

Investing: Learning From What You Already Know (and Don't)

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This essay outlines a philosophy of equity investment. It reflects a point of view anchored in an understanding of investors as participants in a dynamic system within which multiple levels of participation among: markets; industries; firms; governments; systemic influencers; investment and brokerage firms; and individual investors generate multiple effects---- all under conditions of uncertainty, but not without reasonable probabilities.

Many of these ideas originated in the form of blogs on the Accord Advisory Group site ([www.AccordAdvisoryGroup.Com](http://www.AccordAdvisoryGroup.Com)) between October 2008 and May 2011.

I. The Emotional Work of Investment

My central focus begins and ends with the individual investor--- now, more than ever, responsible through his/her investment decisions for the preservation & growth of family capital.

Because my focus concerns the individual financial decision maker, it is important to recognize the individual imperative for “insourcing”--- the development of hardiness and resilience necessary for the emotional work of investment. Insourcing is the stretch beyond what we consciously know (our “know how”) to learning how to “know” what we do not. It involves the expansion of knowledge: from the parsing of noise into information (including the information that the markets are responding to the noisy fears of cascading prices) to self-knowledge about personal tolerance of investment experience---how thinking is sharpened or impaired given the emotion generated by market participation.

Investment is defined as an outlay of enterprise capital in expectation of profit. Usually, this is understood as a combination of interest, income, and capital appreciation. Psychologically, investment is more. Beyond the extension of capital, it represents

an endowment, or placing of trust in an object external to the investor. When this is a corporation, represented by a limited liability joint stock equity share, investment requires the placing of trust in people and institutions well beyond the scope of the typical investor's knowing!

Investing, we entrust our capital to the stewardship of those we do not know within complex business circumstances and decision-making of which we have, at best, only an inkling. This is fundamental to the limited liability joint-stock corporation---- where shareholder owners cede their agency to professional management.

Effectively, this requires belief in the systemic performance of individuals within the limits and constraints of their organizational roles. This behavior is characterized at all levels by "satisficing"--- the compromise between multiple demands, yielding trade-offs between competing issues, with the decision sufficient to accomplish a number of goals.

Individuals' systemic performances may be observable in the company's recent history; and are also reflected in the organization's culture---- neither of which is quantified in financial statements. Indeed, but for corporate activity monitored by the media, much of what a corporation does falls below an investor's line of sight. Beyond the mandatory filings required by law and corporate public relations, the proprietary information of competitive advantage belongs paradoxically, to the company rather than to its shareholder-owners.

Extending beyond the individual firm, an investor's trust also engages the market system--- both regulated and intervened in by multiple government actions. The market itself is composed of many players: institutional funds; corporations; retail investors; brokerage houses and stock analysts. Each operates according to strategies designed to maximize his/her own definitions of gain: whether long, short, cash, or levered. Not only are these strategies imbued with their respective player's organizational cultures, but also their individual personalities and capabilities of action.

Where they can, investment players seek to influence the market. Brokers suggest stocks to their clients from lists endorsed by their firms. Corporate PR posts news on the internet, informing the markets of business activity while intending to spin market sentiment. Even among retail investors, vitriolic dissent on internet message boards reflects the desire for confirmation of investors' decisions--- whether long or short.

The thinking behind each player's investment differs; what remains, within the daily vicissitudes of a share's market price, is that day's market-wide opinion of the discounted value of future expectations for the individual firm within its unique circumstances.

Value is a fantasy of worth beyond present price. Conventions such as fundamental or technical analysis provide the informational metrics at the center of financial decision-making. Because they appear to represent hard and fast data points, they bolster investors' convictions in "knowing"----- especially as they are elaborated by investors with detailed storylines of hope or despair along different future time axes. Such data-driven narratives allay

our anxieties as we place our bets on our expectations of future value.

Investors traffic in two asymmetric realities: the first is of financial analysis coupled with compelling narrative; the second is a concrete laying-down of cash in exchange for a share. After the decision to invest is acted upon, the imagined reality of future value joins material reality. It is the distance of this second reality from its entry point, up or down, that signals contentment or fear.

Our only certain investment knowledge is of not knowing: of probability and risk upon the waves of a volatile market characterized by extremes of over-exuberance and over-correction. What drives our hope are good story-lines: too much bad or too much silence becomes difficult to bear and investors react, attempting to curtail their own loss, but often contributing to the deepening losses of those investors who remain. Perhaps this is the link between the related terms value and valor: to recognize and remain focused on future value requires courage to withstand the personally dangerous risk of loss.

At such times, trust in the investor's narrative may weaken or intensify---- as doubt gnaws at the story's cohesion---- with fear of deepening loss hindering one's earlier ability for staying the course. This is the emotional doubling down necessary to hang on as the market turns against your position. Before investing, it is essential to consider what one will do should this happen: though, in my experience, the experience is unfathomable in abstract--- but must be gotten through and survived in order to reflect on one's genuine capacity for this kind of risk.

Whatever the investor's diligence and expectation for the realization of added value beyond the price paid for the share, once acted upon, the investment becomes aggregated with the millions of other shares subject to market volatility. Because investment in a share joins with all other shares and their owners in a market, a critical unknown is always the buying and selling behavior of other owners. In a profound sense, this unknown reflects an investment in other investors---- all subject to the psychological pressures of investment.

