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The real secret

Price is a clearing mechanism. It is a mass market averaging of supply and demand, incentivising whoever sets the price to maximise profit. Value is a deeply personal reflection on what something is worth. When we decide on something's value to us, we don't much care about how many people want, or have, what we want. It is the story that matters, and that is why niche markets like vinyl records will always thrive.

Capitalism works less as a set of answers, than as a set of evolving questions. Within that there are some questions that remain golden. That never get answered. Warren Buffett wrote an article in 1984 entitled *'The Superinvestors of Graham-and-Doddsville'*. It was to celebrate the 50th anniversary of the publication of Benjamin Graham and David Dodd's book, *'Security Analysis'*. Buffett looked at the track record of nine investors who, like him, had followed what they had learnt from Graham and Dodd. Different tactics, but the same underlying strategy.

While it is likely that in the long run there will always be winners who were just lucky, it is very unusual if those winners operate independently *and* profess the same underlying strategy. Other than a shared philosophy, and a personal connection to Buffett, there was no other reason they should all have done well.

Graham and Dodd's idea was that the higher the margin between price of the underlying stock, and its value, the lower the investor's risk. The *Efficient Markets Hypothesis* (EMH) claims that the only way to make higher returns is to take higher risk. The Superinvestors of Graham-and-Doddsville successfully believed otherwise.

In the cult book *'Margin of Safety'* (you can get a copy for £2,100 on Amazon), Seth Klarman said "***The real secret to investing is that there is no secret to investing.*** *Every important aspect of value investing has been made available to the public many times over, beginning in 1934 with the First Edition of Security Analysis (1934). That so many people fail to follow this timeless and almost foolproof approach enables those who adopt it to remain successful. The foibles of human nature that result in the mass pursuit of instant wealth and effortless gain seem certain to be with us forever. So long as people succumb to this aspect of their natures, value investing will remain, as it has been for 75 years, a sound*

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and low-risk approach to successful long-term investing." This paragraph is quoted in the foreword of the sixth edition of *'Security Analysis'*.

What the EMH assumes is that the investing world can be simplified into two variables: Risk and Return. You get paid for taking more risk. Great investors work hard to understand the intrinsic value of an investment, and that is a factor of Risk and Return. But neither of those variables can be reduced into single numbers. They attempt to do a better job assessing those two variables. They also look at the fundamentals of what it is the business is doing. Price is one thing, but then what you buy goes on to do something. What it does matters. There is no such thing as risk-free return. There is such a thing as return-free risk. Understanding all of this deeply requires a lot of application. If incentives are aligned, you don't get paid for adding risk, you get paid for adding value.

It is true that you can bash out popular, mass music. It is true that many active investors are just replicating their benchmark, but charging more fees. See what works, and push it out at scale. Don't be too adventurous. It is true that passive investment through indices is a solid way to get low cost access to the average returns of the benchmark you have chosen. In fact, Buffett himself says, *"If a statue is ever erected to honor the person who has done the most for American investors, the hands down choice should be Jack Bogle"* (Bogle is the founder of Vanguard and the champion of passive investing).

There will however always be space for the vinyl of investing to thrive. For the analysts who do the work because it is what they love. Who get to the juice of the stuff that can't be summarised by numbers. Who see things differently. Risk is closer to music than to maths. Like sound waves, it is a distribution of things that can happen in different situations. A combination of history, psychology, economics and chance. Yes, a good ear will be able to hear reminders of events past, but the world evolves. Businesses are constantly facing new questions. Those new questions are fascinating.

The active investor needs a sense of humility about just what a challenge it is to be one, but the secret is that there is no secret. The wealth is not instant. The gain is not effortless. In the long-term, it is worth it though.