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Gaia GPS for Managing Your Money

In Focus

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Today we'd like to share with you the major principles and protocols which guide us in the management of your money.

Principle 1: Don't Lose Much

It is impossible to pass any time in investing without seeing an investment lose value as we hold it. Since markets go up about 2/3 of the time, we can figure that your accounts, if they are somewhat market representative, will again rise. But one cannot have the same confidence in a specific investment. We've determined that "not losing much" is the best way we can survive downturns that we may have money to work with when things begin to brighten. Why is it practical to "not lose much"? A 30% drop in an investment, say, from $100 to $70 requires a 43% gain just to get even ($70 times 1.43). The more you lose the harder it gets to break even. A 50% loss, say from $100 to $50, requires a 100% gain to get back even. "Don't lose much" is particularly beneficial after very large gains. We set a "stop loss" high enough to preserve profits but low enough to suspect that something is really wrong but has not yet been reported.

Principle 2: Recognize the Risk and Opportunity of Every Market Cycle and Invest Accordingly

Principle 2 is wonky, but simply put it means that we want to buy what is working and sell it when it is no longer working. The "it" that we hold will vary according to the prevailing economic and investment conditions of the day. In short, there is opportunity in every circumstance if you but seek it out and capitalize properly.

Principle 3: Never Stray Far From Core Competence

After almost three decades of investment management, we've determined that a steady and purposeful strategy fits our personality the best. As exciting as shooting stars may be, they eventually flame out and leave you like the last people in a Ponzi scheme - holding the bag of losses as it were. We've found that few are as nimble as they think they are, when it comes to handling "hot" investments. You can accumulate an average 9% per year record by having a few 11% years and a few 7% or 8% years or you can make your average 9% by hitting some 20% years and some near zero or less years. We prefer the former. Our core competence is income investing - investing in income producing securities. We love the tailwind of a dividend. We will, therefore, not stray too far from our central or core competence of income investing. This said, income securities come in many varieties and, for the most part, we can find good income securities at any market cycle or even in different markets.

Two Levels of Risk Management

In our three principles above, we mainly focused at the individual security level. After all, your account balance is simply the sum total of the value of each security populating it. Our first concern, as we noted above, is the disciplined selection and de-selection (buying, trimming and selling) of individual securities. On top of this focus, we layer a portfolio-wide risk management protocol, the second level of security.

We maintain three measures to guide us when considering overall account performance.

Green means that market risk is low and there are ample bargains to be had. Our portfolio securities remain near the bottom of their price ranges. We are poised to advance.

Yellow is a cautionary condition warning us that something may be wrong, we just do not know what or we are not sure if the condition is likely to get worse. To reach yellow, we must see a spectacular unsustainable high or we must suffer some deterioration in the prices and outlooks of our portfolio securities. In condition yellow, we often raise cash (by selling securities either in part or in whole) and/or by buying a “hedge” – an investment which rises as markets drop.

Red indicates that serious losses exceeding 10% of the portfolio are likely. In condition red, we raise even more cash and/or add even more hedge. The goal of all cash raising and hedge buying is to preserve capital for the eventual upturn.

Putting It All Together

Remaining in our core competence, if we can make substantial gains while avoiding equally substantial losses, we will do well for you. When we buy a security or add to an existing one we never know what the future holds. Hence, we’ve adopted the “don’t lose much” rule. By studying the “internals” of markets and by observing macroeconomic indicators like industrial production, unemployment, various measures of consumer and investment sentiment and more, we can add important context to our understanding of each security’s dynamics.

Thank you for investing with us.