A book summary and review, by Simon Joshua, of

Invested: How Warren Buffett and Charlie Munger Taught Me to Master My Mind, My Emotions, and My Money (with a Little Help from My Dad)
by Danielle Town

A primer on investing methodology and personal financial philosophy that attempts to teach the reader how to integrate Rule#1 (value) investing into a middle-class American lifestyle

Summary Outline:

I. The Investing Prologue: life is stressful and exhausting when you work all the time and have nothing to show for it. Financial independence is the solution—the ability to live without working a job. You must set a goal to achieve: “Your Number” The way to get there is to start investing. The financial industry provides two options.
   a. Hoard your money: save money in cash for forty years. Problem: inflation. The dollar becomes less valuable as products and services become more expensive—your buying power erodes.
   b. Abdicate responsibility for investing to a professional and pay them to do it for you. Problem: professional investment advisors cheat you. They lose your money, then charge you for it, like in 2008.
      i. Your Number is a combination of your minimum living expenses ongoing, years you have remaining to invest, your current investable assets, and your required rate of return. What is possible: 5% if investing with a manager, 15%-26% if Rule #1 investing.

II. The Investing Context
   a. Create a space specifically used for investing.
   b. The majority of corporations are evil because people are evil. Select corporations for their dedication to your personal values. Tell the story of a company before buying:
      i. Mission: does it match yours?
      ii. Management: do they have integrity and talent?
      iii. Moat: what intrinsic, durable competitive advantage does this corporation have over its competitors?
      iv. Margin of Safety: always buy lower than your valuation.
   c. Market theory:
      i. EMH perpetuates follies that value investors capitalize on to beat the market with dependability, disproving EMH.
      ii. Most investors act on Events irrationally, either because of common human faults or because of the part they play (managers).
      iii. The rational thing to do is watch the P/E for individual stocks, Shiller P/E and Wilshire GDP for the market as a whole and wait for Events.

III. The Investing Research: Munger’s four rules and the Big Four Numbers

   In order for Charlie to invest in a company, it must be a business that
   a. Charlie is capable of understanding:
      i. Some information is unknowable, like future events and lying executives. Some information is knowable, like the history of an industry and company, the condition of its assets, its P&L, balance sheet, etc. The sweet spot between them is where investors should sit, knowing enough to be comfortable and not worrying about what they cannot know.

ii. Stay in your Circle of Competence. The overlap between what you do to make money, where you spend that money, and what you are passionate about should clue you as to what industry to research. Buy well-established companies.
iii. Check out the Gurus' trades for companies you might believe in.

b. Possesses some characteristics that give it an intrinsic, durable competitive advantage:
    i. Intrinsic because without this characteristic, the company would not be the same—this is not just a strategy, this is an identity.
    ii. Durable because the cost of competing with this company on the same level as their advantage is too high.
    iii. Brand, Switching, Network Effects, Toll Bridge, Secrets, Price
c. Has management with integrity and talent. ROE and ROIC above 15% the last ten years, total long-term debt = two years' net earnings.
d. Charlie can buy for a price that makes sense, with a Margin of Safety.
    i. Ten Cap price: firm valued at ten times the Owner Earnings
    ii. Payback Time price: free cash flow compounded by Windage Growth Rate for eight years.
    iii. Margin of Safety valuation: a ten-year future valuation adjusted by minimum acceptable rate of return to obtain a current value.
e. The Big Four Numbers: Net Income, Book Value, Sales Revenue, Operating Capitol. Look for a track record of 10% growth on each, forecast a growth rate based on all available and known information.
f. Tell the story, invert the story, rebut the inversion

IV. The Investing Moments: getting into the right companies at just the right time and when to get out.
    a. Low-cost trading platform is required
    b. Practice trading trains the brain to adjust to the emotional strain of investing.
    c. An antifragile portfolio beats the index by including companies that have Moats, protected by a Margin of Safety, and a patient investor waiting for Events.
    d. Use traches to compile the lowest cost basis in an Event scenario.
    e. Watch the news, analysis, and financial reports and your previously constructed inverted story for reasons to sell.

Behind this frame of teaching the reader to invest, the author describes her journey of discovery that includes close personal events and transformation. This storyline is the real value of the whole book. Town tells the story of her difficult relationship with money and investing, her developing a relationship with her father as an adult, her skepticism, doubt, apprehension, trepidation, and gratification around starting on this journey, and her transformation into the confident investor she is now. The most memorable moment in this narrative is when she forgives her father for a perceived period of neglect in her childhood. This is the moment when she realizes she loves him as an adult daughter. What follows is the best line in the whole book (p. 162):

"Achieving freedom, it turns out, was about way more than what was in my bank account."

This is beautifully and unequivocally true.

