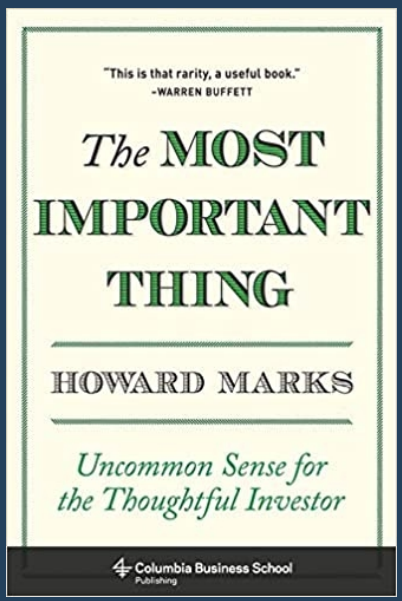

The Most Important Thing

Year of publication: 2011
Author: Howard Marks
200 pages

Have you ever asked yourself what is most important to an investor? Knowing maths? Being courageous? Reading a lot and being connected to the events? That's what Howard Marks, one of the most respected investors on the financial market, including Warren Buffett, teaches throughout the book "The most important thing".

Here you will learn, based on more than Howard Marks fifty years of experience, there's no one most important thing to investors, but at least twenty most important things!!

Score

9

9 Aplicability
9 Inspiration
9 Innovation
9 Impact on results
9 Structure

Main ideas of the book

- In investing, most people consistently do the wrong thing at the wrong time. We must be wary of common sense;
- We must understand market cycles;
- Not respecting risk is a recipe for failure;
- Avoiding a bad investment is more important than taking advantage of a good opportunity;
- The best basis for a successful investment is to know how much what we want to buy is worth;
- We must recognize our ignorance about the future.

To whom is this book indicated?

The book "The most important thing for an investor" is suitable for those who want to understand, through a mature perspective, how the investment market works.

Overview of the book

Overview: Second level thinking

"Investing, like economic science, is more art than science."

According to Howard Marks, for an investor to consistently achieve above-average results one characteristic is required: second-level thinking. What does this mean? Thinking differently, not settling for the obvious and seeking answers to questions that not everyone asks.
An example Howard brings is this: while people with first-level thinking deem "The assets of such and such a company are going down, let's sell!" The second-level thinker thinks "Let's buy! Profits will indeed fall, but less than everyone expects, and this good news will make the stock appreciate."
We need to develop the ability to think better than the consensus. This is not easy, so we need to have exceptional analytical skills, foresight, or perception. These skills will be used to measure the intrinsic value of an asset, as we will see in the next section.

Overview: Value and price

The golden rule of investing is to buy low and sell high, but how do you know what is "high" and what is "low"? Through intrinsic value. It gives investors insight into what the stock is worth, and when its price is below or above this value.
In this logic, Howard Marks supports a style of investing called value investing. This style is based on "buying something for less than it is worth". Since value exerts a magnetic attraction on price, buying cheap will eventually make the asset appreciate.
Howard states that there is no such thing as a good deal that doesn't depend on price. For him, you can only sell well what you buy well. So, any asset can be a good deal if it is bought at a low enough price.
The author admits that buying cheap is not foolproof - because we can make mistakes in the analysis of intrinsic value - but it is our best chance.

Overview: Risk - how to understand, recognize and control

In the book "The most important thing for an investor", Howard Marks states that risk is the essential element for making investments, there is no success for long without taking it into account. We must, therefore:

1. Understand it;
2. Recognize it;
3. Control it.

1. Understand it

Investment returns tell only half the story about it. You have to analyze the risk taken to achieve that return. This analysis Howard Marks calls "risk-adjusted return". If the return was good but the risk was high, there is no merit of the investor.
In this sense, Howard says that there is an illusion that riskier investments produce higher returns. For this to happen, they couldn't be riskier.
This is made clearer by the author's statement: "Risk is first and foremost the probability of losing money".
Thus, the author defines risk in one word: danger.
But how is risk measured? Marks states that it is nothing more than a matter of opinion, as much of the risk is subjective and invisible. There are quantitative ways to calculate it, such as the Sharpe Ratio, but it will never be as good as the opinion of good investors.