But our know how, like most human knowledge, operates under constraints. Once our curiosity is provoked, we seek the closure of answers. And in achieving closure, we generally feel that we have sufficiently satisfied the requirements of our goal. Because equity investment is always an act of trust involving both expectation and money, such casual closure is generally insufficient for weathering the investor's emotional journey. Both before and after our rational decision-making and action, investment and its risks stirs deep emotion. Behavioral economists have demonstrated that humans pay more attention to the pain of loss than the joy of gain; and whether one trades with stop-loss orders or is content to sit (however anxiously) with "paper loss", the fact of loss affects the clarity of our thinking.

At any moment in the market, share ownership reflects an underlying group consensus charged with fantasy and expectation. Keeping track of these expectations and their alignment with one's personal strategy is the ongoing work of the individual investor; and weathering the actions of other investors in the buying and selling

representative of stock price volatility requires emotional resilience.

Habit and avoidance are costly behaviors---- tempering our anxieties but blunting our clarity. Prudent investment requires the reframing of what we know in new contexts. The shares we own represent not only abstract hope, but value delivered through specific companies. Like individual behavior, organizations (whose shares we own) share behavioral similarities. They have a recognizable systemic identity--- a signature way of operating marked by distinct organizational practices. What they do and how they do it differs from other, similar organizations. Within each firm, there are specific systemic roles and specializations; and within each firm, there are pressures and resistances toward the capability of change. What changes are necessary? Where have changes occurred? How are the firms multiple dimensions recognized (or unrecognized) by the market? Does the firm learn from its mistakes? How is that learning folded back into its operations toward greater value?

Similarly, the habits of our fellow investors need to be noted. How do they react to the possibilities of loss, ruin, and panic that attend the realization of value? Often, market action derives not from thought but from positive feedback loops following precipitant action. Here, individual thought is effaced as both programmed trading and individual stop-losses drive the plummeting price cascade. Much of this becomes effaced in retrospect, when we reflect on a stock's price-journey across the smoothing territory of a trading year; but the immediate emotionality of the moment is what powers enormous market fluctuation.

## II. What We Can Do

In investment, the actions resulting from our prudent decision making join millions of others' similarly directed acts creating a powerful group joined in the fantasy wish of increased future share value. Our actions are always "as if" we know; and that "as if" stabilizes our anxieties with false security. It is a kind of magical thinking: as if we could will something that has not yet arrived.

Indeed, much of the frustration in waiting through difficult investment periods of inaction or loss is caused by the continuous reality before us that our magical wishes are ineffective. Often, sitting in an invested position generates the same kind of gratification as watching a pot of water achieve its boil.

Steadfastness is required during such times. Inaction provides a context for anxious rumination rather than emotionally grounded reflection. And like laboratory rats in the famous “learned helplessness” experiments, the investor during such periods remains the passive captive of an unmoving market. The development of patience becomes the necessary companion to investing.

Once invested, we trust our trustees--- both officially, in the firm itself and unofficially, within the markets determining the fluctuations of share price, to grow value. We always proceed under an illusion of understanding, defended by our view of tomorrow’s potential gain (even as we discount today’s loss, the yield of yesterday’s similar illusion...).

There is a large gap between what we easily absorb and what understanding demands. Sometimes we get lucky; and the anxiety driven push for closure corresponds with our wishes for the stock. Sometimes it does not; so we choose what we seek to integrate into our understanding until we are satisfied with our momentary parsing of the unknown. We seek balance in our closures--- a balance in the credibility of our ongoing investment storylines with the balancing of our fears and hopes.

What we understand, what we know, is always selective; and from this selection, we decide on the risk factors before us. Generally, we do not reckon that corporate acts eventuating in publicly acclaimed success or failure are the compromise compounds of acts sufficient to satisfy multiple goals. Instead, we nod knowingly, believing our faith to have been fairly validated.

In a sense, it has been: our combined assessment of firm, industry, market, and response of market players, has generated a multi-factorial equation: a set of interactive effects generating other effects. With all else being equal, both annual highs and lows return

some time the next year to their average: it is the statistical fact of regression.

Returning to insourcing, what is the learning that is necessary for investment? Beginning with learning about a company and the market system in which it trades, insourcing begins with keeping your eyes open: and more, following up on the hunches that occur to you about any aspect of the business, based on what you already know.

It requires the continuous or at least, regular, scanning of changing environmental conditions, both internal and external to the firm. Together with this is the recognition of the investor's emotional mindset. Sometimes, we should simply not trade---- as when we are afflicted by the personal torment of managing one's own funds (as opposed to "other people's money").

Self-management confronts the investor with personal fantasies and tolerances for momentary loss; insourcing requires that the individual become familiar with different moments of self-

awareness—of when anxiety calls out defensiveness, and what kind of defensiveness.

To return to investing, the investor must be in an emotional mindset capable of framing, reframing, and thinking through what is before him/her. Investment is about learning: learning about industries and the social systems in which their shares operate; learning about one's own psychology.

Learning involves the continuously willed act of curation: of spreading out what you know before you, and making choices about what is important, given the current context of action. Because each of us is only capable of paying attention and remembering only a handful of things (the psychologists say 7 plus/minus 2) we are continually involved in shuffling what we know both to fit current imperatives and to learn from them.

Sure, on the one hand, our limited capacity is a liability; but on the other, in pushing the envelope and filling in the gaps, the investor's

curatorial act both develops appreciation of strategic information and one's internal process of insourcing.