

Investing Problems

half a dozen

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Problem #1

Why do stock prices change?

- ▶ This isn't an exercise to calculate intrinsic value to 2 decimals.
- ▶ For stretches of 12 weeks fundamentals of a company are 'unknown' to public.
- ▶ 'Macros' move prices. But can it be modelled?
- ▶ There are constants, known variables and unknown variables.

Problem #2

How to measure pain of drawdown and pleasure of recovery?

- ▶ Pain is a function of speed (acceleration?), extent and duration of drawdown.
- ▶ Pleasure is also a function of speed (acceleration?), extent and duration of recovery.
- ▶ Are these two functions same?
- ▶ Are these two functions for two different individuals the same?

Problem #3

Can every strategy be decomposed to factor equivalents?

- ▶ Does alpha arise due to favorable weightage to an outperforming factor in a cycle?
- ▶ Aside is every factor cyclical? Is anything evergreen?
- ▶ Is value investing, momentum investing, growth investing all factor weights 1 respectively?
- ▶ Can we 'Fourier transform' Warren Buffett? Yes on paper. But can we repeat it?

Problem #4

When does 'capacity to suffer' become 'foolishness'?

- ▶ What matters more - Being proven right or generating portfolio level alpha?
- ▶ Can you suffer on behalf of your investors?
- ▶ What is the quantitative and duration limit of suffering?

Problem #5

Why is the market inefficient when it is against our position?

- ▶ Corollary: Why do investors forget inefficiency when positions are favored by Mr Market?
- ▶ How can Endowment bias be quantified?
- ▶ Can Endowment bias be a boon at times? When?

Problem #6

Is a return of 15% for 10 years better or 18% for 8.5 years (assume same end value)?

- ▶ Should interim utility of money be considered? Is Bernoulli's utility function applicable?
- ▶ Should certainty at end of 8.5 years be weighted higher in this evaluation?
- ▶ What if the index was always higher. Would both these bets in the fund manager be called failed bets?

Solutions

- 1.
- 2.
- 3.
- 4.
- 5.
- 6.

Thank you.