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Cut through the drama, follow the data

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The brain takes refuge in easy stories.

Why is it that almost all fund managers are more lyricists, less intelligent investors?

“Human beings aren’t rational animals; we’re rationalising animals who want to appear reasonable to ourselves,” said the famous social scientist, Elliot Aronson, author of *The Social Animal*. The world around us is a bewildering medley of pure noise. In such a chaotic daily environment, the brain’s protective mechanisms kick in, and takes resort in under-analysed, oversimplified, lazy opinions. The brain takes refuge in easy stories. Data and facts are given the short shrift, because the world always wants a “story”.

Professional investment managers aren’t robots (yet). They are human and love stories. And stories sell. With greater amounts of data being available, the need to “storify” has increased even more. When a fund manager paints a superficial yet magnificent vision of why a particular management has a Midas touch, it is almost always a ‘story’, that has been airbrushed so perfectly that no other room for interpretation, or no other future trajectory can even be mentioned, for fear of attracting contempt. Remember how one could never question IBM, as a stock, at a distant point in history?

So why is a strategy based on ‘storification’ so risky for investors?

Because when a fund manager gives their holdings a golden future, they ignore discordant, inconvenient, conflicting elements (industry cycle, favourable policy, plain luck). In other words, they ignore the risks inherent in every single company or industry on this planet.

Storification is dangerous because it paints a risk-free world; unfortunately, there is no such thing as a risk-free world. True investment greatness is knowing deeply all risks present in a given investment, and then deciding what is acceptable risk and what is unacceptable risk. Storification, on the other hand, increases attachment to that story. Once an investor or fund manager becomes emotionally invested to a particular stock (eg, ARK Investment to Tesla), they find it impossible to detach themselves from their attachment, even when the facts change.

Love in investing is dangerous. This is exactly what happened with Warren Buffett and his Coca-Cola investment. He should have sold this stock several years before he actually did. The data is brutal: Coke has been a rabid underperformer since 1993. Buffett should have bought Pepsi instead of Coke. He couldn't sell because he had storified this stock and its management massively.

In India, you would have heard the talk that you cannot go wrong buying 'blue chips' or consumer stocks with strong brands, moats and cash flows that are predictable for decades. This story is seductive. And untrue. Heard of Gillette India, ITC and Colgate? They used to be part of this list of storied, branded consumer companies. Then their stories went sour, and, very quietly, they went out of the list of these so-called compounders.

When Steve Jobs died, Bill Gates said, "Steve and I will always get more credit than we deserve, because otherwise the story gets too complicated." Which brings us to the next point: should you dismiss a story only when it is based on no facts at all? Actually, the really dangerous stories are the ones that are true in one tiny part, where a small bit of truth is used to build a whole edifice.

In investing, there are always known unknowns. Fashion changes, health trends, new product disruptions, policy changes, etc. Things are rarely linear in real life for a large basket of companies. But they will always appear to be linear for company selected with complete hindsight or a selection of the survivors.

Based on these survivors, a vision of the future is painted in which absolutely everything is perfect, whereas the reality is that, beyond a point nobody, knows anything about anything. Neither company management nor fund managers have any clue about what happens a few months down, let alone years.

All this means that the key to being a good investor is being alert and flexible, rather than being married to a story you have built up in your mind. Always follow the data.