Many Roads Lead to Rome

Introduction

Learning to be a good investor tends to start the same way for many people. Quite unlike most other professions, they believe that investing is easy and that anyone can do it, providing they find the secret. Their journey in search for the secret is colloquially known as the search for the Holy Grail. There are two realities, which conflict with this approach.

First, learning to be a good investor is not easy. Experience indicates that it takes about ten years to gain the education and work experience that leads to the development of sound judgement in any similar profession. It took me longer than that, but I was not studying and investing full-time, I had a day-job. I rarely hear of many investors who have been able to establish a consistent track record in much a shorter time. However, many claim such a feat after a year or so of a bull market. Wall Street has an aphorism for this – it is called mistaking a bull market for brains. A consistent track record can only be demonstrated over a full bull and bear market cycle or two.

Second, many roads lead to Rome, which means that there are many ways to make money investing. There is no single secret or right way to do it. One powerful reason why there cannot be any single secret is that each one of us is different in every respect that makes us the person we are. This includes our upbringing, education, experience, attitudes and beliefs, tolerance for risk and much more. In short, everything which has happened to us since the day we were born. Each of us will have taken many diverse decisions in the journey of life that makes us different to everyone else. The key is not to find the one secret, but to find a method which suits who we are and which will work for us.

My book *Think Like the Great Investors* was written as a tool to help investors with two things. One was to help them to understand what their own temperament type is and therefore what investments to focus on and what methods are likely to be appropriate. The other is to explain the common traps and biases that we all fall victim to as we try to make investment decisions. If you feel you need to develop your knowledge in this area, read it, it will help in the whole of your life where we all naturally make many decisions that involve a systematic deviation from rational judgement.

Let's move on from there and assume that we are already on our journey to investment competence. Some of us will be just starting and others will be well advanced. I put myself in this second category. I have been investing for over 50 years. I have learned a great deal, but I have found that there are always new investing ideas to investigate and test. I fear the day that I ever think I know everything there is to know about investing, because then I will have stopped growing as an investor.

What I want to discuss now is something that I have become more and conscious of over the last few years. This is the need to realise that many roads lead to Rome. I find that one of the most difficult parts of investing is to be able to see how many alternatives there are. This requires imagination. Imagination is not a quality that is often seen as a necessary trait in a good investor.

This is a very big subject. What I want to do is to briefly explore what I see as the three areas in which to look for more than a few roads to take to get to Rome.

The Light Switch Approach

We are all familiar with a simple light switch on a wall. It has only two settings – on and off. There is nothing else we can do with it but flick it to one of those two options. There is no dimmer switch on it. There is no other setting that is neither on nor off.

At this point you might wonder what I am talking about a light switch for. The reason is that I find many investors see their investing decisions like a light switch – a yes or no decision. Do I buy or not? Do I sell or not? Do I do something, or do nothing?

Take what might sound like a simple question – XYZ Co has a breakout from a continuation pattern on its chart – should I buy it or not?

Wrong question! Instead, the question should be to ask - what are all the options open to me?

The moment I ask the right kind of question, the whole landscape is different. What might be some of the answers to that question?

Some options I can think of:

- Wait for more evidence a trend is developing.
- Wait to buy a pull-back to the breakout point.
- Buy a small lot now and build a position over time.
- Buy a full position right now.
- Buy a call option and exercise it if a trend develops.
- Look at other shares with an even better chart prognosis.

I am sure you can think of more options available. There are also many other questions we should probably ask and investigate.

Sticking to this question and this list of options, the task is then to assess the pros and cons of each alternative. Only then can we start to make a good decision.

The lesson from this is that, if we think that we have only two options open to us in a situation, remember that this is light switch thinking. We should try to broaden the question until we come up with all the options. We should not try to assess them as we go. Instead, use the brainstorming method of listing all the options. Then set out some criteria to make a judgement and assess each one against those same criteria. Then we should be able to make a better decision.

Perfectionism

One group of people who find investing difficult are the ones who seek the perfect answer to a question. In some life circumstances there are perfect answers, but not in investing. We all have some elements of the perfectionist in us and that character trait makes investing more difficult for us. I have struggled with this all my life and gradually overcome it to a large extent (I think…).

