Book Investment Titans

Investment Insights from the Minds that Move Wall Street

Jonathan Burton
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Recommendation

Jonathan Burton relays the advice of nine top investors - Harry Markowitz, Paul Samuelson, Jeremy Siegel, John C. Bogle, Joseph Lakonishok, Richard Thaler, Gary Brinston, Peter Bernstein and William Sharpe. The author focuses on different aspects of investing - stock-market risk and reward, indexing, value versus growth investing, investor psychology, international investor strategies and risk tolerance. Burton concludes Investment Titans with observations about common themes - diversifying, investing now and staying invested. This solid book avoids repetition by focusing on different investment issues for different investors.

Take-Aways

- To decide how to invest, realistically and honestly assess how well you tolerate risk.
- The amount of risk you take is one of the few aspects of investing you can control.
- Diversify, because the future is unpredictable.
- Harry Markowitz based his "Modern Portfolio Theory" on creating a portfolio of unrelated stocks.
- Paul Samuelson's "Time Diversification Theory" emphasizes long-term investing.
- Jeremy Siegel urges investing in stocks since stocks have easily beaten inflation.
- John C. Bogle recommends low-cost index funds.
- Joseph Lakonishok advises you to be a value investor, seeking value in out-of-favor stocks that will make good recoveries.
- Richard Thaler believes that investor psychology dominates markets.
- Gary Brinson says you should invest globally by looking for leaders in an industry. Location doesn't matter, since borders and trade barriers are obsolete.

Summary

Nine Investment Titans

Nine investment titans offer their advice on how to make the best investments while weighing risk and reward. In these extensive interviews, they agree that all investors must assess, realistically and honestly, how well they tolerate risk. Unlike your portfolio's return, the amount of risk you take is one of the few aspects of investing that you can control.

The investment titans fall into two camps: "efficient market disciples" who believe the investment landscape is "cut and dried," and those who believe you can predict stock price movements and exploit markets through diligent research. The former group believes that how you allocate your assets to stock and bonds - rather than the particular stocks you select - is the most important factor in meeting your financial goals.

Titan One: Assess Your Portfolio as a Whole

Harry Markowitz emphasizes diversification, since the future is unpredictable. If you diversify, you can balance out your portfolio, because when one group of stocks is declining, another will be appreciating. He developed the "Modern Portfolio Theory," which says that if you create a portfolio of unrelated stocks, each security contributes its own strength.

> "Risk doesn't have to control you; the goal is to control risk. When approaching an investment decision, be realistic about what the market can give you in exchange for the risk you take."

He advises balancing your risk tolerance against the returns you expect. Others' success in the market may tempt you to take more risk than you ordinarily would. Instead, trust your "rational gut feeling" about how much risk you really feel comfortable taking. You will get more return as you risk more, and get less as your risk declines. Find a place that feels right.

> "Investment perspective and risk tolerance are unique with everyone. In truth, no one knows when any bull market will end or begin. In that sense, the risk of being out of the market is actually greater than the risk of being invested." [Paul Samuelson]

Markowitz published a road map to help investors assess the risk of their entire portfolio in the 1950s. He led the way in this field, receiving a Nobel Prize in 1990.

Titan Two: Diversify Within Time

Paul Samuelson does not believe that you can't lose money if you simply hold stocks long enough (say, 10 to 50 years). While long-term stocks will do better than other assets, don't invest on that assumption. Risk always exists, even over the long term. You cannot avoid "systematic risk" of simply being in the market.

Samuelson emphasizes investing for the long term with his "Time Diversification Theory." Step into the market and stay for a lifetime. Make long-term investments, but diversify. Keep a properly allocated portfolio, in which you spread your assets across many securities based on your risk tolerance. But recognize that the market is very uncertain. Don't try to seek precise market timing. Don't jump from one industry to another and from cash to stocks and back again. While it's fine to speculate in stocks with a small amount of money, it's risky to think you can be in the right place at the right time.

> "Insider buying can be a good indicator. If you can't be a corporate executive, invest like one. Insiders are among the earliest to spot value within a company and to act on it. These internal factors will be reflected in the stock price long before investors read about them in the quarterly report." [Richard Thaler]

Samuelson, professor emeritus of economics at the Massachusetts Institute of Technology, also received a Nobel Prize.

Titan Three: Look for the Equity Premium

Jeremy Siegel believes that a stock portfolio which you hold for more than 20 years is less risky than a portfolio of bonds, because inflation undermines the value of fixed-income returns. By contrast, stocks easily have beaten inflation. You risk more by not being in the investment game than by playing. By staying in for the long run, you can enjoy growth and income your entire lifetime.

> “To Gary Brinson, the chairman of influential Chicago-based investment manager UBS Asset Management, stocks should be chosen according to business sectors, not borders. Where a company is based doesn’t much matter, as long as it is a leader.”

However, you won’t get the kind of returns that have occurred since the big bull market started in 1982. Stock returns are lower now because investors have a greater demand for stocks. This is the basis for the equity premium, which increases when few people want to own stocks. But as more and more people have observed the benefits of investing over recent decades, they have become stock buyers. Therefore, they bid the prices up, and their potential return on investment comes down. To be a better investor, maintain a diversified portfolio and avoid short-term market timing. Buy stocks for the long term.

"The key points that Jeremy Siegel suggests can help people to become better investors: Maintain a diversified portfolio. Avoid short-term market timing. Don’t underestimate your true holding period. Even in the darkest moments, stocks are to have and to hold."

Siegel, professor of finance at the Wharton School of Business at the University of Pennsylvania, wrote the bestseller, Stocks for the Long Run.

