RICHARDSON GMP

TOUCHSTONE NEWSLETTER

Richmond | Goodman Wealth Management

Wikivesting

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Between our two families, we have been blessed with 5 sons. As you might imagine, or experience yourself, we have a fair bit of testosterone rampaging through our homes - keeping several local painters/drywallers in business. The wide range in their ages has also allowed us to experience the evolution of how school homework is completed. In our day, we would rush home to complete our homework (ok that might be stretching the truth a little bit) in the hope of heading out on the street to play ball hockey until dark. We knew that if it was history or geography that night, it would take even longer as we searched the Funk & Wagnalls for maps and answers.

Our eldest children, while having the advantage of the internet, at first still had to "search" for answers as the concept of aggregating information on one site was not yet "invented". However, it wasn't too long after that when included on each assignment was a teacher's note: "students are not to use Wikipedia to complete their work". As parents we had no idea what a "wiki" was, and so started our own investigation to see why this was taboo.

It quickly became evident that Wiki is a modern day Funk & Wagnalls…which on the surface shouldn't pose a problem as we all need encyclopedic material. Upon further study though, one of the main reasons it was frowned upon was because Wikipedia relies on a *collaborative* approach to providing accurate information. Hence, in the eyes of the school board, it could not be trusted to be 100% accurate. The fact that Wikipedia explicitly is not designed to provide correct information about a subject, but rather only present the majority "weight" of viewpoints, ***may*** lead to false conclusions.

As with many new things that are feared at first, sentiment tends to mellow. No longer do we see teacher warnings on the homework to avoid Wikipedia. Perhaps it is that we don't *want* to see the warning, for the work has progressed far beyond the part of our parental "lobe" dedicated to high school academics (it's been replaced with topics such as "how to effectively go back to sleep at night after nature calls"). The reality – we think - is that the concept of an unemotional and collaborative approach gets it right *most of the time.* Further, that a critical analysis of potentially imperfect information is a good habit to get into (ie. don't believe everything you read – except this newsletter).

At this point you might be asking why are these guys talking such gibberish and wondering why they aren't smart enough to do high school homework. To be honest we are often guilty as charged on both accounts. But we digress. The reason we led off our newsletter with the Wiki analogy is because we wonder why it took academia so long to accept a collaborative approach to knowledge, for the investing world has been doing this since the genesis of stock exchanges.

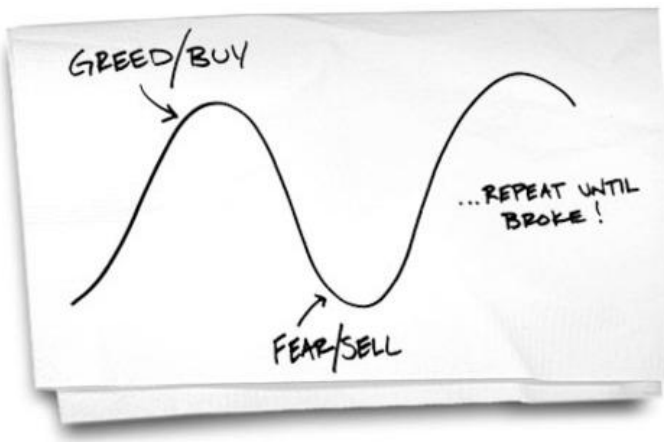
Collaboration – works just fine…until it doesn't!

Part of the difference might be that Wikipedia is about people collaborating on things already known. On the other hand, investing is about tens of millions of people guessing about the future using known information – and doing so in periods measured in milliseconds. Inherently, investing is a game of "one-upmanship" (you won't find this phrase in Wiki) but the results are more often than not similar to the masses because it is hard to be right 100% of the time – or even close to that! It's collaboration without collaborating!

For the most part, this second by second, minute by minute battle is rather mundane. However, things get interesting every once in a while when extremes are reached. It's at these times when collaboration can become dangerous to an investor. Yet that is exactly the circumstance that most people find themselves drawn to. In our world, it's called the "herd mentality".

The image below comes from one of our favourite "reads", Carl Richards. Carl's communications are often beautifully simple, and rarely accompanied by lengthy explanations. A tribute to the phrase "a picture is worth a thousand words".

Or at least 7.



Source: Carl Richards

This simple line and seven words tell a lengthy story about one of the biggest problems facing investors – BEHAVIOUR.

One of our above mentioned sons just completed his first year of University, where one of his courses included a component called Behavioural Economics. When asked if this had something to do with acting silly in class, I was met with the same disapproving stare I received from many of *my* professors over the years. Instead, he said that it looked at how sometimes people can deviate from a standard of rationality. He referred to this as something called cognitive biases.

Eager to learn more, this demanded an analysis from Wikipedia! Several paragraphs later, it boiled down to how people process information that leads to decisions or judgements. From a long list, the "bandwagon effect" stuck out. This is purely an emotional force and has no basis at all in being efficient and disciplined.

Hence Mr. Richards' perfectly accurate depiction above about how time and again investors jump on the bandwagon – at the wrong time - regardless of its direction. Yet despite this being well documented, the effect is overpowering. The reason is just as simple: humans have a very short memory once they start to see a string of gains or losses. They assume that current great (or terrible) times will last forever.