2. Recognize it

The main source of risk is participating in trades where asset prices are high. By doing so, Howard states that you are likely to buy the asset priced above its intrinsic value and end up losing money in the long run.
The author explains that, unlike common sense, to recognize the risk of an asset we should look at its price, rather than its quality. Two points are discussed in this regard:

- If there is a general opinion that an asset is of low quality, its price falls, and consequently, its risk decreases.
- When everyone wants an asset because it appears to be of quality and gives a certain return, the price of the asset rises, and it becomes riskier.

3. Control it

Howard Marks says that the job of an investor is to take risks intelligently. Since risks are inevitable in most investment strategies, a good investor must control them, that is, take them:

- At the right time;
- Under the right circumstances, and;
- At the right price.

According to the author, we must control them even if they do not manifest themselves, because in bearish moments they appear.

Overview: Cycles

Howard says that most of the time the future will look a lot like the past, and will have up cycles and down cycles.
In this sense, one of the biggest mistakes investors make is to insist on extrapolating current events into the future, thinking that a trend will continue indefinitely. Howard summarizes this concept in two rules:

- Rule No. 1: "most things behave cyclically";
- Rule No. 2: "big win-loss situations occur when people forget Rule No. 1".

This became clear for example in the 2008 crisis. Before the crisis occurred, investors were so optimistic that they thought that there was no way the scenario would change and that growth would be permanent.
Thus, they were too tolerant of risk and put everything at risk, practicing stock values out of touch with reality.
With the crisis that followed, the thinking was reversed. It was a consensus that the scenario would only go from bad to worse, and that there was no solution to the disaster that occurred.
In both cases, of growth and crisis, the concept of cycles was forgotten. We should not be so optimistic when the market is growing, nor be so pessimistic when a crisis occurs, because the cycle will prevail and the situation will reverse at some point.
Howard exemplifies this predominance of cycles with the figure of a pendulum. It is always moving towards one of the two extremes and rarely stays in the middle.
The importance of recognizing this movement lies in the advantages it offers to those who know how to recognize it and prepare for it.

Overview: Negative influences

According to Howard Marks, in investments, most mistakes do not originate in factors linked to information or analysis, but in psychological factors that he calls negative influences:

- Greed: is one of the strongest negative influences, it is capable of ignoring prudence, reasoning, fear, memories of painful past lessons... In short, it makes us ignore all the elements that keep us out of trouble;
- Fear: is the opposite of greed. Marks defines it as panic, very common in crises, which prevents investors from reflecting and making the right decision;
- People's tendency to discard logic, history, and traditionally established models: The author maintains that this is usually due to greed, and quotes John Kenneth Galbraith, regarding the "extreme brevity of financial memory": "there are few areas of human endeavor where history is worth as little as in the world of finance;
- Tendency to conform to the herd view: It is difficult for us to sustain a position contrary to that of the majority, but this is what will guarantee us the highest profits, as we shall see later;
- Envy: Most people find it extremely difficult to observe other people making money, and end up making hasty decisions because of this;
- Ego: seeing yourself in front of other investors making profits in the short term can be difficult, but Howard is categorical: it is a premise for achieving solid and constant profits in the long term to keep your ego under control, being prudent and controlling risks.

Finally, Howards Marks states that these are widespread and constant mistakes. An investor needs to recognize and combat them. None of this is easy, but, as Charlie Munger quotes, "it's not meant to be easy."

Overview: The contrary point of view

"*In investing, most people consistently do the wrong thing at the wrong time.*"

Howard Marks states that the great opportunities are in what others don't notice. When everyone is panicking, selling their stocks, it takes courage to buy them. When everyone is buying wildly, the courage is in selling them.
In summary, the author states that most people are optimistic in the highs and pessimistic in the lows. We should be wary of these two behaviors, and act oppositely. This is what will allow us to take advantage of bargains, as we will see below.

Overview: Finding Bargains

According to the author, bargains are assets that most people think are worse than they are, which causes them to be underpriced. To identify them one needs to put second-level thinking into practice, and identify where others are going wrong in their analysis.

Overview: Patient opportunism

According to Howard Marks, in investments, there is only one real penalty that can occur: making investments that can generate losses. Therefore, it is more important to wait for the right opportunity to appear than to miss one.
It's like in a baseball game you don't have to hit every ball. We won't be eliminated by missing good opportunities, we can wait until a spectacular one comes along. If that opportunity doesn't come, we have to be patient. Acting when there is nothing to be done can only lead to losses.

