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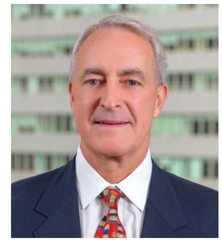

Thoughts for Investors

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Signal to Noise Ratio: Reducing Investment Noise

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The Signal-to-noise ratio (SNR) is a science and engineering measure referring to the ratio of desired signal to the level of undesired background noise. Often measured in decibels, it gauges sound intensity. You want a high SNR to be able to accurately hear important signals, to distinguish between meaningful signals and random fluctuations, and to be able to detect weak signals among noise. "Sounds" like something investors can use! You want to distinguish what is important to hear/know from what is unimportant, confusing, and throws you "off track" from making better investment decisions.

"The worst wheel of the cart makes the most noise."

– Benjamin Franklin

There are two complementary ways to make sure you have a high SNR ratio. You can increase the signal or decrease the noise. Few investors can or are willing to take the time to increase the signal. That would require spending time doing research such as reading, talking to industry participants, meeting with managements, analyzing, discarding information, and deciding when to buy, sell or hold. That's what we do most of the day! Or you can decrease the noise. That's what we suggest you do. In this letter I will review three ways to reduce the noise and help the signal get through.

"Media is the plural of mediocrity."

– Jimmie Breslin, journalist, and author

#1: Be selective in your consumption of media. A plurality of media on a topic is not necessarily a signal. According to the UK government website, the role of media is "to educate, inform and entertain." While it's sometimes difficult to know which one of these is the goal, when investing, it's critical to know. TikTok is likely more entertainment than education. Just because someone has a million "followers" doesn't automatically authenticate a signal. Tom Brady pitched FTX. Parsing the Fed's next move (or not) is the latest investing noise. Decades ago, the market hung on the announcement of the weekly M1 money supply number, remember that? Of course not. In the long run, it turned out to be noise, unimportant to good decision-making. Everything is not a signal. Often the "signal" is hidden in the "outlier", the "contrarian", the ignored, more than the "plurality." If correct, you will often be early in an investment because others won't yet recognize the "signal." That's OK. You will have a head start on a long-term gain. As a client wisely told us decades ago, "If you are not too early, you are too late."

"It doesn't take many observations to think you've spotted a trend — and it's probably not a trend at all."

– Daniel Kahneman, author, psychologist, and economist. On the psychology of judgment, decision-making and behavioral economics.

#2: Be careful not to believe all volatility or trends are a signal that needs to be acted on. While all volatility is a sound, it's only important if it's a signal rather than noise. They can look similar. How can one distinguish? Ask yourself whether volatility is indicating something about a stock's value, in which case it is a signal, or is simply a fluctuation in its price, in which case it is likely a noise. When influenced by ever-present investor emotion, large daily or intraday fluctuations in a stock's price are often just noise. The value of a company usually doesn't change that quickly in either direction. For all the stated potential of EVs and Tesla, the stock has recently declined dramatically. Is this price volatility emotional noise or a signal indicating a change in its value?

"If the job has been correctly done when a common stock is purchased, the time to sell it is almost never."

– Philip Fisher, legendary growth stock investor

That is why we rarely use strategies like "stop loss", "stop limit" or many "hedging" strategies like "puts", "calls", "collars" or "structured products" which can reduce important liquidity. These strategies are susceptible to being triggered erroneously by what turns out to be noise rather than a signal. They should be used sparingly and specifically, not broadly. As always, they come with a financial cost that reduces return. Having a great stock "called away" prematurely, potentially incurring a capital gain or loss, for some fleeting "extra" income, is a risk. Don't forget to also think about the risk from the "sponsors" of hedging strategies.

Having the great opportunity to meet with Sir John Templeton several times, I once asked him why, as a great international investor, he never "hedged" against "currency risk". Before the Euro, almost every country had their own currency. You could make a profit in Swiss stocks denominated in francs, but lose it converting back to US dollars, hence the often wide-spread use of hedging. His answer was hedging introduces the unknowable of geopolitics into a decision, always has a "cost" to implement, and by his estimate, only a 50% chance of success. We believe investors should be as or more concerned about the "costs" of hedging their portfolios from unknowable and often undefinable "risks", than the costs they normally worry about (management fees).

Volatility gets your attention, especially if you are constantly checking your portfolio/net worth. Volatility as noise is ever-present, yet rarely do decisions need to be made in a split second (except if you are a trader which we don't suggest.) *Volatility is not risk unless you don't know the difference.*

"Everyone has a plan until they get punched in the mouth."

– Mike Tyson

#3: Have a plan and guard against overdiversification which can increase confusing "noise" in a portfolio. If you want French food, go to your favorite French restaurant. If all you want is a "meal", a buffet will suffice, though it probably won't have the same quality. Many portfolios we've reviewed look like buffets, an emphasis on diversification (quantity) over quality. That amplifies the chance for noise to mask a signal. A financial plan which includes an S&P 500 index fund, with 500 stocks, and maybe some "sector" funds like biotech or artificial intelligence, can become a very big buffet. It will certainly fill you up, though you will not own enough of the "quality" stocks. So how have investment buffets worked out? In a recent WSJ article, Northwest Mutual claims, "The New Magic Number for Retirement is $1.46 Million" and Fidelity Investments states, "about 2% of Fidelity 401(k) participants have a balance of $1 million or more." It's understandable if you are young and don't have a $1 million balance. Yet according to CNN, the average 401(k) balance for 45–54 year-olds is $142K and for 55-64 year-olds is $207K. They have a lot of catching up to do. What is your balance?

"True merit, like a river, the deeper it is, the less noise it makes."

– Edward Wood, 1st Earl of Halifax

In summary, after almost 50 years of nearly free index investing, 24x7 transparency of business news on your phone, regulatory scrutiny, and substantial education and emphasis on the importance of financial planning, why are so many retiring investors unprepared, and young investors potentially following them over the same cliff? In a word, "noise." The most recent and strongest "noise" is concern over the direction and magnitude of potential interest rate changes. Like a "babbling brook", debate has become so loud it is drowning out the real "signal" and/or being mistaken for the signal. The real signal is not interest rates. Nor is it media or Wall Street commentary about the entire stock market and economy at-large. The real signal is listening to the condition of companies (stocks) best prepared to adapt and take advantage of whatever economic condition exists.

Do you have the $1.46 million "magic number" (or more if your expenses are greater)? Are you are retiring in the next decade, or two? Are you wondering whether with today's persistent inflation and increasingly high prices, you are on the right path to retire "comfortably"? If you are concerned, start "dialing down" the noise and let us help strengthen the signal.

"Noise proves nothing. Often a hen who has merely laid an egg cackles as if she laid an asteroid."

– Mark Twain

AUDI PARTEM ALTERAM

"HEAR THE OTHER SIDE"

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