The Formation of an Investment Philosophy

In March 2015 the renowned corporate bond investor Howard Marks did a very good presentation at Google discussing his way of investing and how he developed his investment philosophy from 1969 and onwards. You will find it here:

https://www.youtube.com/watch?v=6WroiiaVhGo

What is remarkable is that in an hour long video he manages to present how he formed his investment philosophy from the very beginning in early 1970s. The markets of that time, his meetings with clients and other investors, and not the least important books that he read contributed to his views. His journey from zero to hero is very inspiring. I think everyone will learn a lot from that journey, and you can travel pretty closely to that by first listening to the video, and then reading the books that was key for him.

The US investments legends have a long history of sharing knowledge which is an inspiration for all of us at InvestingByTheBooks. Enjoy my further intro below.

After finishing university in 1969 at the age of 23, Marks chose among 6 job-offers which all had the same pay. He didn't know what to do besides in a broad sense something in finance. Investing then had no stars, no big pay and status, i.e. there was no big pull. He chose a job as an equity research analyst at Citicorp since he had worked there one summer and thought it was fun.

In 1978 he was asked to meet the soon to be infamous Michael Milken to find out more about high yield bonds, a concept that was new and little understood. In those days bonds that were not investment grade were considered un-investable. The meeting taught him that it's not what you buy, but what you pay that matters. This was an epiphany for Marks. Michael Milken explained that there is no upside in investment grade bonds, they're great companies but all this greatness is priced in. In high yield bonds, which Moody's at the time said "fails to possess the characters of a desirable investment" there was an upside.

The meeting with Milken meant that Marks moved from equity research to high yield within Citicorp after which he joined TCW group in 1985 to do more in high yield bonds and later on also in distressed debt. In 1995 Marks together with a number of colleagues from TCW founded Oaktree on 6 tenets.

Besides their experience the investment philosophy of Oaktree has also been influenced by literature. In his presentation Marks mentions the following books:

Fooled by Randomness by Nassim Taleb, you find a review here:

https://static1.squarespace.com/static/5325c4b3e4b05fc1fc6f32ed/t/5375bb65e4b0f1679c087910/1400224613315/2012-05-11_BR_BB.pdf

A Short History of Financial Euphoria by John Kenneth Galbraith, you find a review here:

https://static1.squarespace.com/static/5325c4b3e4b05fc1fc6f32ed/t/5378f94be4b0f5318f91b02b/1400437067979/2013-06-19_BR_ML.pdf

The Losers Game by Charles Ellis, you find a review here:

https://static1.squarespace.com/static/5325c4b3e4b05fc1fc6f32ed/t/5370898ce4b0b85060a06bcf/1399884172901/2011-09-05_BR_ML.pdf

Charles Ellis' book should be read together with *Extraordinary Tennis for the Ordinary Player* by Simon Ramo.

Mark's key conclusions from the books and the meeting with Milken:

- Taleb says the future consists of a range of possibilities, with the outcome influenced by randomness
- Galbraith says forecasting is futile
- Ellis says if the game isn't controllable, its better to work to avoid losers than to try to go for winners (further evidence in Simon Samo's book)
- Milken says holding survivors and avoiding defaults is key in bond investing.

The above and a lot of other influence formed Oaktree's 6 tenets, which have been the same since 1995:

1. The primacy of risk control
2. Emphasis on consistency
3. The importance of market inefficiency
4. The benefits of specialization
5. Macro forecasting not critical to investing
6. Disavowal of market timing

Howard Marks adds a few comments on the above. Noteworthy are the following:

- Oaktree do macro forecasts, but they don't make big bets on a specific outcome. They have a scenario and allow for that unexpected things can happen.
- If you can consistently be a little better than the average every year, you will be in the very top over time since most investors are not consistent.

Bottom line - The secret to making money is to buy something for less than its worth. Compared to equity, in credit there is also a maturity of what you buy, so eventually if you are right, the value will crystalize. This has helped Oaktree to an unlevered return of more than 20 percent per year before fees.

Howard Marks doesn't try to time the market, just to buy it cheap and with the help of a maturity it's easier in bonds than in equity.

Here is a bonus for you: Mr. Marks wrote part II, Fixed Value Investments, in the updated 6th version of Graham & Dodd's *Security Analysis*. Review can be found here:

https://static1.squarespace.com/static/5325c4b3e4b05fc1fc6f32ed/t/5375ad14e4b0ccfe9439240b/1400220948665/2012-04-11_BR_BB.pdf.

Bo Börtemark, May 05, 2015