

The Stock Picking Mindset

Two of the main reasons that most active investors fail in their endeavours to grow their capital through timing the market are:

1. Placing too much emphasis on individual trades and
2. Not persisting with strategies that they try.

Let's deal with persistence first. No strategy works brilliantly all the time in the market because the market cycles through different phases of rising, falling and traveling sideways for varying lengths of time. This means that EVERY strategy that is deployed in the market will either stagnate or will go into drawdown for periods of time. How long the period is will depend on what the market does.

It is during the times of stagnation and drawdown that the great majority of active investors have difficulty persisting with particular strategies. What they do is chop and change their strategies trying either to find a single strategy that works brilliantly in all markets or match different strategies to the prevailing market at any given time. Both are impossible to achieve.

Because investors have difficulty persisting with, or rather, remaining consistent in their execution of particular strategies, they are not successful in the markets over sustained periods of time. "I tried that once and it didn't work!" or "It worked for a while!" are their anecdotes at social gatherings quite confident that their assessment of the scenario is 100% correct!!

Part of the reason that they do not persist and the main reason that they fail with active investing is their inability to raise their thinking threshold to investing at the portfolio level. They operate at the 'stock picking' level, putting all their energy and time into trying to pick a winner or more appropriately, trying NOT to pick a loser!

Successful active investors raise their level of thinking to the 'big picture' level, that is, the portfolio level. Practically this is done by focusing on the equity curve rather than individual trades. The outcome of individual trades is of no concern to the successful active investor who objectively defines entry and exit points to individual trades regardless of whether individual trades are winners or losers.

Their focus is on the outcome of the combination of trades over a large sample over a long period of time. This is their edge in the market. The larger the sample, the higher the statistical reliability is of achieving the outcome of a researched edge. The equity curve that results from the large sample of trades is what is of utmost importance to the consistently successful active investor.

Taking this a step further, the active investor who thinks at the portfolio level will adapt quickly to multi-strategy investing understanding that individual strategies will have a positive impact on the equity curve when the market cycle suits that strategy.