I was recently reviewing some old notes and ran across a comment made by David Merkel from the Aleph Blog back in 2013. The discussion centered around•the impact of volatility on investment disciplines. **The most important concept is that most investors tend to chase performance. Unfortunately, performance chasing occurs very late in the investment cycle as exuberance overtakes logic which leads to consistent underperformance.**•What David touches on is the importance of being disciplined when it comes to your investment approach, however, that is singularly the most difficult part of being a successful investor.

> *"One of the constants in investing is that investment theories are disbelieved, prosper, bloom, overshoot, die, and repeat. So is the only constant change? That's not my view. There are valid theories on investing, and they work on average. If you pursue them consistently, you will do well. If you pursue them after failure, you can do better still. How many times have you seen articles on investing entitled 'The Death of ____.' (fill in the blank)* ***Strategies trend.*** *There is an underlying kernel of validity; it makes economic sense, and has worked in the past. But any strategy can be overplayed, even my favorite strategy, value investing.•Prepare yourself for volatility. It is the norm of the*

market. ***Focus on what you can control - margin of safety.*** *By doing that you will be ready for most of the vicissitudes of the market, which stem from companies taking too much credit or operating risk.* ***Finally, don't give up. Most people who give up do so at a time where stock investments are about to turn.*** *•It's one of those informal indicators to me, when I hear people giving up on an asset class. It makes me want to look at the despised asset class, and see what bargains might be available.* ***Remember, valid strategies work on average, but they don't work every month or year. Drawdowns shake out the weak-minded, and boost the performance of value investors willing to buy stocks when times are pessimistic."***

When it comes to investing it is important to remember that no investment strategy works all the time. Most guys know that in baseball a player that is batting .300 is a really solid hitter. In fact, according to the•?Baseball-Almanac,?•the ALL-TIME leader was Ty Cobb with a lifetime average of .366.•This means that every time that Ty Cobb stepped up to the plate he was only likely to get a hit a 36.6% of the time.•**In other words he struck out, or walked, roughly 2 out of every three times at bat.**•All of a sudden that doesn't sound as great, but compared to the performance of other players - it was fantastic. **The problem is a .366 average won?t get you into the *"investor hall of fame"*; it will likely leave you broke.**•When it comes to investing it requires about a .600 average to win the game long-term.•No, you are not going to invest in the markets and win every time.•You are going to have many more losers than you think.**What separates the truly great investors from the average person is how they deal with their losses ? not their winners.**

10-Rules That Work

There are 10 basic investment rules that have historically kept investors out of trouble over the long term. These are not unique by any means but rather a list of investment rules that in some shape, or form, has been uttered by every great investor in history.

1)•You are a speculator - not an investor

Unlike Warren Buffet who takes control of a company and can affect its financial direction -•you can only speculate on the future price someone is willing to pay you for the pieces of paper you own today. Like any professional gambler - the secret to•long-term success•was best sung by Kenny Rogers;•*"You gotta know when to hold'em...know when to fold'em"*

