

PERSPECTIVES

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Investing

How *Moneyball* shows us the value of rules-based investing

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Movie reviews aren't going to be a regular column in Perspectives, but we thought it would be a good idea to encourage our readers to watch *Moneyball* (better still: read the book!).

Moneyball is not just entertainment, but a reminder of the limits of subjective decision making and the importance of a good systematic process. These are the building blocks of our investment philosophy. *Moneyball* gives us a unique way to look at decision-making in a different way.

The movie starts off with a scene between Billy Beane, the general manager of the Oakland Athletics baseball team, and his team of experienced scouts. They are discussing the coming season's roster. You notice right away the scouts have used very subjective measures to rate players. Some measures were really odd, like how a player looked, or even how a player's girlfriend looked ("it might indicate the player's lack of confidence"). And it isn't just one scout in the scene who thinks like this: they all do! For decades, this was how the real-life baseball league decided on players. But, as you see in the film and book, the measures the scouts used were weak indicators of a player's success. As a result, many highly-touted players didn't work out, and many shunned players turned out to be very good.

The difficulties faced by the scouts are similar to those faced by investors. When trying to decide which companies to invest in, it is tempting to be influenced by factors which are more related to how a company looks, rather than how likely it is you will make money by investing in its stock. That's the problem with subjective approaches: they feel good, but they just don't work out that well for most people. To reliably grow and protect your wealth, you need a logical process.

A logical process is a system based on objective factors that are proven and make sense. Billy Beane hired a Harvard graduate to create a system called *sabermetrics*. Using this system, along with merely a shoestring budget, Beane created a team that won 20 games in a row – the most in history. The system was then adopted by the Boston Red Sox, who went on to win the pennant in 2004, breaking the longest drought in baseball history. *Sabermetrics* is now widely used in major league baseball.

Similarly, when we select stocks, we use a system to look for companies with good characteristics and reasonable prices. We have many rules in place to remove the subjective measures that would likely hurt us. In our process, we look at things like earnings, dividends and other measures of value, and variables that are factual and have predictive ability. That's how we determine if a company is worth investing in.

One more key point from *Moneyball* was how Billy Beane stuck to his process. The hard part wasn't just coming up with the system; it was also sticking to his guns, especially when things weren't going well. It's the same for investing. No process is perfect. There are going to be good times and there are going to be bad times – but being disciplined and sticking to the process is a key part of success.

We encourage you to read the book or watch the movie. You'll learn a little bit more about our own *Moneyball* system!



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