Nine Rules to Better Stock Investing

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> The Wall Street machine acts as a huge distraction that creates noise and confusion in the markets—and in our own brain chemistry—that makes long-term investing more difficult.

Guy Spier, manager of the Aquamarine Fund, believes that the best way to overcome the shortcomings of our inadequate brains is to carefully structure our environment to eliminate the Wall Street noise and adhere consistently to some simple guidelines. Based on his own experience as a professional fund manager and value investor, he authored the book "**The Education of a Value Investor**" (Palgrave Macmillan Trade, 2014).

Here, Spier outlines the nine key rules to a better investment process that he describes in his book.

1. **Stop checking the stock price so often.**

   Many investors check their stock prices not only on a daily basis but also sometimes minute by minute. We may have a nagging fear that if we stop paying constant attention, something bad will happen to our investment. Seeing the stock price on the monitor gives an investor false reassurance that everything is okay.

   If you're speculating on the latest hot biotech or Internet stock, it may make some sense to follow every mad gyration: A brokerage firm issues a wildly bullish report and your stock suddenly surges by 20% as other speculators pile in. But I'm trying to invest in a more measured way, buying stakes in companies that I can hold for years, if not indefinitely.

   > If I were solely managing my own account, I'd set up a system in which I'd look at the price of my holdings only once a quarter, or possibly even once a year. As things stand, I need to be able to update investors in my fund, so I check the price of my holdings no more than once a week.

   With the type of businesses I invest in, it's not imperative to know what's going on from day to day. Virtually all my investments are in companies that are heading in a positive direction and it's really just a question of how long it takes.

If you invest in businesses like this, it shouldn't really matter if you switch off the monitor, curl up on the sofa, and read a book. After all, Warren Buffett didn't make billions off companies like American Express (AXP) and Coca-Cola (KO) by focusing on the meaningless daily movements of the stock ticker. It's a wonderful release to see that your portfolio does just fine when you don't check it.

2. **If someone tries to sell you something, don't buy it.**

In the early years of running my funds, my returns were decent and I was hurt that nobody paid any attention to me. Then I must have landed on some list of up-and-coming fund managers because the phone started ringing off the hook.

Everybody wanted to sell me something: stocks, research, newsletters, phone services and countless other products. At first, these calls seemed a measure of my success, but I soon began to see that I made lousy decisions when I bought things that salespeople were hawking to me.

The problem is that my brain (and most likely your brain too) is awful at making rational decisions when confronted with a well-argued, detailed pitch from a gifted salesperson. So I adopted a simple rule that has proved extraordinarily beneficial. When people call to pitch me anything at all, I reply in as a pleasant a manner as possible, "I'm sorry. But I have a rule that I don't allow myself to buy anything that's being sold to me."

> There may be times I miss out on a brilliant investment idea, but over a lifetime, I have no doubt that I'll benefit much more by detaching myself from people with a self-interest in getting me to buy stuff. My rule is: If the seller has a self-interest in me buying, I'm not buying.

3. **Don't talk to management.**

For much the same reason I don't talk to salespeople, I don't want to speak with the management of the companies I'm researching. Heretical as this might sound, my own experience is that close contact with management is likely to be detrimental to my investment returns.

The trouble is, senior managers—particularly CEOs—tend to be skilled salespeople. No matter how their business is performing, they have a gift for making the listener feel optimistic about the company's prospects. But this gift of gab doesn't necessarily make them a dependable source of information. Knowing my own rational limitations, I'd prefer not to expose myself to this potentially distorting influence.

> I know some money managers who will do their research, then say, "I need to meet management so I can get comfortable." But who knows how management will mess with their minds? If I have to meet the CEO to understand why I should buy the stock, that's a serious warning sign. It should be clear enough from all of my other research.

There are some exceptions to the rule. Berkshire Hathaway's (BRK.A) Warren Buffett and a small but growing minority of CEOs at companies like Fairfax Financial (FRFHF), Leucadia National Corp. (LUK) and Markel Corp. (MKL), try to share the information that they would like to know if they were in their shareholders' shoes.

4. **Gather investment research in the right order.**

> The first idea to enter the human brain tends to be the one that sticks. That's why I need to be extremely careful about the order in which I gather research and explore investment ideas.

As I've discussed, I work to eliminate ideas from salespeople. What if a friend or peer I respect suggests that I look at a particular stock that they think I should buy? I try to stop them short and say something like, "Wow, it sounds really interesting. Let me read up on it before we talk so we can have an informed conversation."

Then I need to be careful to do the research in the right sequence. My routine is to start with the least biased and most objective sources. These are typically the company's public filings, including the annual report, 10-K, 10-Q, and proxy statement. These aren't perfect, but they are prepared with a good deal of care and attention, especially in the United States, and they are reviewed by lawyers.

The accountant's audit letter is also key. It can subtly signal that the accounts are not all that they appear to be. In the annual report, the management's introductory letter is also important. Is it a public relations puff piece, or is there a genuine desire to communicate what's going on?

After working my way through the corporate filings, I typically turn to less objective corporate documents, such as earnings announcements, press releases and transcripts of conference calls.

There may also be helpful information to glean from a book about the company or its founder. In some cases, they have such depth that I'd read them before the corporate filings. Investors looking at Berkshire Hathaway for the first time would do well to read the books that Roger

Lowenstein ("**Buffett: The Making of an American Capitalist**," Random House, 2008) and Alice Schroeder ("**The Snowball: Warren Buffett and the Business of Life**," Bantam, 2009) wrote about Buffett. Likewise, in studying Wal-Mart Stores (WMT), a good place to start would be Sam Walton's book "**Made in America**" (Bantam, 2003).