2) Asset allocation is the key to winning the *"long game"*

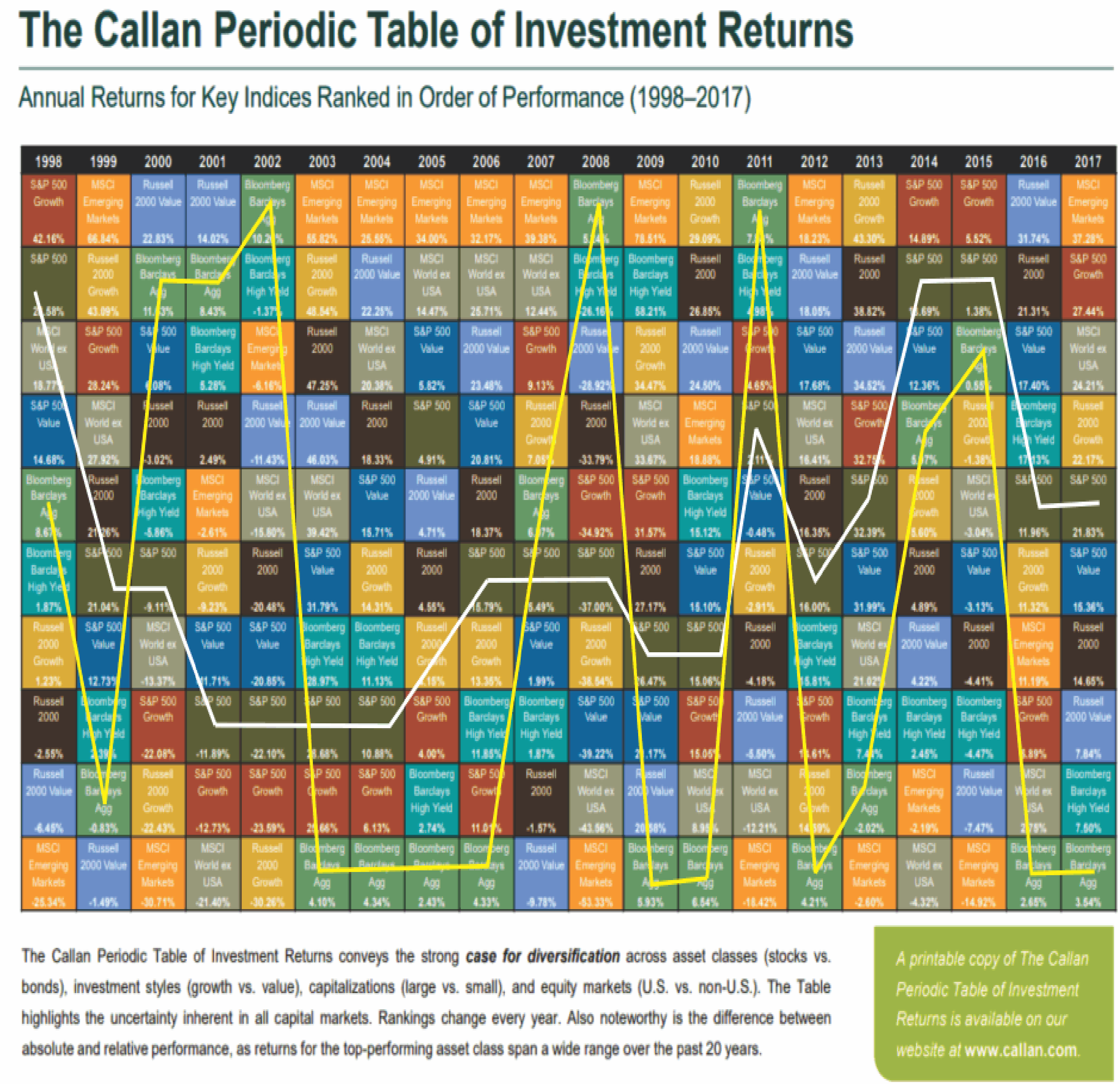
In today's highly correlated world there is little diversification between equity classes. Therefore, including other asset classes, like fixed income which provides a return of capital function with an income stream, can reduce portfolio volatility. Lower volatility portfolios outperform over the long term by reducing the emotional mistakes caused by large portfolio swings.

3) You can't *"buy low"* if you don't *"sell high"*

Most investors do fairly well at•*"buying,"*•but stink at•*"selling."*•The reason is purely emotional, which is driven primarily by•*"greed"*•and•*"fear."*•Like pruning and weeding a garden;•a solid discipline of regularly taking profits, selling laggards•and rebalancing the allocation leads to a healthier portfolio over time.

4) No investment discipline works all the time - Sticking to a discipline works always.

Like everything in life, investment styles cycle. There are times when•growth outperforms value, or international is the place to be, but then it changes. The problem is that by the time investors realize what is working they are late rotating into it. This is why the truly great investors stick to their discipline in good times and bad. Over the long term - sticking to what you know, and understand, will perform better than continually jumping from the *"frying pan into the fire."*