Reviewer's Response

The reluctant mindset with which Town ushers in the details of investing is so compelling. It is empathetic to the way each of us thinks. To a professional, it might seem like market theory, valuation, statements, and methodology are old hat. But to a "Normal" such things are jargon and nonsense. Town's emotional reluctance to broach these topics, for reasons few could outmatch, and her ability to fully communicate that emotion, combine to make her relatable. She is so vulnerably eloquent that I cannot help but put myself into her shoes at every step. I know literary talent when I see it, and I saw it clearly in the pages of this book.

The practice of investing is where Town and I part ways, as she could have predicted. Her methodology is born of the mindset that "beating the market," or outperforming an index, reliably and consistently, is not only possible (for the talented investor) but necessary for everyday retail investors. I take issue mainly with this foundation. Skip to the conclusion on page 6 for my response to it.

What follows is an attempt to show wherein the author is uninformed, misinformed, illogical, or wherein her treatment of subject matter is incomplete in four general areas—though I feel I could pick a bone with almost any section of the book, that is, any of the "math-y bits." One exception is the value premium—firms with high book-to-market generally outperform those with low book-to-market. I agree with this because I can prove it with statistical certainty.

1. Town begins with the idea that financial independence equates to freedom from the necessity to work a job you hate. Common sense says, if you hate your job, leave it. If it is not worth the pay, quit and find one that is. I know this is hard to do. I did it. Now I love my job. Mankind was created to work and to live with purpose. Your employment and your purpose do not always have to match up perfectly, but you must have both. If you find purpose, you will find some semblance of freedom. Ultimately, finding the Truth is the only way you can find true freedom. This also is hard, this also I have done. You can too.

"There is no dignity quite so impressive, and no independence quite so important, as living within your means."
– Calvin Coolidge

"Our greatest fear should not be of failure, but of succeeding at something that doesn't really matter." – D.L. Moody

2. Immediately after explaining what efficient market hypothesis is, Town dismisses it with anecdotes of value investors. Firstly, what this really means is that a few talented people have beat the market using similar methodologies. What it does not mean is that everyone who uses that methodology will beat the market. Ben Graham published *Security Analysis* in 1934. Is it possible to know how many investors have tried value investing since then? Assuming we could know, what percentage of those investors have really killed it in the stock market? Is that percentage significantly higher than that of any other methodology for stock picking? Secondly, can you assume that you will outsmart millions of other investors when valuing any single company, even if you knew you had the most effective methodology? Every investor has misperceptions and unreliable instincts, even you. This is behavioral economics, and it is a study that Town, her father, Munger, and Buffet have all failed to indulge to its fullest extent. **They agree that investors act irrationally but deny that they themselves are susceptible.** And lastly, if it were possible for you to be a perfect human, it remains that you would statistically be more likely to buy a dud or a failure than a winning stock. What guarantees of success do you really have? I hate to be the bearer of bad news, but **we are all human, and stock picking could never work for everyone**.
3. We move on to expected returns. Let me say outrightly that 15% compound annual growth is unrealistic, even including the astronomical track record of some value investors. That is because **portfolio returns do not equal investor returns**. Even a perfect portfolio cannot operate under the delusion that all its investors will patiently hold it until they must liquidate, and that they will liquidate with discipline. There are asset classes that have achieved high returns, given the long history of small and value stocks. That is not to say that, after all costs, a perfectly disciplined investor would experience that return over time. These human traits we are burdened with have such power over us that it is all we can do to recognize when they are perverting our behavior. Trying to control our behavior by using words to overpower our own instincts, perceptions, and emotions for fifty years is not a reliable plan. How long do you go between diet cheat days? Again, I must say we are all human. As for expected annual returns, 12% or less is a more realistic number to use for planning purposes. Any more is accurately called magical thinking.
4. Town conveys in great detail the methodology used by value investors to price a company for potential investment. As a licensed investment advisor, and someone that my friends and colleagues affectionately call a nerd, I must admit I could not follow her explanation. The middle of chapter 7 is where she started to lose me; by the end of chapter 8, I was completely gone. I could follow the purpose of these formulas. **But the layout, description, and explanation left much to be desired in communicating how to employ them**. Town's dramatic thesis is that if *she* could learn all this, and implement it, certainly you could too. Either she is a lot smarter than she thinks, or this method is not really all that simple. I think both are true. She admits that the successful investors, after all their preparation, still operate on a gut feeling. That would make the whole thing un-learnable.

The central claim of this book is that you can learn to price companies and decide whether to buy them and that knowing some information will empower you to do so. This claim is predicated on the philosophy that an investor has to pick the right stocks in order to be successful. If you want to deny both EMH and prudent, academic asset allocation, then you have no choice but to put in the time to learn stock picking. **But if EMH and certain other academic principles are true, then you have no need for any of it**.

You have a choice: either you need to beat the market, or you do not. If you do not, you also do not need any predictions of which stocks will endure the decades ahead, and you do not need any predictions about what the market is going to do in the immediate future.

The quality of your life is largely determined by the quality of the questions you ask. Town fails to ask the right questions. For a list of questions that will give you a good start, contact me.