The Secret to a Peaceful Investing Journey

Sheetal Malpani & Tejas Gutka

In a recent study done in the US, researchers looked at how teens were spending their free time and which activities correlated with happiness, and which didn't. The researchers analyzed data of over 1 million teens from a nationally representative survey of 8th-, 10th- and 12th-graders that's been conducted annually since 1991. The following is a summary of the findings of the survey:

> *"Every year, teens are asked about their general happiness, in addition to how they spend their time. It was found that teens who spent more time seeing their friends in person, exercising, playing sports, attending religious services, reading or even doing homework were happier. However, teens who spent more time on the Internet, playing computer games, on social media, texting, using video chat or watching TV were less happy.*
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> *In other words, every activity that didn't involve a screen was linked to more happiness, and every activity that involved a screen was linked to less happiness. The differences were considerable: Teens who spent more than five hours a day online were twice as likely to be unhappy as those who spent less than an hour a day."*

While the above study was for teens in the US, we can safely assume that the same can be applied to the larger population across the globe. In fact, the authors of the study had previously found that adults over age 30 were less happy than they were 15 years ago. They summarized their findings as follows:

> *"Recent adolescents reported greater happiness and life satisfaction than their predecessors, and adults over age 30 were less happy in recent years. Among adults, the previously established positive correlation between age and happiness has dwindled, disappearing by the early 2010s. Mixed-effects analysis primarily demonstrated time period rather than generational effects."*

One of the biggest blessings of the Internet has been easy access to information – from personal health and well-being to the selective broadcasts from family, friends and neighbours. However, there are two problems that arise out of this – a) an information overload and b) envy.

Information Overload

The Internet provides access to an abundance of information. However, our capacity to process such information is limited. Thus, when faced with an information overload, we cannot differentiate signal from noise. We consume information thinking that it is signal, whereas in reality it could very well be noise. This inability to differentiate between signal and noise hampers our decision-making ability. Consider the following excerpt from Nassim Taleb's book *Antifragile*:

> *"Imagine someone of the type we call neurotic in common parlance. He is wiry, looks contorted, and speaks with an uneven voice. His neck moves around when he tries to express himself. When he has a small pimple his first reaction is to assume that it is cancerous, that the cancer is of the lethal type, and that it has already spread. His hypochondria is not just in the medical department: he incurs a small setback in business and reacts as if bankruptcy were both near and certain. In the office, he is tuned to every single possible detail, systematically transforming every molehill into a mountain. The last thing you want in life is to be in the same car with him when stuck in traffic on your way to an important appointment. The expression overreact was designed with him in mind: he does not have reactions, just overreactions.*
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> *Compare him to someone with the opposite temperament, imperturbable, with the calm under fire that is considered necessary to become a leader, military commander or a mafia godfather. Usually unruffled and immune to small information —they can impress you with their self-control in difficult circumstances. For a sample of a composed, calm and pondered voice, listen to the interview of*

"Sammy the Bull" Salvatore Gravano who was involved in the murder of nineteen people (all competing mobsters). He speaks with minimal effort. In the rare situations when he is angry, unlike with the neurotic fellow, everyone knows it and takes it seriously.

The supply of information to which we are exposed under modernity is transforming humans from the equable second fellow to the neurotic first. For the purpose of our discussion, the second fellow only reacts to real information, the first largely to noise. The difference between the two fellows will show us the difference between noise and signal. Noise is what you are supposed to ignore; signal what you need to heed.

Indeed, we have been loosely mentioning "noise" earlier in the book; time to be precise about it. In science, noise is a generalization beyond the actual sound to describe random information that is totally useless for any purpose, and that you need to clean up to make sense of what you are listening to. Consider, for example, elements in an encrypted message that have absolutely no meaning, just randomized letters to confuse the spies, or the hiss you hear on a telephone line and that you try to ignore in order to just focus on the voice of your interlocutor."

Drawing parallels to the investing world, investors or portfolio managers who can avoid noise are better off compared to those who are focused on myopic moves, monthly data, and short-term noise. This was well articulated in our previous month's newsletter, where one year of a below par summer season was short-term noise for air cooler or air conditioner stocks and not a signal to exit the long-term opportunity that the sector offered. However, investors who are too glued to the screens or the pink papers would have used this reason to offload (every 3rd or 4th year whenever summer season is below par) the stock, which otherwise has been a large wealth creator over the last 8-10 years.

"What information consumes is rather obvious: it consumes the attention of its recipients. Hence a wealth of information creates a poverty of attention, and a need to allocate that attention efficiently among the overabundance of information sources that might consume it."

— Herbert Simon

Envy

Anecdotally, people are unhappy in the age of Internet and smartphones as they remain glued to other people's lives. This brings misery as people start to envy others and eventually change their track (give up on their own independent thought and do what others are doing). This in turn leads them away from their circle of competence, resulting in more unhappiness and misery. Looking into other people's lives especially via social media makes us think on a relative basis rather than on an absolute basis. It leads us to indulge in a consumption pattern beyond our means just to have social approval which may impact our health or finances over medium term. For instance, a recent working paper claims that neighbours of lottery winners tended to spend more on conspicuous goods, put more money into speculative investments such as stocks, borrow more money, and eventually, declare bankruptcy.

Similarly, in investing we start to view stocks relatively (looking at other people's portfolio performance, focusing on noise, watching every 10% move on the most talked stocks) and indulge in churning the portfolio to catch the next best stock. This exercise barely results in alpha creation as we try to capture on short-term noise patterns while missing out on long-term signal and patterns. For example, many times, investors sell the leader of the sector because it has become expensive and buy the 3rd or 4th largest player within the same sector as valuations are relatively more attractive than the leader. However, such a strategy rarely works. We believe absolute return investing is always fruitful despite short-term anxiety of portfolio underperformance, which we have realized is a part of the game.

"Envy is a really stupid sin because it's the only one you could never possibly have any fun at. There's a lot of pain and no fun. Why would you want to get on that trolley?"

- Charlie Munger

The big lesson for investors here is that both information overload and envy can derail the process of long-term compounding. We think the more information we consume, the more signal we'll consume. Only the mind doesn't work like that. When the volume of information increases, our ability to comprehend the relevant from the irrelevant becomes compromised. We place too much emphasis on irrelevant data and lose sight of what's really important.

The best way to understand noise is to read newspapers and magazines that are more than a year old and evaluate the importance of the headlines as on date. You'd realize that there is more noise than signal there. The solution, of course, is not to become completely passive. Instead, the solution is a familiar adage: everything in moderation; ration the supply of information as much as possible.

The next time you read a sensational headline, think about whether the impact is transient or permanent – i.e. is it really a signal or a noise. Follow the underlying thesis of the investment decision, don't overreact to noise which is transient in nature but look for pointers which are unconfirming to your thesis. Remember this the next time you think about elections, the Union Budget, or the monsoons.

Similarly, focus more on your long-term rate of compounding rather than the short-term returns of your peers. Both investors and money managers lose the most money in trying to beat their peers rather than achieving a reasonable rate of return. Think about the investor who bought technology stocks in 2001 because his/her peers made a lot of money in them, or who bought infrastructure and real estate companies in 2008 because everybody was making a fortune in them.

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