Overview: Knowing what we don't know

According to Howard Marks, knowing what we don't know is literally being aware of what we don't know. This consists of recognizing that our knowledge about the future is limited, and that if we do not recognize this we are in great danger of making a mistake. In this sense, the author is convinced of two things:

1. It is not at all easy to know what the macroeconomic future holds;
2. Few people have any special knowledge about it that gives any real advantage in investments.

Howard's tip is to try to know the specific realities of specific segments or businesses. This way the chance of making a correct prediction will be greater, and it will be possible to achieve concrete advantages. Diversifying actions among market segments, companies and regions is also a tip from the author to prepare for an uncertain future.

Overview: Understanding our position

In the book "Most Important to an Investor", Howards Marks places great importance on cycles for investment success, as seen earlier.
By understanding where we are in the cycle, we can get valuable insight into the future, and we can avoid heading with the herd toward failure.
To discover that position, understanding and knowing the factors of the present is essential. Therefore, Howard states that we should stay aware of everything that is happening around us and make decisions accordingly. Examples of analysis we can do are:

- Is the asset price high or low?
- Are investors optimistic or pessimistic?
- Is the market difficult to access or open to anyone?
- Are interest rates high or low?
- What are the trends for the moment?

Overview: Appreciating the role of luck

Howard is sincere when he says that much of the success of investors depends on luck. Chance can bring down good strategies, and benefit other not-so-good ones. Because of luck, the author states that it is easy to confuse things like:

- Luck and skill;
- Theory and reality;
- Bad investors and good investors.

Marks states that we should therefore consider the world as an uncertain place, where luck can change the game. This way we will have many benefits, such as:

- Invest defensively;
- Focus on avoiding pitfalls;
- Beneficial respect for risk.

Overview: Investing defensively

"*There are old investors and bold investors, but there are no old and bold investors.*"

With this sentence Howard Marks begins this chapter, making it clear that investors with aggressive strategies do not sustain themselves in the long run.
Marks advocates a style called defensive strategy, in which success consists not in taking winning actions, but in avoiding losing ones. In this way, it is possible to maintain steady growth and stay in business.
The author summarizes the defensive posture in three words: "investing with fear", which consists of taking some actions, such as:

Use rigid standards for buying and selling stocks;
Demand low prices;
Be wary of overly optimistic forecasts;
Carefully diversify the portfolio.

Overview: Avoiding traps

Here Howard brings up another source of pitfalls to avoid, in addition to the psychological factors and analytical errors discussed earlier: lack of imagination. By this, he means a lack of vision to understand the correlation between assets - how much one asset influences another.
Without understanding this influence, we do not know if the portfolio diversification we have made is effective, and a small shock in the market can put everything at risk

Overview: Adding value

Howard says that the performance of good investors is asymmetric; they don't follow the market, but outperform the market by adding value.
An aggressive investor who knows how to add value maximizes gains in a rising market and doesn't lose as much when it's down, for example. A defensive investor, on the other hand, follows the market, when it is up, and outperforms the market, when it is down.
This is only possible through second-level thinking, understanding cycles, and the other most important factors for the investor that are discussed in the book.

What do other authors say about it?

n the book "**The Intelligent Investor**", by Benjamin Graham, the father of value investing, the author also addresses that investments should not aim at the short term, but at constant and sustainable growth.

According to Tony Robbins, in his book "**Unshakeable**", we also need to "know what we don't know", and focus on what we can control. He sustains that we need to center on the defensive type of investments, looking for asymmetric investments - the ones with limited risks with good returns. He additionally suggests that we should diversify efficiently.

Also, in "**The Dumb Things Smart People Do with Their Money**", Jill Schlesinger addresses the most common mistakes to be avoided with money, and how parents and children can maintain a financially balanced routine.

Okay, but how can I apply this in my life?

- Study the assets you are investing in to find out their intrinsic value;
- Respect the risk, it can ruin any investment;
- Understand the cycles, and evaluate the present situation to measure where you stand;
- Work from the opposite point of view, and avoid doing "what everyone else is doing";
- Seek to understand how psychological factors are influencing your investments.

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