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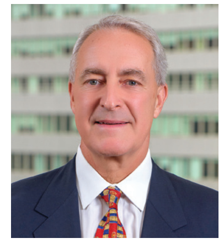
Thoughts for Investors



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Why Conviction is a Key to Wealth Creation

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What separates great investors from the rest? Financial success, Charlie Munger explained, comes from *being smart, working hard, making a few really good decisions with high conviction, over an entire career, and being lucky.*

How to be *smart* and *work hard* are as varied as humanity. The impact of *making a few really good decisions over an entire career* will be addressed in a future newsletter. As for being lucky, Samuel Goldwyn and Gary Player famously said, *"The harder I work, the luckier I get."* Translation: keep trying. In some cases, Uncle Sam lets you write off your mistakes. This newsletter focuses on conviction as a key to wealth creation.

What is Conviction?

"I didn't get to where I am by going after mediocre opportunities."

– Charlie Munger

Conviction means believing in your investments strongly enough to own them through the inevitable ups and downs of the stock market. If you buy stocks based on tips, trends, politics, or financial media noise – you're trading, not investing. Traders must time entry and exit correctly, often multiple times, and pay taxes along the way. Without conviction, many investors sell too early or diversify excessively, only to regret missing out or not owning enough of the best performing stocks. That's not helpful if you are concerned about "affordability".

Diversification vs. Conviction

"Diversification is protection from ignorance."

– Warren Buffett, a "Money Master"

Diversification isn't a cure-all or guarantee success. It doesn't eliminate risk. It just spreads risk out, potentially leading to mediocrity or mistakes. In a crisis, when everything is correlated, diversification is less helpful than you think. Investors are taught a lot about diversification but rarely about conviction. Can you truly have conviction about all 500 stocks in an S&P 500 index fund? Do you understand the fundamentals of each? Probably not. How about Embecta Corp., currently ~0.000005% of the S&P 500 index?

The Power of Concentration

"I don't want a lot of good investments; I want a few outstanding ones. If the job has been correctly done when a common stock is purchased, the time to sell it is almost never."

– Philip Fisher, growth stock investor and "Money Master"

Would you ever "almost never" sell a stock? If you have conviction, you might… and that often leads to **concentration**, owning enough of a stock to move the needle on your net worth. The best kind of concentration happens naturally when great stocks **compound** over time. Maybe company stock? Over the years, I've met many employees who had conviction about where they worked. They bought company stock in small amounts and/or reinvested dividends over time and through high and low prices and created wealth. Gates, Bezos, Walton and Jobs were not the only ones creating wealth for themselves. It's the democratization of wealth creation. Though Buffett and Munger were not founders of Apple, nor bought all at once, at one point, Apple stock grew to 50% of Berkshire Hathaway's equity portfolio. That's conviction! You can't protect wealth until you've created it – so focus on conviction first.

Why We Avoid Over-Diversification

"A lot of people think that if they have 100 stocks they're investing more professionally than they are if they have four or five. I regard this as insanity."

– Charlie Munger

Our portfolios typically consist of no more than 35 stocks, giving us both concentration and diversification. Studies show that ~30 stocks provide about 85% of the diversification benefits of the S&P 500. Owning hundreds of stocks often adds complexity, overlap, dilution, mediocrity, and even mistakes. Nor do we automatically "rebalance" when we've found a great stock. That is a sign of wavering conviction.

The Risks of Leverage

"If you are smart, you don't need leverage. If you are not smart, you really don't need leverage."

– Warren Buffett

Some investors, with and without financial means, use leverage to amplify returns and create wealth. No doubt they exhibit conviction. But leverage can be dangerous. A recent WSJ article highlighted the popularity, and danger, of leveraged ETFs which use financial instruments like swaps, options and futures contracts to amplify the price movements of a single or group of stocks. These strategies rarely last over *"an entire career"*, capitalizing on the benefits of compounding. Instead, they often end in losses.

Patience Pays Off

"When the tide goes out, we see who has been swimming naked."

– Warren Buffett

Market and economic downturns expose weak strategies that were hidden during prosperous times. If you lack conviction, you'll likely sell at the worst time. True conviction means staying invested through volatility and letting compounding work its magic. *Volatility is not risk unless you don't know the difference*.

In Summary

"You make your money by the waiting."

– Charlie Munger

Conviction isn't about putting all your eggs in one basket or ignoring diversification—it's about believing in your investments enough to hold them for the long term. Spreading money across 500 (or more) stocks isn't conviction. It's hoping the "rising tide" will lift all boats. Many may not be seaworthy. The S&P 500's performance this year largely comes from concentration in the "Magnificent 7" stocks—proof that conviction matters.

If your goal is financial security, don't overlook conviction. Start with meaningful amounts, stay invested, and let time do the heavy lifting. That's what Buffett and Munger did.

"It is often easier to tell what will happen to the price of a stock then how much time will elapse before it happens."

– Philip Fisher, Money Master

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"HEAR THE OTHER SIDE"

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