FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

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Fishing for Returns

Time is but the stream I go a-fishing in. ~ Henry David Thoreau

I grew up in Lake County, Florida, which is named for its over 1,000 lakes. Our home was surrounded by a large lake and a network of canals, and we had a Summer place on the largest lake (with more canals), so I spent a LOT of time fishing, often with other boys. We primarily fished for largemouth bass, followed by bluegill and bream, and sometimes specks (speckled perch, or crappies as the Yankees called them) in the Spring.

I have found that fishing is very similar to investing. It taught me some of the key lessons I needed to learn to become a successful investor:

***Get up early*.** We used to get up and head out at the crack of dawn, while everyone else was still asleep. As an investor, you should get up early, check the futures market, read the news and be ready for the market open at 9:30.

***Avoid competition and crowds*.** The poor people fished at public parks and under bridges, because they didn't have access to a boat, a dock or lakefront property. We never wanted to fish in such places because we knew they were "fished out." The best place to fish was a small or medium-sized lake that no one ever fished in. The less accessible the body of water, the better.

In a world of uncertainty, humans use a couple of heuristics that you often see among fishermen. First, if a fisherman sees a number of other fishermen in the same area, he often assumes that the fish must be biting there. Humans are herd animals, and for millennia (but not today on Wall Street), usually the safest thing to do was to imitate everyone else. Second, after a fisherman lands a large fish, other fishermen often (comically) immediately cast their lines near the same spot, an example of recency bias.

To see whether an investment fishing spot is "fished out," I created two metrics for each of the 1,500 stocks I track: market cap/followers and market cap/analysts. Market capitalization (the market value of a company's stock) is an imperfect measure of a company's size since it reflects its valuation (which can vary widely). For the number of followers, I use the number of investors who follow the stock on a website that's popular with more sophisticated investors. Analysts is the number of Wall Street analysts who cover the stock (which reflects investor interest). These two ratios can vary dramatically between stocks. For example, for an investor favorite such as Petmed Express, the ratios are less than 1 and 1. For an unsexy company such as Becton Dickinson (a $71 billion company that makes medical surgical supplies), the ratios are 21 and 48. In which of those two fishing holes do you think you're more likely to find an opportunity, if one exists?

***Fish in structure*.** Most fish like to hang out around what fishermen call "structure" that provides a hiding place, shade and a habitat for their food: underwater plants, fallen limbs or trees, docks, depth changes, etc. To get to the best fishing holes, you need a small, shallow-bottomed fishing boat.

Investing in an index fund is like being a passenger on a giant trolling ship out in the deep, open water. They have to fish there because their draft is too deep to get into shallow water (where the structure is). They're just not equipped to go after the smaller fish in the canals and small coves. Sure, the ship has set out 500 different fishing lines and is fishing on an industrial scale, but there are lots of other ships trolling in the same area. They catch a few fish (*everything*, including all kinds and sizes of trash fish, turtles, gators), but not a remarkable number. So academic theorists talk about the Efficient Lake Hypothesis, and how there are just no trophy bass to be had. The experience is dirt cheap for the passengers since they don't have to buy any fishing gear or do anything else, but this type of "fishing" requires no craft, isn't interesting and lacks soul.

***If you want to catch fish, go for small and dependable*.** Catching a largemouth bass is quite exciting, but most days, you don't catch any, and almost certainly not more than two in one day. If you definitely want to catch some fish (say, if you need some for dinner or you're fishing with small kids), you want to fish for bluegill and bream using real bait. Similarly, doubling your money in a glamor stock is exciting, but it doesn't happen very often. If you want dependable returns over the long term, invest in dividend-paying small cap value stocks, where there's opportunity and dependability but not a lot of competition.

***Catch and release*.** Occasionally we would keep what we caught, clean it and eat it, but 98% of the time, we practiced catch and release. Similarly, when investing, don't wed yourself to a stock or a story. If the stock becomes significantly overvalued or its fundamentals deteriorate significantly, sell it, take your profits and move on. There are other fish you can catch.

***Use the right gear*.** If you want to fish for bass, you need a rod and reel, fishing line with a strength of at least 12 pounds, and a good lure (my favorite was a black and blue Culprit worm with a twirly tail). If you want to catch bluegill or bream, you need a cane pole with worms or crickets. Similarly, if you want to invest in bonds, bullion or REITs, you need to use a tax-deferred account to shelter that ordinary income from current taxation. If you want to invest in foreign stocks that are based in a country that withholds taxes on dividends, you need to use a taxable account so you can claim the Foreign Tax Credit.

***If nothing is biting, be patient, persistent and content*.** If you're fishing for bass, most days you don't catch anything. Similarly, in the stock market, the vast majority of the time, nothing really happens and few significant opportunities are available. That's just the way it is. Don't try to force it. Just because you want to catch a fish right now, that doesn't mean you can. Just accept it, pause to notice and savor and appreciate the natural beauty around you, and come back another day. The lake and the market will still be there.

