, an obvious trade comes along. If it is obvious to many, it will become crowded and volatile and risky. Before it becomes obvious to too many, you will not be able to convince your boss, the risk manager, the client, the prime broker, the investment committee, or indeed your wife. Often you will need market counterparties to trade with without alerting them to the opportunity. Hired guns or investment banks, can help to run interference. The instruments available to capture the trade will often not be available, or you won’t be set up operationally to trade it, your risk systems cannot capture it or measure it, your back office will have no idea to settle it. If you are Supreme Commander, you might be able to surmount these obstacles, by which time, half of the opportunity has been realized by price discovery and the trade is becoming crowded.

Markets are prone to changing direction when the majority agree. If a market is going up and all agree that it will continue, it is likely to reverse. If the consensus is that the market will fall, it is likely to fall. If, there is disagreement and uncertainty, markets may be volatile but are likely to hold the current trend. When there is a strong consensus, either there is no longer incremental capital to maintain the trend, or there is sufficient incremental capital to reverse it.