

Investing, risk management, and other cultures

The following monologue encompasses several subjects, and attempts to redefine several terms. It will describe the meaning of risk management, what it means to be an investor. It is an opinion and not financial advice.

I'll admit, I, like many of you, did not foresee the Chinese crackdown on tech companies. Did I think there was a shorter the leash the companies would get compared to American companies? Yes, but I did not imagine it was this short. Neither did Jack Ma, or the Chinese CEOs, shareholders, employees of Chinese tech companies.

If they didn't see it coming, we, the westerners trying to ride on the backs of the Chinese dragons, didn't stand a chance predicting it ourselves. Nassim Taleb would say this is a Black Swan, and he, just like many fund managers using this excuse while explaining to their investors why the returns this year are lower than S&P 500 are right. However, anywhere you look there is a possible looming black swan. A negative black swan and a positive one. The possibility of a financial Armageddon exists too. This is true, as the fact that at any given moment, there is a boy who cries wolf, but for some reason when they are finally correct, we call them prophets. This last habit places us in a predicament, as we have difficulty to differentiate who is a true oracle (like our good friend Warren) and who is a false prophet. It's why we shouldn't race to crown our new champions as Jim Cramer raced to call Cathie "the greatest investor of our time", or follow closely Michael Burry's moves. They might have been extremely lucky gamblers, just like anyone who made money on shorting the Chinese market this year, or calling "Tesla, Tesla, Tesla", or buying GameStop at the right time. Any of these, if they are not just lucky gamblers, could be the very best of our times. The investors are a finance version of Major League GMs, trying to win a world series. Cathie wood places all bets on swinging for the fences and signing home run hitters, Burry tries to do it solely through elite pitching.

The Big short, introduces the characters, wonderfully, not as geniuses, but simply as people who weren't lazy, by crediting their success in the film with a beautiful line to one simple action "they looked". Despite Burry being one of them at the time, since then, he's left the realm of minor leaguers and moved into the majors. Now, I do not recommend to anyone to join the game of risk management, to try and become a major leaguer. The cost it will demand of just trying to play in the league is dangerous. I always tell anyone who asks me about baseball, "80% of baseball fans don't understand the game". But I do want to offer to all those standing on the sidelines, to all those peeking in, a pair of 3D glasses, that will give the entire concept of finance new depth, investing, a new meaning. To all those are thinking of playing the game at the minor league level, a different way of thinking. Anyone who wants to be a pro will not waste their time on these lines, their eyes are deep in Graham's "Stock Analysis" or watching something by Aswath Damodaran. The Intelligent Investor was and is designed for "passive investors" or anyone who should remain a "passive investor", 90% of the population. The pros ladies and gentlemen, is no place for us mere mortals, because the cost of playing this game is way too high. It's our future, just watch a quick youtube video explaining the concept of compound interest. The catch, is that there is no escaping the game, and every human on the planet is a player.

This leads me to the idea that no one on this planet is a passive investor, therefore the terms of passive and active investors should not exist. Everyone is active about their investing decisions. You choose how to invest your time; you choose how to invest your funds based on the return you want to receive. You buy a better mattress in order to invest in better sleep, you go to school to increase

your knowledge or income, you buy shirt by a certain brand to improve how you feel, you invest in real estate or stocks to increase your income or personal wealth. Forget the terminology of active and passive too when it comes to income. Having a return on your pension fund should take work. If you're not educating yourself that you will be able to pick the best fund for you, don't be disappointed when your returns are below the market's average or below what you could have earned. Don't fall victim to the industrial era's education system, the one we use to this very day, designed in the 18th and 19th centuries to maintain socio economic classes. The system that chooses not to teach financial literacy, that focuses on calculus instead of more useful forms of math like probability and statistics. Don't fall victim to the financial system and terminology designed in the 20th century in order to keep you baffled and make detrimental financial mistakes on a regular basis so you pay high fees to professionals who aren't worth the management fees you pay. They want you to disregard the fact that you are making an investment decision every month when some of your paycheck goes to your retirement fund. If you change your fund, you should have an educated reason why you're changing funds, and if you don't, you should have an educated reason why not. You make investment decisions in how you want to invest your time (spend it with your kids or parents) or capital (a new pair of jeans or owning more shares). Most try to look away from this issue, because it scares them, when in fact, they should be trying to figure these things out. If the education system, did its job and taught them the power of compound interest in grade school, they would understand why they are all active investors, or shall I say simply, investors. So how do we call the Cathie Woods and the Peter Lynchs of the world, how do we call the guy in the office who doesn't stop talking about how he is made money on GameStop. We call them risk managers, because they are trying to get the best returns, compared to the risk they are taking on the capital they are managing, either their own, or their investors.