I am often sent a question about investing and asked what is the right thing to do? This is another example of asking the wrong question. In investing there are very few absolute right and wrong answers. To try to find which answer to a problem is more correct than any other answer is an exercise in frustration. This is because we are dealing with a question, the answer to which depends on what happens in the future. The future is largely unpredictable, so it is nonsense to think there is a best answer, except in hindsight, which is too late. Trying to find perfect answers is to misunderstand the nature of investing.

I have lost count of how many times I have had to choose between buying one of two stocks. Many times the decision may have come down to stock A having a near textbook perfect chart pattern and stock B a less than perfect one. I may have decided to buy stock A, because it had the better pattern, but looking back afterwards, it was stock B that did much better. The way to look at this is that again I have made a decision based on the wrong question – which stock had the better chart pattern? What determined the outcome may have been something different altogether, not to do with chart patterns, but all to do with the performance of the business. It might even have been unknowable at the time the decision was made.

This question of what is the right decision to make is another example of many roads leading to Rome. The reality of investing is that there is more than one effective decision we could have made and there were also several ineffective decisions we could have made. I prefer this idea of effectiveness, rather than using the terms right or wrong.

The advantage of using effectiveness as the criteria has two advantages. First, it focuses us on the idea that there are many possible answers, more than one of which may have a positive outcome. Second, it focuses on the idea that the outcome is unknowable, no matter how much information we have. The only way we will know which of the answers that would have yielded a positive outcome gave the best result is in hindsight.

The other thing this way of looking at the issue exposes is that there is no point trying to reach perfection. Instead there are several courses of action, which may give a satisfactory outcome. Since we cannot know which is best until afterwards, trying to judge in advance which course of action is best is another case of asking the wrong question. Instead, our investment plan should provide some criteria for assessing the options into two categories – options that have a good probability of a positive outcome and options that do not. Once we have a small number of options that should have a positive outcome, we can take a different approach to the problem. We can take a small position in each stock and let the future decide. The positions that start to work well can be built into full positions. The ones that do less well can be left as small positions, in case they are late developers, or closed out.

Too Available

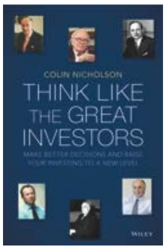
The third situation where many roads lead to Rome, but only one or two are seen is in imagining a range of different scenarios for how the future might unfold. This is where our human weakness of limited or distorted imagination can lead us astray.

The psychological trap here is known as availability bias. The easy way to understand this is that our memory is an unreliable instrument. It tends to give great prominence to a previous happening that was the most recent example, the most vivid example or the example that affected us personally. This is a real problem in trying to imagine a range of possible scenarios. One or two past events may stick in our mind to the exclusion of other possibilities. This can cause us to think that they are the most probable outcomes, when an objective examination shows that other scenarios are just as likely or even more likely.

The key to seeing all the many roads that lead to Rome in a situation is to assemble as many possible outcomes as we can. This is where knowledge of history is very valuable. It can alert us to how wide the range of possibilities really is. It can also help in putting them in a truer perspective. If we do not know the full range of things that have happened before and cannot imagine them for ourselves, we can find other people who can help us do so. Ask them to play devil's advocate with our scenarios. Ask them to help us to imagine other ways the future may unfold.

Once we have a list of the roads to Rome, we can seek out objective information on each road and arrange them in a rough order of likelihood. Again, don't attempt to put them in a perfect rank order because that is simply not possible. Only one can actually happen, so all the others cannot be ranked accurately even in hindsight.

The other thing is to realise that we don't need them in a perfect rank order. We just need as complete a list as we can dream up. Then, we can take each one in turn and analyse how it would affect us if it came to pass. We then try to work out a strategy to follow if it does happen. This way, for each possibility, we should have a contingency plan. Then the easy bit is to watch what unfolds and put the appropriate strategy into practice.



Conclusion

One technique that is very helpful in this whole area of seeing all the alternatives is known as the art of contrary thinking. This is also covered in my book *Think Like the Great Investors*. It is an art well worth cultivating if we aspire to be good investors.

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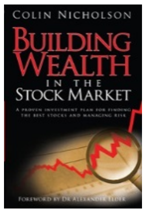

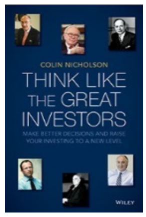

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