

Focus on the ‘Knowable and Important’: That’s the Strike Zone

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In ‘The Secret to a Peaceful Investing Journey’, we touched upon information overload and the need to differentiate between signal and noise. We take that idea further this month and present some tools to demonstrate how an investor can differentiate between the two.

An occupational hazard of a career in the equity market is facing an open-ended question in the form of ‘*kya lagta hai (what do you think)?*’ From peers to relatives to schoolmates, everyone’s curiosity is piqued the moment they realise that my income is somehow derived from the stock markets. This casual inquiry about my thoughts is often a conversation starter at family gatherings and an ice breaker at social events. My moment of glory, however, is quashed by my own confession, ‘I don’t know’. I am usually offered a front row view of my image travelling from that of a sage to amateur at the speed of light. An awkward anticlimax.

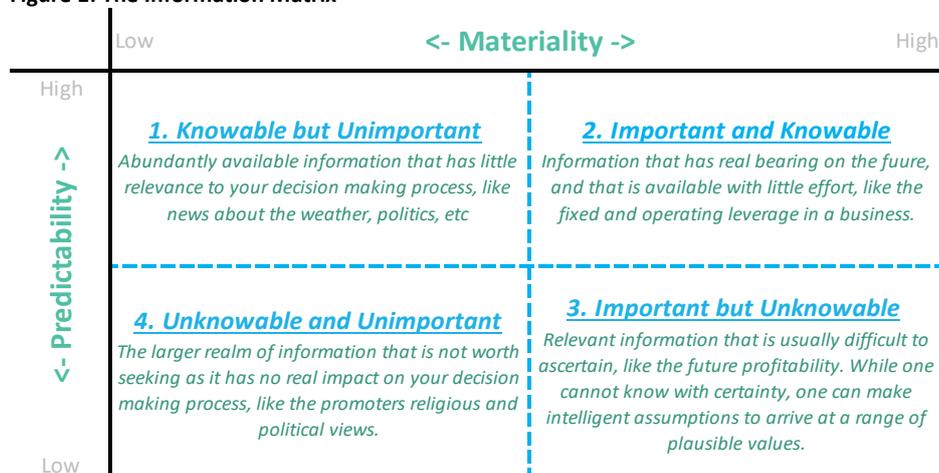
The truth is, nobody knows! Indeed, self-proclaimed experts always have an opinion and a rationale to back it up. The media glorifies these opinions (especially the ones that have gone right) and the general public spends an inordinately long time discussing and debating these. We believe most of these opinions are most likely nothing but educated guesses. The question is not whether someone knows what the future holds, the question is - does it matter and how does he/she really know? Those are the questions that nobody pauses to ponder upon – is it material and is it predictable?

In his 1998 talk at the University of Florida, Warren Buffet, while responding to a question on macroeconomics said the following:

“I don’t think about the macro stuff. What you really want to do with investments is figure out what is important and knowable. If it is unimportant and unknowable, you forget about it. What you talk about is important but in my view, it is not knowable...we have never either bought or not bought a business because of any macro feeling of any kind. We don’t read things about predictions, about interest rates or business or anything like that because it doesn’t make any difference.”

This is as relevant today as it was then. In fact, it is more relevant today in the hyperconnected age of unlimited information. In order to remain sane, it is even more important today that we screen all information through the predictability and materiality filter.