Risk management is an art, it something that you can mathematically quantify, but more than anything you need to have a feeling for the risk. Because the result of a mathematical equation depends on the question you are asking, the variables you are inputting. The question, is just as important as the answer. And the answer can be twisted and turned based on the meaning we want to give the numbers. The odds you call heads or tails correctly every time you flip a coin, are 50% every flip. However, if you flip a coin an infinite number of times, the odds of you getting the call right a million times in a row at some point is 100%. But we do not have an infinite amount of coin tosses in our life, and therefore the odds of anyone of us flipping a coin and calling it right a million times in a row is so close to zero it is practically zero. And if you do not understand this theoretical probability experiment, risk management is probably not for you. If the person managing your funds doesn't understand it, well, I don't need to say more about it for you to understand my thoughts on the matter.

An investment portfolio must include the concept, that a military coup in your country can happen, that a civil war can happen, that a tsunami can wipe out an economy. These things have happened before, and they can and will happen again. Amazon will perish, one day IBM will be a name in a text book, the questions are how, when and where. These are events that you can't always put into numbers. The data that you have in order to quantify the probability is flawed, hence the information you are processing into intelligent decision making is missing some important pieces to the puzzle. You have to accept that you do not see everything, in addition to the idea that your eyes might be lying to you, or your brain might be deceiving you. One has to develop a gut feeling sometimes, the same feeling that led Derek Jeter as he raced to the right field foul line on his famous flip play. He felt it in his gut that he needed to be there. That's why he is Derek, that's why nobody else is him. So, if you choose to manage risk, if you choose to play the game with the pros and not just pick the team (or the index fund) that is best for you, you must understand that in order just to

beat the average market return over 20 years, you are trying to bear the very best of a pool of 8 billion people. Every time you invest in common stock, when you buy shares of Alphabet or Salesforce, you might be playing against major leaguers. You do not know who threw the pitch, who is selling you the stock. You must comprehend that this game is so hard, that the very best choose one tiny dimension of the game in which their feelings are just as true as their analysis, because they know how little they know compared to all there is to know. Any fool can beat the market by a long shot in a given year. But it takes the very best of 8 billion to beat the market's average return on a time span of 20.

If you invest in a company in a different country, or an industry you don't operate in regularly, you have to take into account that you will have surprises. If you cannot accept a country where a government might behave in a way you did not expect or not necessarily agree with, investing in that country is not for you. If you don't accept the concept that the Chinese regime might decide tomorrow to take over Alibaba, Tencent or Baidu, and your shares might hit zero, investing in a Chinese company is not for you. What is likelihood of this happening? So close to zero it is practically zero. What are the odds of the U.S government doing the same to Facebook tomorrow? Once again, so close to zero it is practically zero. Which event is by far less likely to happen? The latter one. This however should be calculated into your portfolio. If you were asking yourself what was Jack Ma thinking when he said what he said that infuriated the Chinese government, you have to accept the probability that he wasn't thinking too far ahead. A man who managed his company under the concept of "Here at Alibaba we don't plan" is likely to behave in a similar manner. And if you bought the shares of Alibaba without knowing he said that famous quote, then you should have never bought the stock in the first place. If you are angry every time Mark Zuckerberg says I'm sorry you should not own Facebook either. You should only do business with people you accept their style of doing business. As Jimmy Iovine said about Dr. Dre after the famous Beats and Apple deal signing blunder, "I know what horse I am riding with". When doing business in a foreign land, whether it is Australia and you are Chinese, or North Carolina and you live in Montana, you have to accept the people do business differently in different places. So don't be surprised if people do business differently than you, don't be surprised that you do not understand how things operate there, or your ideas do not apply to that place. If you do not accept the way they do business (and accepting is not the same as agreeing) do not do business with them. Understand that you might be surprised for better or for worst and include in your portfolio the concept that positive and negative black swans will happen.

Investing and risk managing are journeys of self-discovery. An adventure where you change just as much as the world you live in does at the path you walk in twist and turn your whole life. You choose how to invest your time, how to allocate and utilize your capital, whether it is your intellect, your funds, or your network to get the optimal results suited for you. Everybody want to be wealthy; everybody wants to be happy. What is happiness and wealth to you and how you will achieve them? That is something that only you can decide.