

The Riverwood Wealth Management Group at Morgan Stanley

News and Views

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It is hard to believe, but September is indeed here. We know how silly it is to say how fast time seems to go by, but doesn't it seem like it flies by even faster every year? Last month we opined on forecasting and those that try to tell us what is going to happen in the future. We do understand the need to have a view about what you believe is likely to occur in the future. Doing so can help guide in making decisions today. After all, if you believe it is going to rain, you might take an umbrella with you. What we find frustrating, or even comical in some ways, about the process is the absolute certainty that many make their forecasts. Our view is that one cannot predict the future with any consistency or certainty. Instead, one should prepare for multiple possible outcomes.

When it comes to investing let's consider some of the ways to help navigate possible pitfalls inherent in the need to make "guesses" about the future. First, we would argue that it makes sense to consider the possibility that the future outcomes you believe will occur may not happen at all. In other words, being humble enough to recognize that you may be wrong. A degree of humility that seems to be absent from many forecasters. Keeping this in mind will help avoid the risk of having all your eggs in the one basket that needs your prediction to come true in order to be a success. When recognizing that there is a chance that something other than your prediction might occur, you are able to be prepared, to some degree, for other outcomes.

Second, we believe that over an investing lifetime it is better to be approximately correct frequently than it is to be precisely correct once in a while. This describes the concept of frequency versus magnitude. Is it better to bet all you have on one coin flip and potentially double your money (of lose it all), or is it better to make a series of smaller bets? There are many considerations here and the idea of risk versus reward is certainly one of them. When it comes to investing it can be easy to focus on being "right", but what is often overlooked is the negative impact of being "wrong". The allure of being "right" or making a big "score" by over allocating to a specific outcome can be hard to resist, but at the end of the day we believe the law of averages make it difficult to do so often enough for it to be successful over the long term. Further, we would argue that the benefits of being occasionally correct are outweighed by the potential harm of being overconfident and over-allocated to a specific outcome...only to be wrong. After all, if you lose it all on the "one big coin flip", you have nothing to make another bet.

Lastly, we believe that having a disciplined, consistent, and repeatable investment process can potentially, over time, provide more favorable results than making random investments of varying sizes based on something like a "feeling". Having such a process does not assure a successful investment, but we believe it has the potential to increase the frequency in which such outcomes occur. This process can be unique to you, your views about an industry, your analysis of the underlying fundamentals of the investment, or many other variables. We believe the most important part of this concept is the idea that investing should be somewhat devoid of emotion. This can be as difficult as the idea of wanting to be precisely correct discussed above. But we think having a process to follow when making decisions about allocation choices and sizes can help remove some of the randomness involved in emotional choices.

We hesitate to use too many analogies, but it seems like the idea of baseball batting average is applicable to use here. We have noticed that it is not unusual for the players that have the highest number of home runs to also have a very high strike out percentage. They can afford to swing for the fence because they are playing a game and often get another chance at bat. Unlike investing, where too many strike outs might mean no more chances to invest. Rather, we believe in hitting for average (trying to get on base more often), and seeking to maximize our efforts around that goal as opposed to swinging for the fence makes sense when it comes to investing. Call anytime.

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

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Forecast



Actual



In a nutshell, we believe there is value in having a view of how the future may unfold. But we also believe that allocating in a manner that requires one to be consistently and precisely correct in those forecasts is not a repeatable process over time. Rather, we believe that investing in a manner that can potentially have more positive outcomes over a wider array of possible future outcomes/events can be a more consistent and repeatable process.

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