Figure 1: The Information Matrix

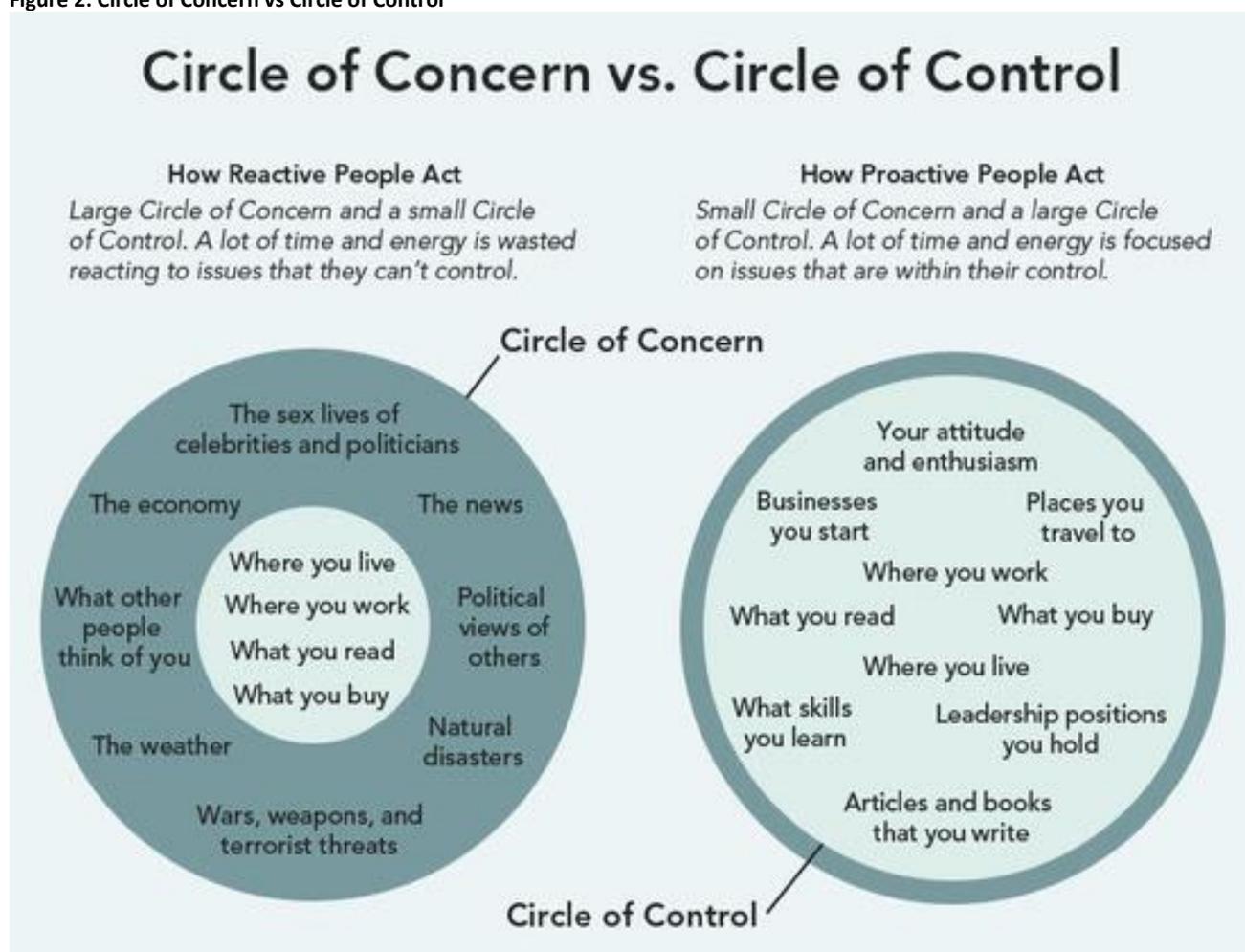


Source: Tamohara

The above quadrant represents information viewed through the lens of materiality and predictability. While the explanations make it clear that what we should focus on are 2 & 3, typically what grabs our attention is 1 & 2. This is because information that is freely available is easy to grab, while we need to work hard to estimate that which is uncertain. Thus, we approach information from a *reactive* perspective – we react to that which is thrown at us. You hear news about fraud, murder, robbery etc and you react with disgust. Similarly, you read about traffic jams and global warming, and you curse the governance bodies. While it is important to be aware of your surroundings, it is by no means helpful to simply be reactive even though it may be our default setting. There is another way to live – being *proactive* i.e. seeking out information that is relevant and actionable rather than simply available.

Stephen Covey, in his famous book *'The 7 Habits of Highly Effective People'*, explains this by talking about the difference between **Circle of Concern** and **Circle of Control**. As the name suggests, circle of concern includes the things that concern us. These are also the things that we have little control over. On the other hand, circle of control includes things that we can influence. Clearly, news, political scandals, gossip, social media trolls etc fall in the circle of concern. On the other hand, how much of your income you can save, how you behave in the different phases of the market etc fall in the circle of control. The following graphic depicts two different variations of the circles of concern and control.

Figure 2: Circle of Concern vs Circle of Control



Source: James Clear (jamesclear.com)

On the left is how most of us approach the two circles, while on the right is how we should approach the two circles. By clearing out the clutter of abundantly available non-relevant information, we can create more bandwidth to focus on the things that really matter. Thus, rather than chasing expert opinions on the direction of the markets or macroeconomic forecasts, or checking prices five times a day, investors would be better off focusing on the things that really matter in investing – their investment horizon and financial behaviour.

A better way to think about this is to think in terms of US President Eisenhower's decision-making principle, also popularised by Stephen Covey in the same book. As per Eisenhower, there are two types of problems/activities – **Urgent** and **Important**. Urgent means tasks that require immediate attention, things that shout 'NOW'. On the other hand, Important tasks are things that contribute to our long-term goals. In terms of information, urgent is akin to the breaking news flashed by media all day long. The shelf-life of this "news" is only a few minutes. It will likely not matter a few months or a few years down the line.

For an investor, value-addition lies in determining news flow that can have an impact on the long-term hypothesis underlying his/her investments. Accessing the long-term prospects of the business will be far more financially rewarding than analysing quarterly variances. Understanding the management's past actions and capital allocation decision will go a long way in helping make the right investment decision rather than celebrating the impact of a 25bps interest rate cut on the next year's EPS. Staying away from the short-term noise is like avoiding bad company – don't shy away from it.

Time is an asset that is in short supply; do not waste it in chasing answers to questions that have no relevance other than now. The next time someone gives you an opinion on a short-term event, say, 'If it won't alter my long-term hypothesis, it's not worth my time'. **Focus on what you should know rather than what you can know, because that is the strike zone for investors.**

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