# Chapter Five: *Unraveling the Mystery*

by Nathan Polackwich

In addition to connecting the Loser's Game of tennis to investing, Charles Ellis made a related argument that there are three paths an investor might choose to achieve superior investment results: the intellectual, the physical, and the emotional.

Investors that successfully pursue the intellectual path, quoting Ellis, "have a deep and profound understanding of the true nature of investing, see the future more clearly, and take long-term positions that turn out to be remarkably successful." The physical path entails attempting to outwork the competition by, for example, using the most powerful computers to gather and analyze the most and timeliest information; essentially, dedicating your life to staying one step ahead of the competition. Finally, investors might choose the emotional path of investing, which, as Ellis put it, "is simply to work out the long-term investment policy that's truly right for you and your particular circumstances and is realistic given the history of capital markets, commit to it, and – here is the emotionally difficult part – hold on."

There is a link between the Loser's Game and the three investment paths: Those pursuing the emotional path have acknowledged that, at least for them, investing is a Loser's Game, and thus try to keep things simple and their mistakes to a minimum (play defense and keep the ball in play). Those pursuing the intellectual and physical paths are attempting to play a Winner's Game, albeit with differing offensive strategies.

Which offensive strategy should players of the Winner's Game use? Ellis contends that the physical path is futile because it's too crowded and competitive. Here again I agree with Ellis but for differing reasons. In my view the weakness of the physical path is that its basis is determinism, which, as was discussed in Chapter 2, is the idea that everything has a cause and by breaking each one down you can "determine" the outcome of a system.

Recall Edward C. Johnson's advice that successful investing requires knowing who you are. His reason, as quoted in *The Money Game,* was that

> The market…is like a beautiful woman – endlessly fascinating, endlessly complex, always changing, always mystifying...[T]his is no science. It is an art. Now we have computers and all sorts of statistics, but the market is still the same and understanding the market is still no easier…There are no formulas which can be automatically applied. If you are not automatically applying a mechanical formula, then you are operating in this area of intuition…or judgment.

Johnson is neither the first nor the last great investor to say that investing is an art not a science. And he's right. While determinism is the foundation of traditional or Newtonian science, we know that in practice the stock market's chaotic nature makes determinism impractical. Thus, stock-picking is an art-form requiring intuition and sound judgment. It is an intellectual, not physical, endeavor.

Judgment is at the heart of the intellectual path and the key to success in the Winner's Game. Consider Warren Buffett, the best and most recognizable example of an "intellectual" investor. Buffett reportedly doesn't have a computer, stock-quote machine, or even a calculator in his office. Yet somehow he has consistently managed to achieve mind-boggling investment results. Clearly, it wasn't the *amount* of information Buffett had that allowed him to best his peers, but how he *applied* the information he did have.

This question of information amount vs. application is at the center of the distinction between a puzzle and a mystery, something Malcolm Gladwell noted in a recent *New Yorker* article.

> Osama bin Laden's whereabouts are a puzzle. We can't find him because we don't have enough information…The problem of what would happen in Iraq after the toppling of Saddam Hussein was, by contrast, a mystery. It wasn't a question that had a simple, factual answer. Mysteries require judgments and the assessment of uncertainty, and the hard part is not that we have too little information but that we have too much.

The question of which stocks will provide the highest future returns is also a mystery. With the advent of the Internet and public companies now providing highly detailed and generally accurate financial reports, investors today are drowning in information. Thus, there is no missing puzzle piece, and it will be the quality of your judgment that will determine your success in unraveling the stock market's mystery.