RIAPro: 15-Investing Rules To Win The Long-Game

I wanted to share with you a post I wrote for our ***RIAPro subscribers (try risk-free for 30-days)*** on the 15-investing rules to win the long-game. The rather ***?Pavlovian?*** response to Central Bank interventions has led investors into a false sense of security with respect to the risk being undertaken.

However, to understand why the *"rules"* are important, one must first understand the definition of *"risk"* as it relates to investing. *Howard Marks* previously penned a great piece on this concept.

> ***?If I ask you what?s the risk in investing, you would answer the risk of losing money.*** *But there actually are* **two risks** *in investing:* ***One is to lose money, and the other is to miss an opportunity. You can eliminate either one, but you can?t eliminate both at the same time.*** *So the question is how you?re going to position yourself versus these two risks: straight down the middle, more aggressive or more defensive. I think of it like a comedy movie where a guy is considering some activity. On his right shoulder is sitting an angel in a white robe. He says: ?No, don?t do it! It?s not prudent, it?s not a good idea, it?s not proper and you?ll get in trouble?. On the other shoulder is the devil in a red robe with his pitchfork. He whispers: ?Do it, you?ll get rich?.* ***In the end, the devil usually wins.*** *Caution, maturity and doing the right thing are old-fashioned ideas.* ***And when they do battle against the desire to get rich, other than in panic times, the desire to get rich usually wins. That?s why bubbles are created*** *and frauds like Bernie Madoff get money.* **Unemotionalism**

Unemotionalism

Howard goes on to discuss the importance of *"unemotionalism"* in managing a portfolio.

> ***How do you avoid getting trapped by the devil?*** *I?ve been in this business for over forty-five years now, so I?ve had a lot of experience. In addition, I am not a very emotional person.* ***In fact, almost all the great investors I know are unemotional. If you?re emotional then you?ll buy at the top when everybody is euphoric and prices are high. Also, you?ll sell at the bottom when everybody is depressed and prices are low. You?ll be like everybody else and you will always do the wrong thing at the extremes.*** *Therefore,* ***unemotionalism is one of the most important criteria for being a successful investor.*** *And* ***if you can?t be unemotional you should not invest your own money, period.*** *Most great investors practice something called contrarianism. It consists of doing the right thing at the extremes which is the contrary of what everybody else is doing.* ***So unemtionalism is one of the basic requirements for contrarianism.?***

It is not surprising with markets surging off the March lows, the Fed flooding the system with liquidity, and the mainstream media trumpeting the news, individuals became swept up in the moment. After all, it's a *"can't lose proposition."* Right?

Greed & Fear

This is why being unemotional when it comes to your money is a very hard thing to do. It is times, such as now, where logic states that we must participate in the current opportunity. However, emotions of *?greed?* and *?fear?* cause individual?s to take on too much exposure, or worry they have too much and a crash could come at any moment. These emotionally driven decisions tend to lead to worse outcomes over time. As Howard Marks? stated above, it is in times like these that individuals must remain unemotional and adhere to a strict investment discipline. It is from Marks? view on risk management that I thought sharing the rules that drive our own investment discipline. **I am often tagged as *?bearish?* due to my analysis of economic and fundamental data for *?what it is?* rather than *?what I hope it to be."* In reality, I am neither bullish or bearish.** I follow a very simple set of rules which are the core of our portfolio management philosophy. We focus on capital preservation and long-term *?risk-adjusted?* returns. Do I make mistakes? Absolutely. Do emotions still seep into our decision making process? Of course. We are humans, just like you, and suffer from the same frailties as everyone else. However, we try and mitigate those flaws through the fundamental, economic and price analysis which forms the foundation of overall risk exposure and asset allocation. The following rules are the *?control boundaries?* under which we strive to operate.