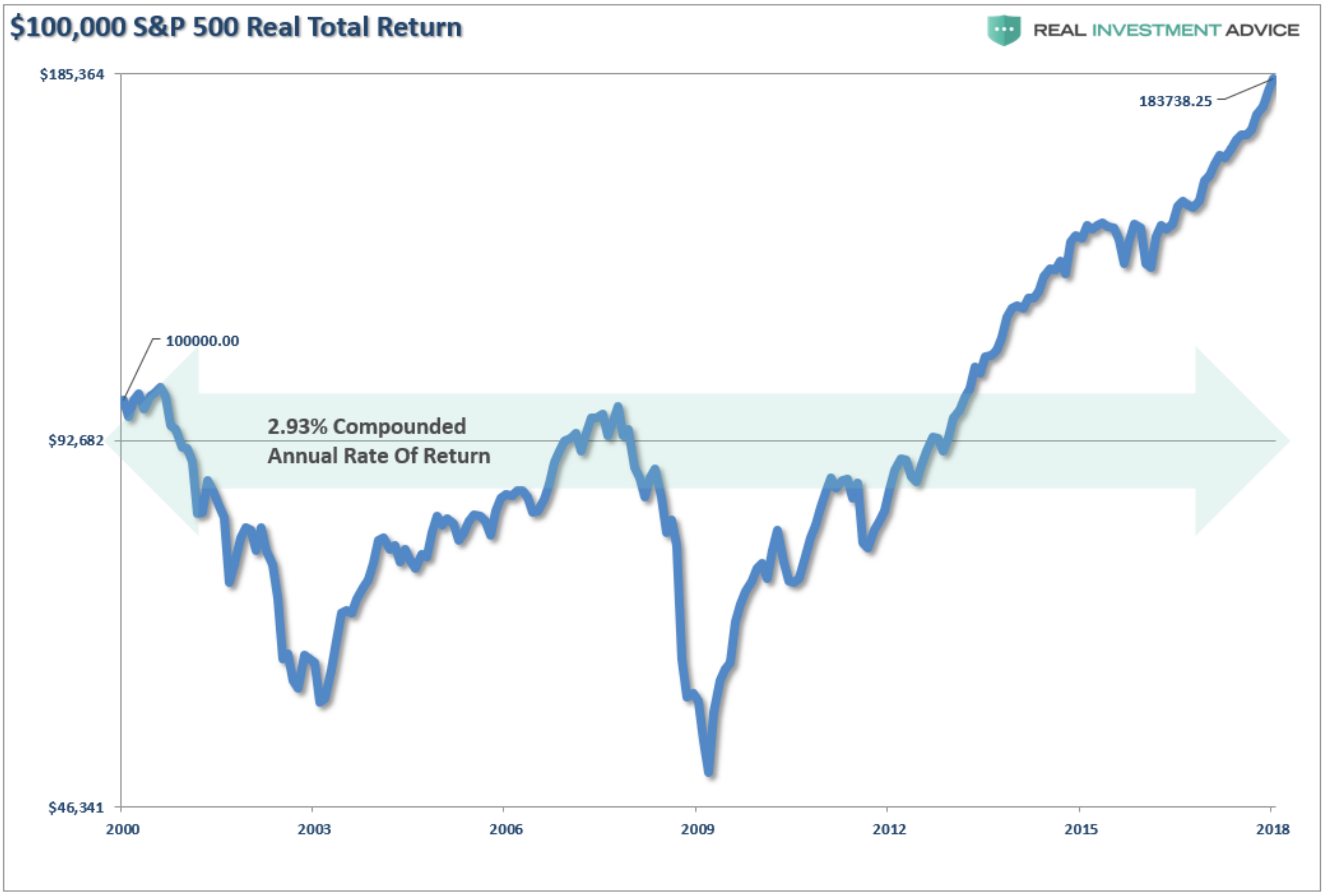


5) Losing capital is destructive. Missing an opportunity is not.

As any good poker player knows - once you run out of chips you are out of the game. This is why knowing both *"when"* and *"how much"* to bet is critical to winning the game. The problem for most investors is that they are consistently betting *"all in all of the time."* as they maintain an unhealthy level of the *"fear of missing out."* **The reality is that opportunities to invest in the market come along as often as taxi cabs in New York City. However, trying to make up lost capital by not paying attention to the risk is a much more difficult thing to do.**

6) Your most valuable, and irreplaceable, commodity is *"time."*

Since the turn of the century investors have recovered, theoretically, from two massive bear market corrections. It took 14- years for investors to get back to where they were in 2000 on an inflation-adjusted total return basis. Furthermore, despite the bullish advance from the 2009 lows, the compounded annual total return for the last 18-years remains below 3%.



