Chapter Three: *Know Thyself*

by Nathan Polackwich

I'm not much fun to play tennis with. While I will "swing out" in practice, in games I just try to hit every shot back and keep the ball in play. And I almost never hit winners. But I win more often than I should. I started playing this way after reading the investment classic *Winning the Loser's Game* (1975) by Charles Ellis. In the book, Ellis connected investing to Simon Ramo's assertion in *Extraordinary Tennis for the Ordinary Player* (1970) that tennis is actually two different games: a Winner's Game played by professionals and very good amateurs, and a Loser's Game played by everyone else. In the Winner's Game, professionals hit good shots and *win* points. In the Loser's Game, amateurs hit poor shots and *lose* points. The way to avoid losing the Loser's Game is, as Ellis explained "to be conservative and keep the ball in play, letting the other fellow have plenty of room in which to blunder his way to defeat, because he, being an amateur will play a losing game and not know it."

Ellis believes, and I agree, that most people should play investing as a Loser's Game. His reason, however, is that with so much competition in the stock market among professional investors, the investment game has become too hard to win (and this was in 1975 so you can imagine how he feels now). My reasoning differs. I think the stock market's chaotic nature means we're all – including professionals – basically amateurs. A monkey throwing darts could get lucky and pick better performing stocks than the best professional investors for years. But the average amateur tennis player wouldn't get a game off Roger Federer! Thus, because the chaotic nature of the stock market essentially precludes the possibility of mastery, most people should approach it as a Loser's Game.[*]

What if you are one of those brave or naïve souls who wish to try their luck at playing investing as a Winner's Game? Realistically, the stock market's infinite complexity suggests that opportunities to score points will be exceedingly rare. Charlie Munger addressed the daunting nature of the task in his USC Business School speech.

> It's not given to human beings to have such talent that they can just know everything about everything all the time. But it is given to human beings who work hard at it - who look and sift the world for a mis-priced bet that they can occasionally find one…But a huge majority of people have some other crazy construct in their heads…[T]hey apparently ascribe to the theory that if they work a little harder or hire more business school students, they'll come to know everything about everything all the time. To me, that's totally insane. The way to win is to work, work, work, work and hope to have a few insights.

[*] Even if you don't plan on playing investing as a Winner's Game, many of its lessons are applicable to life in general and thus worth learning.

The fact that we can't know everything about everything means that stock-picking is inherently a half-hazard endeavor. You wander through the wilderness hoping to serendipitously discover a pot of gold. But since you can't be everywhere at once, other investors will find most of the pots before you. That's O.K. – In the stock market new pots are always popping up. You needn't act unless you're certain you've found the real McCoy. Never forget the investment maxim that "it's easier to make up missed opportunities than lost capital."

Players of the Winner's Game, then, should focus on making fewer and hopefully better decisions. Warren Buffett says that he could improve most investors' performance by giving them a punch-card with twenty slots in it, each representing one of the twenty investment decisions they can make over the course of their lives. Each time they act, a hole is punched, and once all twenty slots have a hole no further decisions can be made. Buffett reasons that with just twenty moves available, investors will put more thought into each decision, act only when a *very* significant opportunity arises, and concentrate bets on their best ideas.

You can't approach the game of investing with just a vague hope of winning. You have to find an edge and conceive a strategy to exploit it. And you must *never* stray from your circle of competence. There's an old saying in poker[*] that if you've been in the game for 30 minutes and you don't know who the patsy is, you're the patsy. So the paramount rule of the Winner's Game is "Know Thyself." As Edward C. Johnson III observed in the investment classic, *The Money Game* (1967)[†]:

> A series of market decisions does add up, believe it or not, to a kind of personality portrait. It is, in one small way, a method of finding out who you are, but it can be very expensive…If you don't know who you are, this is an expensive place to find out.

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[*] Once cited by Buffett

[†] *The Money Game* was written by George J. W. Goodman under the pseudonym, Adam Smith. In the book Goodman quotes Edward C. Johnson III, who, as of this writing, is CEO and Chairman of the Board of Fidelity Investments, a position he's held since 1977. Johnson's family founded Fidelity in 1946, but Johnson was responsible for much of its subsequent success.