I avoid reading any press coverage until after I've studied the corporate filings. The corporate filings are my meat and vegetables—less enjoyable, but usually more nutritious.

As for the equity research published by brokerage firms, I read little of it, and I never rely on it. Once I'm finished with all of my other research, I sometimes pull up these reports so that I know what Wall Street is saying about a company or industry. But I'm careful to make this research the last thing I read, so that I've already formed my own impression.

5. **Discuss your investment ideas only with people who have no axe to grind.**

By now I probably sound like some weird mix of social outcast and appalling snob—refusing to speak with CEOs, sell-side analysts, or even friends with a stock idea. So is there anyone that I am actually happy to speak with about potential investments?

If I want somebody else's perspective (and I often do), I seek out the opinion of a trusted peer who also manages money professionally. I've found that investment discussions work best when they adhere to three ground rules that I borrowed from groups like the Young Presidents' Organization. First, the conversation must be strictly confidential. Second, neither person can tell the other what to do, as this tends to make people feel judged and become defensive. Third, we can't have any business relationship, because this could skew the conversation by adding a subtle or not-so-subtle financial agenda.

The goal of these conversations isn't to reach the "right answer" or engage in intelligent debate. It's to share our experiences and information. To achieve this, it helps to ask open-ended questions. For example, instead of asking what a company will earn next year, it's more useful to ask something like, "What needs to happen for it to generate a lot of cash next year?"

> My advice: Pool your knowledge with other investors, but stick with those people who can keep their ego in check.

6. **Never buy or sell stocks when the market is open.**

As a long-term value investor, my interests are in stark opposition to the interests of Wall Street, which is designed to generate trading activity that is lucrative for the firms. What I need to do is simply invest in a handful of great businesses and then stay put. Wall Street is rewarded for activity. My shareholders and I are rewarded for inactivity.

But I do need to buy or sell stocks to do my job. When I do, it is important for me to detach myself from the price action of the market, which can stir up my emotions and cloud my judgment.

> I have a rule, inspired by my friend and fellow value investor Mohnish Pabrai, that I don't trade stocks while the market is open. Instead, I prefer to wait until trading hours have ended. I then email one of my two brokers, preferring not to speak with them directly, and ask to trade the stock at the average price for the upcoming day.

Occasionally I break this rule because there's a particularly compelling reason to trade a stock during market hours. As with all of these rules, the point is not to let the rules become a straitjacket, but to have them guide my behavior in a generally healthier direction.

7. **If a stock tumbles after you buy it, don't sell it for two years.**

When a stock has surged, selling it can be a joy. But it can also be bittersweet, like parting with an old friend. When a stock has tumbled, selling it is even more emotionally fraught. Pabrai developed a rule to deal with the psychological forces aroused in these situations: If he buys a stock and it goes down, he won't allow himself to sell it for two years.

Once again, this rule acts as a circuit breaker, a way to slow me down and improve my odds of making rational decisions. Even more important, it forces me to be more careful before buying a stock since I know that I'll have to live with my mistakes for at least two years.

> In fact, before buying a stock, I consciously assume that the price will immediately fall by 50%. I then buy only the amount that I could handle emotionally if this were to happen.

8. **Don't talk about your current investments.**

Over the years, I began to realize that it was a bad idea to speak publicly about stocks that I own. Once we've made a public statement, it's psychologically difficult to back away from what we've said—even if we've come to regret that opinion.

I experienced this firsthand with a stock called EVCI Career Colleges (EVCI), which I'd bought around 2003. Within 18 months, it surged seven-fold, making it the most successful investment I had made up to that point.

At that point, I should have sold all of my shares. But I had given an interview extolling EVCI as an example of my investing prowess. As a result, I was publicly invested in the stock and couldn't part with it even though it was no longer cheap. For various reasons, the stock subsequently halved in price. In retrospect, I could see that I would have been much better off if I'd never spoken about it since this would have given me more latitude to sell once the circumstances changed.

I'm not dogmatic about this rule. If I'm chatting privately with a shareholder, I might end up talking about a particular stock that we own. But even in these private conversations, I try to remain neutral and understated.

Now, instead of discussing current holdings in my letters to shareholders, I provide a detailed postmortem on stocks that I've already sold. This gives shareholders a clear insight into how their money is being invested, but it doesn't interfere with my ability to act as rationally as possible going forward.

9. **Create your own investing checklist.**

> I am a firm believer that investors need a written checklist to stop them from making the same mistakes over and over again. I devote a whole chapter to this idea in my book, but here I'll just explain the basic idea: Make a list of all the investing mistakes that you have made in the past. Then, before you buy or sell a stock, go over your list to make sure you aren't about to make the same mistake again.

A checklist is not a shopping list of the desirable attributes that we're looking for in a business. It's a list of predictable errors. My checklist includes items like: Is a top executive going through a tough time personally that might cloud his or her judgment? Is there a key part of the company's value chain that is vulnerable? Is the stock cheap, not just based on what I think will happen in the future, but on where it is trading today?

Sometimes reviewing my checklist takes me as little as 15 minutes. But it has led me to abandon literally dozens of investments that I might otherwise have made.

My checklist includes about 70 such items and—this is important for this rule as well as all the other suggestions in this article—it continues to evolve.

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