Titan Four: The Outperforming Average

John C. Bogle emphasizes minimizing expenses. He disparages market strategies, theories and cost-benefit analyses. Instead, he stresses simple, low-cost approaches, based on low management fees and superior investment returns.

> “One of the easiest investment rules for people to follow is John Bogle’s all-consuming passion, minimizing expenses.”

Low-cost index funds provide a good value. Rather than trying to beat the market by buying and selling the latest hot stocks, buy a representative sampling of the stocks in the index. While such funds may outperform the index occasionally, they only will do so by a very small amount. However, they capture nearly all of the benchmarks they are tied to, and do so efficiently and inexpensively. This approach also cuts down on management costs.

> “Investors need to make a realistic and honest assessment of their risk tolerance, for portfolio risk is one of the few factors within their control. Portfolio return, unfortunately, is not.”

The index you use is the key factor in your return. Instead of using the Standard and Poor’s 500 Index, use the Wilshire 5000, which indexes the total stock market.

Bogle is the founder of the Vanguard Group of mutual funds.

Titan Five: Seek Uncommon Value

Joseph Lakonishok is a strong supporter of value investors who understand that "what goes down must come up." Value investors look for stocks the value of which other investors have assessed incorrectly. Rather than paying premium prices for popular growth stocks, they look for "Wall Street’s dogs."

Out-of-favor stocks usually will be cheaper than growth rivals. Typically, these stocks are low because the companies have made big mistakes. But, sometimes, their executives take good, solid chances and they recover. The value investor can profit handsomely from this. But be patient. You can’t expect your investments to pay off quickly. You need "emotional contrarianism," so you can live with any bad news about the company in which you have invested. Growth stocks typically reward past success. Look toward the possibility of future success. It’s a good sign when a company does a lot of research and development relative to sales, since that indicates that the company’s insiders hope for a more positive future.

> “Asset allocation - how much you confer on stocks and bonds - not stock selection, is most important to meeting financial goals.”

Lakonishok is a finance professor at the University of Illinois and a well-known institutional money manager.

Titan Six: Investor Psychology

Richard Thaler’s strategy of behavioral finance discounts efficient market models on the grounds that investors are not rational at all times; their emotions drive them. He believes that psychology and behavior are dominant influences on stock price movements. However, if you stay calm and cool when others overreact, you can do much better in the market.

> “Josef Lakonishok, a finance professor at the University of Illinois and a respected institutional money manager, is a staunch supporter of value investing.”

Avoid the systematic errors of judgment or "heuristic biases" that undermine investors’ choices. Don’t be overly confident or optimistic; don’t confuse chance with skill. Get over your aversion to loss. Don’t regret your decisions or ignore the big picture. Do not think about what others are doing: People bid Internet stock prices to unrealistically high levels.

Try to buy like an insider. When corporate insiders buy shares in the open market, they may have some insights about the company that they announce to the public - but which the public ignores. Conversely, when insiders sell at a very high level, that’s not a good sign.

Thaler, a professor of behavior sciences at the University of Chicago, focuses on investor psychology and behavior.

Titan Seven: Invest Globally

Gary Brinson believes in selecting stocks based on business sectors, not on borders. Globalization has made borders and trade barriers obsolete. Today, people trade stocks around the clock on all major exchanges, so a company’s location does not matter. Look for leaders in a business sector and invest in them. Think about worldwide opportunities and international investing in a global environment.

> “Globalization will make borders and trade barriers obsolete. Stocks will trade around the clock on every major exchange.”

The key rule for investing is how well you allocate your money across stocks, bonds and cash, rather than the specific stocks you pick or your market timing. Overall, your asset mix accounts for about 94% of how well your investments do. Thus, decide on your basic allocation, and once you decide what portion you will invest in stocks, look at non-U.S. companies. International investing offers "potentially high returns, portfolio diversification and participation in the rapidly evolving global economy."

> “William Sharpe developed the Sharpe Ratio, which is now a standard measure of whether fund managers are good at their jobs. The better the ratio, the better the fund’s risk-adjusted return.”

Brinson is chairman of the UBS Asset Management.

Titan Eight: The Good Investor

Peter Bernstein, a master of "the art of holding hands," works with new investors who need counseling, especially those who never have experienced a true bear market. Bernstein believes that a good investor is realistic and accepts uncertainty. The future is unpredictable, even though many investment counselors argue that equity increases in the long term. Extrapolations provide a road map that suggests when deviations from the past might show up. But a total break from the past also might occur.

Approach investing with the recognition that "we don’t know exactly how to measure risk. And we sure don’t know how to measure the market." Diversify. It may cost you more in the short run, but it’s the only way you can survive the really hard times.

Bernstein is a best-selling author and investment counselor.

Titan Nine: Expanding Investment Opportunities

William Sharpe, an expert on asset allocation and simplifying the method for measuring and controlling portfolio risk, developed a number of helpful investment tools, including the "Capital Asset Pricing Model" (CAPM), which indicates how much risk a mutual fund manager is taking with your money. He developed the "Sharpe Ratio," which measures how well fund managers are doing their jobs. And now he has developed an investment-planning tool called "Financial Engines," to help everyone do investment planning.

Use these tools and concentrate on using, not beating, the market. Focus on your optimal asset allocation. Diversify over time. If you seek higher returns, accept the greater risk that you will take when times are bad.

Sharpe is a retired economist from Stanford University. He shared the 1990 Nobel Prize for his work in asset allocation and simplified risk-measurement methods.

About the Author

Jonathan Burton is a prolific and well-known financial journalist. *Investment Titans* grew from his "Leaders in Finance" series, which he wrote for *Asset Management.* He co-authored the best-selling *Electronic Day Traders' Secrets* and has contributed to *to The New York Times, Bloomberg Personal Finance, The Economis* and *The Christian Science Monitor.*