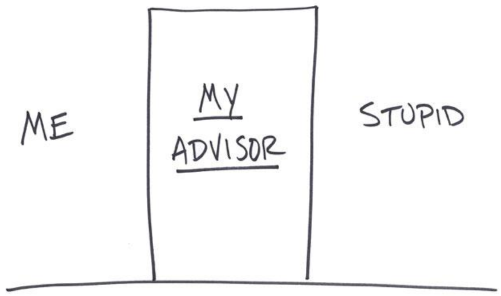
That's where we come in as your advisors.

"Luck is what happens when preparation meets opportunity"

(Anonymous)

Our responsibility is partly to provide an objective sounding board for all those times when the market becomes a roller coaster and clients either want to jump ON the bandwagon (when greed takes over), or jump off (when fear reigns supreme).

In other words, and in stealing another Carl Richards sketch below, we are here to stand between our clients…and the stupidity of the herd mentality. This is most valuable *at the greed/fear extremes* when, unlike Wikipedia, collaboration is a *bad* thing. We use tools to identify the collaborative traits in the market and weigh the risks inherent in following (or straying from) the herd.

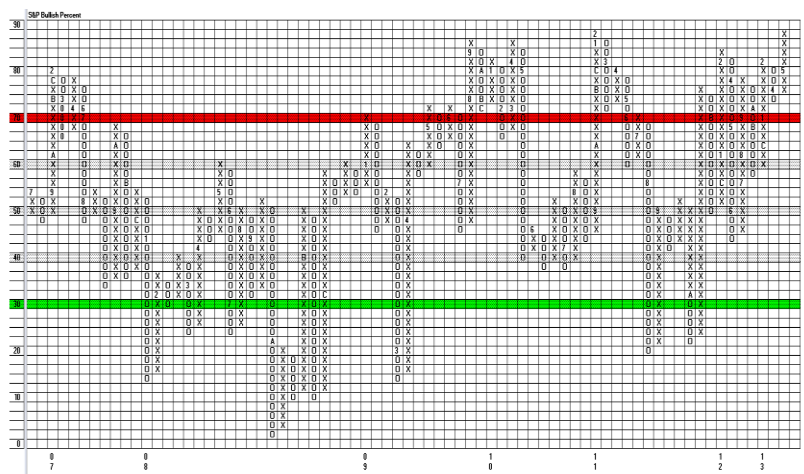


Source: Carl Richards

We'll be brief because our clients have seen this before…but it's worth repeating. Our whole investing discipline is based on identifying extreme risk "zones" in the markets. We steadfastly follow charts which we affectionately call the "X's & O's" charts. The proper name for this discipline is "Point & Figure" charting, and was developed in the late 1800's. It still stands the test of time precisely because it clearly shows the "Greed/Buy and Fear/Sell" points in a cycle.

This chart is something we use every day to see if the markets are at the Greed (red line) or Fear (green line). This is faithfully drives our decisions to AVOID collaborating with the rest of the world when they continue to act in defiance of what they should be doing. It is what has kept us ahead of our peers and allows our clients to sleep at night.

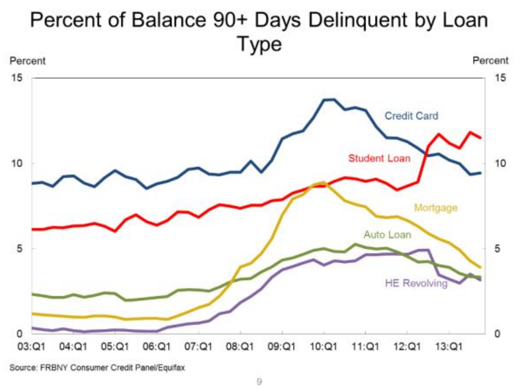
To paraphrase the quote that led off this section: We *prepare* very hard to identify opportunities to either lower risk when greed is high and look to capture opportunity when others have lost faith. That's the kind of "luck" we strive for!



Looking Forward:

It would be a grave omission not to be concerned with what is happening in the Ukraine. The only thing we are certain of is that things are changing there by the hour. But from a big picture perspective, we recall our history books and are concerned with the similarities between Putin's "approach" and that of Germany's annexation of certain regions before the onset of WWII. Back then, the sentiment was almost universal (except Churchill) that allowing Germany to take over bits of land here and there (eg. Rhineland and the Sudetenland) was of no great consequence…until it was. Thus we would prefer an early, firm approach to any plans by Putin to reverse the 1991 dissolution of the USSR. On the other hand, Putin may have to limit his nationalist tendencies in this interconnected world where economic sanctions have more teeth than they used to. Can Russia "afford" to be aggressive? Our hope is that they cannot.

Our second concern lies in an area we have mentioned before: Student loans. The picture below says it all in that while all other types of loan delinquencies are declining, student loan problems are going in the other direction.



The student loan problem may have greater repercussions for the economy than the housing problem did. Student borrowers are delaying major life decisions, like buying a home or car, as a result of their student loans. What's more, unlike other debt, most student loan debt can't be forgiven in bankruptcy.

We certainly don't want to end things on a "downer" so we want to convey to you that as it stands right now our primary risk measure is not flashing warning signs for the North American equity markets. Granted, this cannot take into account things like sudden twists in the Ukraine, but we do remain optimistic for a slowly growing economy on the back of low interest rates. American consumers are steadily improving their situations (eg. also depicted in the chart directly above), although by no means are they on a clear path. In the meantime, we are still finding investable ideas that provide an acceptable reward for the risk taken.

And finally, we leave you with one final quote to underscore the importance of not following the herd at times:

"If I had asked people what they wanted, they would have said faster horses"

- *Henry Ford*

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