The problem is that the one commodity which has been lost, and can never be recovered, is•*"time."*• For investors getting back to even is not an investment strategy. **We are all•*"savers"*•that have a limited amount of time within which to save money for our retirement.**•If you were 18 years from retirement in 2000 - you are now staring it in the face with a large shortfall between the promised 8% annualized return rate and reality. Do not discount the value of *"time"* in your investment strategy.

7) Don't mistake a•*"cyclical trend"*•as an•*"infinite direction"*

There is an old Wall Street axiom that says the•*"trend is your friend."*• Investors always tend to extrapolate the current trend into infinity. In 2007, the markets were expected to continue to grow as investors piled into the market top. In late 2008, individuals were convinced that the market was going to zero. **Extremes are never the case.** It is important to remember that the•*"trend is your friend"*•as long as you are paying attention to, and respecting its direction. Get on the wrong side of the trend and it can become your worst enemy.

8) If you think you have it figured out - sell everything.

Individuals go to college to become doctors, lawyers, and even circus clowns. Yet, every day, individuals pile into one of the most complicated games on the planet with their hard earned savings with little, or no, education at all. For most individuals, when the markets are rising, their success breeds confidence. The longer the market rises; the more individuals attribute their success to their own skill. The reality is that a rising market covers up the multitude of investment mistakes that individuals make by taking on excessive risk, poor asset selection or•weak management skills.• These errors•are•revealed by the forthcoming correction.

9) Being a contrarian is tough, lonely and generally right.

Howard Marks once wrote that:

> *"Resisting ? and thereby achieving success as a contrarian ? isn't easy. Things combine to make it difficult; including natural herd tendencies and the pain imposed by being out of step, since momentum invariably makes pro-cyclical actions look correct for a while. (That's why it's essential to remember that 'being too far ahead of your time is indistinguishable from being wrong.') Given the uncertain nature of the future, and thus the difficulty of being confident your position is the right one ? especially as price moves against you ? it's challenging to be a lonely contrarian."*

The best investments are generally made when going against the herd. Selling to the•*"greedy"*•and buying from the•*"fearful"*•are extremely difficult things to do without a very strong investment discipline, management protocol, and intestinal fortitude. For most investors, the reality is that they are inundated by•*"media chatter"* which keeps them from making logical and intelligent investment decisions regarding their money which, unfortunately, leads to bad outcomes.

10) Benchmarking performance only benefits Wall Street

The best thing you can do for your portfolio is to quit benchmarking it against a random market index that has absolutely nothing to do with your goals, risk tolerance or time horizon.

> *Comparison in the financial arena is the main reason clients have trouble patiently sitting on their hands, letting whatever process they are comfortable with work for them. They get waylaid by some comparison along the way and lose their focus. If you tell a client that they made 12% on their account, they are very pleased. If you subsequently inform them that 'everyone else' made 14%, you have made them upset. The whole financial services industry, as it is constructed now, is predicated on making people upset so they will move their money around in a frenzy. Money in motion creates fees and commissions. The creation of more and more benchmarks and style boxes is nothing more than the creation of more things to COMPARE to, allowing clients to stay in a perpetual state of outrage.*

The only benchmark that matters to you is the•annual return•that is specifically required to obtain your retirement goal in the future. **If that rate is 4% then trying to obtain 6% more than doubles the risk you have to take to achieve that return.** The end result is that by taking on more risk than is necessary will•put your further away from your goal than you intended when something inevitably goes•wrong.**It's all about the risk** Most people are in denial about uncertainty. They assume they're lucky, and that the unpredictable can be reliably forecasted. This keeps business brisk for palm readers, psychics, and stockbrokers, but it's a terrible way to deal with uncertainty. **It should be obvious that an honest assessment of uncertainty leads to better decisions. It may seem contradictory, embracing uncertainty reduces risk while denial increases it.** Another benefit of•*"acknowledged uncertainty"*•is it keeps you honest. A healthy respect for uncertainty, and a focus on probability, drives you never to be satisfied with your conclusions. It keeps you moving forward to seek out more information, to question conventional thinking and to continually refine your judgments and understanding that difference between certainty and likelihood can make all the difference. The reality is that we can't control outcomes; the most we can do is influence the probability of certain outcomes which is why the day to day management of risks and investing based on probabilities, rather than possibilities, is important not only to capital preservation but to investment success over time.