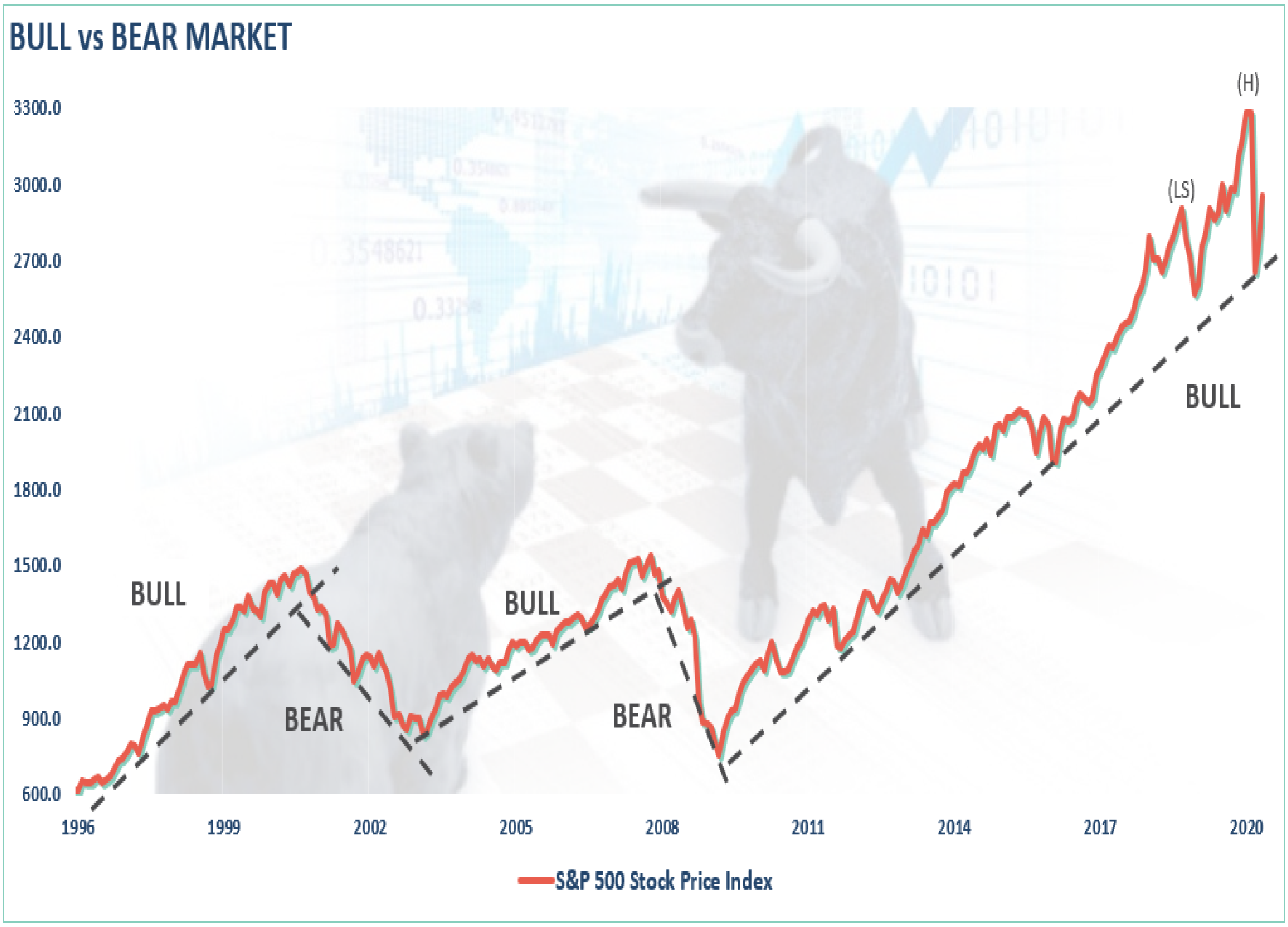
The 15-Rules

1. **Cut losers short and let winner?s run**. *(Be a scale-up buyer.)*
2. **Set goals and be actionable.** *(Without specific goals, trades become arbitrary.)*
3. **Emotionally driven decisions void the investment process.** *(Buy high/sell low)*
4. **Follow the trend.** *(80% of portfolio performance is determined by the long-term, monthly, trend. While a ?rising tide lifts all boats,? the opposite is also true.)*
5. **Never let a *?trading opportunity?* turn into a long-term investment.** *(Refer to rule #1. All initial purchases are "trades," until your investment thesis is proved correct.)*
6. **An investment discipline does not work if it is not followed.**
7. ***?Losing money?* is part of the investment process.** *(If you are not prepared to take losses when they occur, you should not be investing.)*
8. **The odds of success improve greatly when the fundamental analysis is confirmed by the technical price action.** *(This applies to both bull and bear markets)*
9. **Never, under any circumstances, add to a losing position.** *(?Only losers add to losers.? - Paul Tudor Jones)*
10. **Markets are either *?bullish?* or *?bearish.?* During a *?bull market?* be only long or neutral. During a *?bear market?*be only neutral or short.** *(Bull and Bear markets are determined by their long-term trend.)*

11. **When markets are trading at, or near, extremes do the opposite of the *?herd.?***
12. **Do more of what works and less of what doesn?t.** *(Traditional rebalancing takes money from winners and adds it to losers. Rebalance by reducing losers and adding to winners.)*
13. ***?Buy?* and *?Sell?* signals are only useful if they are implemented.** *(Managing without a ?buy/sell? discipline is designed to fail.)*
14. **Strive to be a .700 *?at bat?* player.** *(No strategy works 100% of the time. Be consistent, control errors, and capitalize on opportunity to win.)*
15. **Manage risk and volatility.** *(Control the variables that lead to mistakes to generate returns as a byproduct.)*

The Bull Trend Still Lives

Currently, the long-term bullish trend that began in 2009 remains intact. The correction in early 2016 was cut short by massive, and continuing, interventions of global Central Banks. The 2018 correction, reversed with the Fed returning to a more *"dovish"* posture and cutting rates. The 2020 crash reversed due to the most extreme monetary interventions the world has ever seen.



What is important to note is that it is taking increasingly larger amounts of interventions to keep the "bull trend" intact. The limits to the efficacy of monetary interventions are becoming evident. A violation of the long-term bullish trend, and a failure to recover, will signal the beginning of the next *"bear market"* cycle. Such will then change portfolio allocations to be either *?neutral or short.?* **BUT, and most importantly, until that violation occurs, portfolios should remain either long**

or neutral.

Conclusion

The current market advance against a backdrop of deteriorating economics and fundamentals is certainly worth worrying about. However, with Central Banks furiously flooding the system with liquidity, the "*risk*" of "*fighting the Fed,*" potentially outweighs the reward. How long it can last is anyone?s guess. **However, importantly, it should be remembered that all good things do come to an end. Sometimes, those endings can be very disastrous to long-term investing objectives. This is why focusing on *?risk controls?* in the short-term, and avoiding subsequent major draw-downs, will allow the long-term returns to take care of themselves. Everyone approaches money management differently. Our process isn't perfect, but it works more often than not. The important message is to have a process that can mitigate the risk of loss in your portfolio. Does this mean you will never lose money? Of course, not. The goal is not to lose so much money you can't recover from it. I hope you find something useful in it.**