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Relax

"At one point, two former employees say, Goldman's top management was demanding hourly profit and loss statements from certain teams [at Goldman Sachs Asset Management].."

- Richard Teitelbaum, Bloomberg News.

The watched pot does not boil. The financial equivalent of this old saw, and one of our personal favourites, which we make no apology for repeating here, is Nassim Nicholas Taleb's fictional retired dentist. This hypothetical investor is guaranteed to earn 15% per annum from his portfolio with an associated volatility of 10%. These statistics are not open to dispute. But if our investor friend monitors his portfolio in real time, however, the random price oscillations of his portfolio are likely to trigger extreme anxiety. Depending on the frequency with which he observes his portfolio, our dentist will experience varying degrees of heartache and distress. The frequency of portfolio observation versus probability of a pleasurable outcome for our imaginary investor is shown below:

Timescale – frequency of portfolio monitoring	Probability of favourable outcome (joy)
1 second	50.02%
1 minute	50.17%
1 hour	51.30%
1 day	54%
1 month	67%
1 quarter	77%
1 year	93%

(Source: 'Fooled by Randomness', by Nassim Nicholas Taleb)

The message is clear. Too much observation can be bad for you. If Taleb's dentist simply restricts the frequency with which he checks his portfolio – a fundamentally sound portfolio – he will boost his chances of incurring a positive emotional outcome from his monitoring. Note that nothing changes about the composition of his portfolio – only the frequency with which he checks it. Investors determined to watch the pot may end up being scalded.

There are other reasons to be wary of a focus on the short term. Jim Leitner of Falcon Management once said:

"If all investors allocate money to a one-month time frame, by definition there are going to be fewer opportunities there.. there's just too much competition over short-term trading, which is a timing-driven business. With timing, sometimes you're going to be right and sometimes you're going to be wrong, but it's not going to be consistent over time.. Meanwhile, the longer-term opportunities still exist because there hasn't been that much money allocated with multi-year lockups.. That's not happening yet and probably won't because investors are way too nervous and shortsighted."

We draw an additional distinction between the business of trading and the business of investing. Trading, an activity we try and avoid, for reasons of psychological disinclination and cost, is inherently a short-term activity, not unrelated to speculation. Investing, on the other hand, we regard as a longer term commitment of capital to high conviction themes which we expect to result in a meaningful positive return. Ben Graham nicely discriminated between the two styles in 'Security Analysis':

"An investment operation is one which, upon thorough analysis, promises safety of principal and an adequate return. Operations not meeting these requirements are speculative."

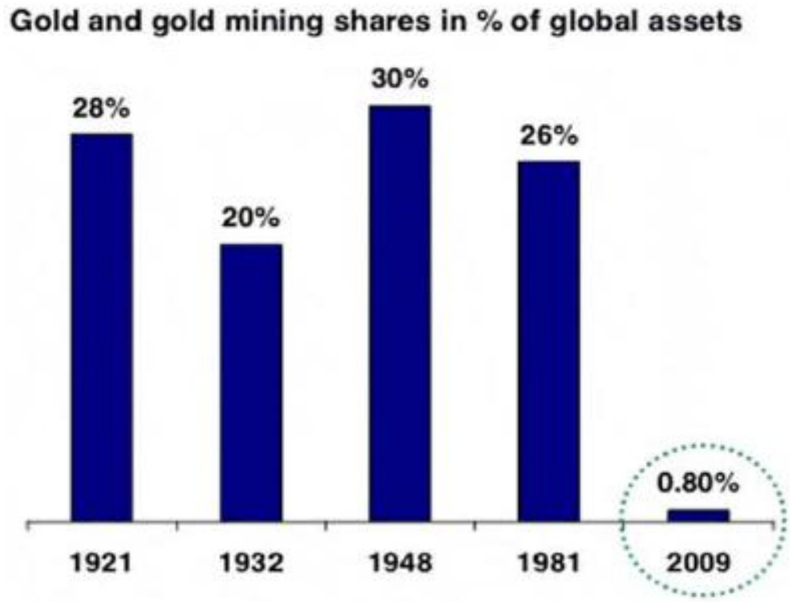
The crowning injustice of our age is that the monetary authorities, as a by-product of the bailout of the banking system, have effectively demolished cash deposits and badly manipulated the price of government debt, and have therefore forced investors to take on unnaturally high risk simply to keep their heads above the water of inflation.

The exquisite challenge of our age is that we are drowning in information and cultural impulses to (over-)trade. The Internet is simultaneously a trove of wonders and a cesspit of misguidance. So it may be that the biggest threat to portfolio performance this year will not be market-led but purely psychological: will we be able to hold our nerve in the face of perhaps vicious short term price volatility ? The current siren is gold, now resting on its 144 day moving average.

Gold price, USD, last 12 months

Nothing ***whatsoever*** about the bigger macro picture gives us any misgivings about the rationale for maintaining exposure to natural money, in the form of gold and silver. Here in the UK, the prospect of stagflation lurches ever closer. Throughout the West, the monetary pumps continue to be primed. Tides of unbacked liquidity may or may not support equity markets, but they are certain to continue to devalue fiat currency in real terms. Japanese government bonds have just been downgraded for the second time – the country, like almost all the rest of the developed world, is drowning in debt. Europe faces a rolling debt crisis that simply cannot and will not be solved with bailout funds – it will be resolved by debt defaults. The US faces ongoing deterioration in the credit quality of its states and municipalities. With the looming prospect of what Jim Sinclair calls "quantitative easing to infinity" in western economies, precious metals are the only real money in town. We just have to keep the faith in response to inevitable market fluctuations that are actually buying opportunities in disguise.

Why keep the faith with regard to gold ? One chart alone paints a thousand words. While the chattering media classes continue to disparage precious metals by citing supposed bubble conditions, the reality points to an overwhelming lack of institutional sponsorship:



Sources: Silberjunge.de, Erste Group Research, QB Partners

Jesse Livermore was one of the most outstandingly successful traders of the early 20th Century, immortalised in Edwin Lefèvre's 'Reminiscences of a Stock Operator'. On the few occasions when he lost money, it was invariably because he chose to override his own rules. He said many insightful things about the psychology of successful investing, but perhaps his most pertinent observation was the following:

"After spending many years in Wall Street and after making and losing millions of dollars I want to tell you this: it never was my thinking that made the big money for me. It always was my sitting.. The big money is made by the sittin' and the waitin', not the thinking."

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