***Keep an eye on your line*.** Fishing can be pretty boring and monotonous, and it's easy to become distracted from the task at hand. But when your bobber goes under or you feel a strike on your line, you need to be ready to set the hook. Similarly, when a large opportunity presents itself in the stock market (which happens maybe once or twice a year), you need to be ready to place trades.

***Manage risk*.** One morning we were paddling our canoe on the lake when a very large gator surfaced quite close to us and checked us out. I was less concerned about him tipping our canoe and more concerned that his huge mouth would suddenly emerge from the water and engulf my paddle arm. My dad says, "Life is all about risk management." As an investor, your primary concern should be risk management (avoiding losing money), not returns.

***Don't try to catch gators*.** Sometimes nothing would be biting (so we'd be kind of bored) and a small gator would surface nearby. A couple of times, I switched to a floating lure and tried (successfully) to catch the gator. It was fun and novel, but getting the hook out of his mouth with just my bare hands was kind of tricky. Similarly, if you get bored as an investor, don't try to catch a gator: IPOs, cryptocurrencies, pot stocks, SPACs, etc. Getting your money out of such a position without losing some of your flesh can be tricky.

***Don't get your lure caught*.** One of the suckiest things for a fisherman is getting his lure caught on a tree limb or something underwater. Once I even got a treble hook embedded in my thumb after I reached for it in my pocket, and when I was in the ER to get it cut out of me, the other treble hook on the lure got caught in the net-like shirt I was wearing. Talk about a fishing tale! As an investor, you want to ensure that you don't get your capital caught in an illiquid investment, an unprofitable business that doesn't pay a dividend, a product with a back-end load, or a security that becomes worthless.

***Avoid confiscation of your catch*.** While in Florida a couple of months ago, I was watching an osprey flying with a fish he had just caught when another osprey swooped in and tried to make him drop it. Sometimes a fisherman might have his catch on a stringer and a gator or turtle will get it. I was once fishing with a friend in a canal when an owl swooped down and tried to fly off with his Jitterbug (a splashy surface lure). As an investor, you want to avoid confiscation of your capital. This is usually done by a government (in the form of taxes or the nationalization of a company or its assets), but can occur through theft or fraud (e.g., Bernie Madoff, Enron, MF Global).

***Know what you're targeting*.** We used to use a gig (similar to a trident) to spear gar, a trash fish that had a reputation of being bad for game fish. One day I was looking around boat slips with my gig when I spotted what I thought was a mudfish in shallow water. I gigged it, but it turned out to be a 5 lb. bass! I felt terrible. As an investor, you want to know what you're buying. Does the company actually have assets, a legit product or service, sales and positive free cash flow, or are you just buying a story? I recently discovered that the furniture company Ethan Allen decided to change the ticker symbol for its stock from ETH because its stock price started going crazy after ignorant speculators started buying it when they thought they were buying the cryptocurrency Ethereum. They gigged a bass.

***Avoid stories*.** Humans love stories because for millennia, it's the only way we had to transmit information from one generation to the next. Fishing tales are a classic genre, but listening to them and acting on them probably won't catch you any fish. Likewise, forget about investment stories, especially those in the financial media. Do your own research (especially the numbers) and your own thinking, and draw your own conclusions.

***Cycles influence results*.** Towards the end of my fishing career, I started paying attention to what were supposedly the best days and times to fish, which was based on moon phases. Guess what? Moon phases also affect investors' mood. I once read about a study that found that if you had bought stocks at every new moon and sold them at every full moon, you would have significantly outperformed the market over the long term.

Go after what you can see. In the Spring, the fish would build beds in shallow water (so they were easy to see) and it was common to see a bass on or near a bed. We tried to catch those fish because we at least knew they were there, unlike what the murky deeper water may or may not contain. As an investor, if you see an obvious deal (such as a financially strong and highly and consistently profitable company that is growing quickly, pays a nice dividend and has high inside ownership, selling at an attractive valuation), you should go for it.

Use modern technology to locate opportunities. We used to fish blindly, without knowing what, if anything, was underwater. These days, serious fisherman have a high-tech sonar device on their boat to see where individual fish are so they can target them. As an investor, there are all kinds of online screens that are available to find the types of companies you're interested in. (However, their usefulness can vary considerably. For example, if you're looking for value stocks and a screen shows you the results of stocks with a low price/earnings ratio, that's not very helpful because (1) earnings are not the same thing as positive free cash flow, which is not the same thing as dividends, (2) the earnings are probably just for the last year instead of say a 10-year average, and (3) the stock may be cheap for a reason (i.e., it's a value trap.) Nevertheless, never before has more data been available to investors.

What You Should Be Doing Now

Recommended documentary: The China Hustle on Amazon Prime Video. This is excellent and illuminating, but towards the end, they (weakly) try to imply that this was the fault of capitalism, Trump and the Republicans. That if only there was more government regulation of the financial markets, this would not have happened. Um, no.

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