MANAGING UNCERTAINTY

Stock markets are always changing and always moving. At any one time, there are many punters (otherwise known as market experts) telling us why the market is going to crash and many others telling us why it is going to fly. Unfortunately the most sensible experts are often quite unemotional and very consistent in their approach which makes them boring to interview. This means you often don't hear from the real experts in the financial press. Most of the press coverage goes to those punters who are dramatic in their language and therefore good for a quote. These are also usually the least sensible people to take direction from and should be ignored.

There are relatively simple ways to survive and thrive during turbulent markets but you need to be prepared to follow your own path and ignore the noise. One of my favourite investment thinkers, Herman Steyn from Prescient Investment Management, has a very different view to his industry peers and is not afraid to express his views. He is very rarely quoted in the press (like another of my favourites, Dave Foord) because he has a consistent message and is not dramatic in his approach. However both these men have brilliant insights that we can all learn from.

SUCCESS IN YOUR METHOD

When I listen to Steyn's thoughts on investments, I am constantly reminded that all successful investors have one thing in common – they all have a very firm conviction in their methodology. More importantly, they are able to implement this methodology rigorously, irrespective of the current market conditions or investment fashions. This is very difficult to do on a consistent basis, especially when you are managing large amounts of money and you are underperforming your peers. A classic example of this consistency is Warren Buffett who ignored the Information Technology (IT) sector in the last few years of the 1990's. During this time, IT was the top performing sector in the US and was generating great returns for investors. This meant that Buffett's returns were pedestrian in comparison to most of his industry peers. He repeatedly told his investors and the press that he was avoiding these IT shares because he had no method for valuing them and therefore did not know what to pay for them. At the time he was ridiculed with many pundits asking whether he was too old to manage money and past his "sell by" date. He was eventually vindicated when IT shares crashed in the early 2000's while his "outdated" portfolio performed brilliantly.

The lesson from Buffett is that you need to develop your own method of choosing investments and make sure that you stick to this method through all market conditions. It takes time and a lot of research to develop your own way but it is vital to do so if you want to ensure success over a long career of investing. Your strategy does not need to be complicated – in fact it should be relatively simple but you still need a way to make money decisions, that distinguishes you from the herd.

IN CHAOS THERE IS ORDER

If you have a proper investment methodology, the current market uncertainty (chaos might be more accurate) will not be a major source of stress for you. As an extreme example, if you have decided that you are only going to trade two blue chip shares over your lifetime then any market drop will be an opportunity for you. The reason is simple, you only need to monitor two investments so you will have a great understanding of their real long term value. When the entire stock market falls and drags your particular shares down, you will know when you shares are trading at a huge discount to their real value. This will be the time to buy your shares. When the markets are booming, your shares might become too expensive (according to your valuation) at which time you will sell them. By following this method, you will find that stock market chaos becomes irrelevant to you as you are not focussing on hundreds of different factors when making your investment decisions. You will only need to concentrate on a few factors. In this way, your method allows you to create order out of chaos.

Naturally, such a focussed trading method is not recommended for all investors but the principle of having a method that obliges you to concentrate on a few, limited factors is relevant. This is the real key to thriving during stock market uncertainty.

UNUSUALY UNCERTAIN

In the context that the financial system has recently recovered from a near catastrophic collapse, it is natural that the global economy is not going to recover in a nice, predictable pattern. The global economy has always been complex and constantly changing. It is natural that it will move forward and reverse again as it attempts to find a new equilibrium. This is normal – it is certainly not unusually uncertain as the American media like to tell us. As investors, we should take advantage of other people's emotional decisions by investing correctly in these times. For those people who are already invested, it is imperative that you stick to your strategy in difficult times as your investments need time to provide the required growth.

REVIEW CONSTANTLY BUT BE SLOW TO CHANGE

You should be very reluctant to make regular changes to your overall investment methodology. You need a high level of conviction in the way that you manage your money and constant change to your methods will not build confidence. It is important that you review your investment methods on a regular basis (preferably in the good times) to ensure that you are following the right path. The best money managers are usually very curious to learn more about other people's methods but they are VERY slow to change their own. The very best ones tend to tweak their methods slightly over long periods of time but the general theme remains the same. If you can do this with your own money management decisions you will have a high probability of success over time.