

The Riverwood Wealth Management Group at Morgan Stanley

News and Views

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Over the decades of writing this letter, we have often commented on the importance of having a sound repeatable process to utilize when making decisions. Sometimes one can have a bad process, or no process, and still end up with a good outcome. An example might be a cook making cookies that follows no recipe and simply uses items available in their cupboard without going to the store to buy needed ingredients. It is possible that even with no recipe and the wrong ingredients that occasionally a good cookie will be the result. While the skill level of the cook would have some impact on the results, the more times one goes about cooking this way the greater the likelihood of a bad cookie. Conversely, having a good process and the correct ingredients can occasionally result in a poor outcome...a bad cookie. Maybe one of the ingredients was spoiled or maybe the oven malfunctioned. Despite doing everything correctly, the result was bad. This can simply be attributed to bad luck. But if the cook consistently follows the recipe and has all the correct ingredients the likelihood of a good outcome should outweigh the chances of a poor one.

As with cookies, if we look at the investing world it is our view that having a bad process (or no process) from which you base your investment decisions will probably increase the likelihood of a poor result. While it is true that you may occasionally have a good, or profitable, outcome without utilizing a process, we believe that could be attributed more to randomness than to skill. And again, having a good process does not guarantee a successful outcome (remember the malfunctioning stove) but we would argue it can increase the likelihood of one.

What makes up an investing “process”? In a way, we like to compare this to pilots using a checklist to review all the different systems on the aircraft before they take off. Checking off on key items before taking off. Because everyone has their own unique goals and objectives, these items will likely vary from investor to investor. Knowing your tolerances for risk, your time horizons, your objectives, and so forth should be among the considerations. For our part, we like to include a review of the fundamental aspects of a company part of our investing process. The price of the stock relative to earnings, the debt levels, the cash flow, and so forth. Think of a process like a checklist you have compiled that has attributes you are looking for (or looking to avoid) in an investment. In compiling this list, you have determined that companies that meet these criteria seem to increase the likelihood of generating the outcome you are striving for, not only in this specific investment but as part of your overall holdings and your unique long-term goals.

Another component in this conversation has to do with how to define what a good outcome is. *This is easier to do with cookies than it is with investing.* With investing many would argue that success or failure of an investment is measured by profit or loss. We believe it is a bit more nuanced than that. For example, a poor process to choose a stock might be something like “my horoscope told me to invest in it”. Making an investment based on a horoscope may result in a profit, but we would attribute the profit to random luck more so than any sort of repeatable process. Luck, good and bad, is always part of any outcome and the goal behind having a process in place to deliver decisions that strive to increase the former and reduce the latter.

Lastly, we believe a good process needs to be repeatable and measurable. Is the process such that it can be consistently repeated? Which aspects of the checklist seem to more present in successful (or poor) results? Can the process be adjusted over time because of these observations? If you watch sports, you often see the idea of a repeatable process. Golfers will go through the same routine before every putt. Basketball players will do the same before every free throw. They believe the steps of their routine (or process) can increase the likelihood they make the putt or the free throw. As you know, investing is hard, and we believe anything you can do to help increase the likelihood of good outcomes should be utilized. Thanks for letting us help, call us anytime.

“Working hard to earn your trust...and even harder to keep it”

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	Good Process	Poor Process
Good Outcome	Higher probability of occurring and higher likelihood of being repeatable	Lower probability of occurring and lower likelihood of being repeatable
Bad Outcome	Lower probability of occurring and lower likelihood of being repeatable	Higher probability of occurring and higher likelihood of being repeatable

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