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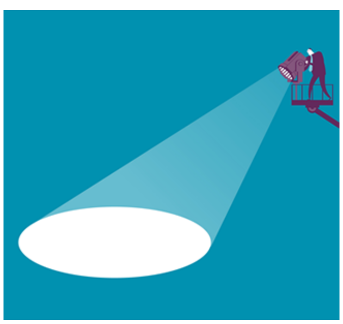
Undervalued Posts from the Financial Blogosphere: Second-Order Thinking

By Tadas Viskanta

Categories: Guide, Performance Measurement & Evaluation, Philosophy, Portfolio Management



This is the second post in a series that seeks out posts from the financial blogosphere that may not have received the attention they deserve. You can find the first edition also at the ***Enterprising Investor****.*

When it comes to content in the financial media and blogosphere, it pays to read with a practiced eye and take what bloggers write with a grain of salt. This is due, in part, to the fact that everyone is talking up their book. Also the pressure to generate content puts bloggers at risk of publishing items without a true editorial process in place.

Anyone reading the *Financial Analysts Journal* and other similar publications can be confident that what they are reading has been given a thorough going over. Even that may not be enough these days. A recent paper by Campbell R. Harvey, Yan Liu, and Heqing Zhu argues we should begin holding research findings in finance to a higher statistical standard. They note that t-ratios higher than 2.0 for newly found factors are insufficient to account for the extensive data mining inherent in financial research.

What does this mean? In short, many of the findings touted in the financial media and blogosphere are "likely false" and may simply be a function of chance. This puts a higher burden on the reader to think through not only the statistics being presented but also the underlying economic and/or financial assumptions being tested. Marginally statistically significant findings absent some solid intuition behind them should be approached with a healthy amount of incredulity.

Writers (and readers), especially in the age of increasingly short attention spans, want findings served up in bite-size chunks that are easily digestible. There is room in our media diet for some of that. In this edition of Undervalued Posts from the Financial Blogosphere, I want to highlight posts that take the opposite tack.

The pseudonymous Jesse Livermore at *Philosophical Economics,* in "Dilution, Index Evolution, and the Shiller CAPE," looks at a rarely discussed issue. Livermore notes that much of the index-level valuation data we use and discuss has a significant flaw. To simplify, we treat today's index as being substantially similar to the index five, 10, or even 20 years ago. We do this despite the fact that company turnover and sector shifts inevitably change the underlying nature of the index over time. In short, today's S&P 500 is not your father's S&P 500.

Livermore uses the example of Ireland's ISEQ to show how the financial crisis had a profound impact on the composition of the index, thereby making historical comparisons moot. This second-level thinking has applications to the US and broader European markets as well. Most importantly it shows us why we should not take index-level data at face value. The shorthand of indexes is valuable in talking about broader market trends but should be scrutinized to a greater degree when it comes to making actual investment decisions.

The next post I want to highlight, "The Myth of Passive Investing Begins to Unravel . . ." by Cullen Roche at *Pragmatic Capitalism,* also challenges some of our long-held beliefs. The active-passive debate has been fodder for academics, practitioners, and bloggers since the first index fund was launched. Roche is rightly skeptical that what is passed off as passive these days is anything but.

Once we move beyond a true global market portfolio every deviation is an implicit active bet according to Roche. There is not necessarily anything wrong with this approach. There are very good reasons — including risk tolerance — and bad reasons — like home country bias — to deviate from the global market portfolio. However, we should acknowledge that these deviations are active investment decisions. This realization makes the active-passive debate a sideshow that distracts investors from more important issues.

Changing gears, it is worthwhile noting the work that goes into a post that on its face seems quite simple. Tren Griffin at *25iq* has been writing a series of posts about "a dozen things" learned from notable investors and venture capitalists. In "A Dozen Things I've Learned from Jeffrey Gundlach about Investing," he looks for lessons from the reigning "bond king."

For a figure like Gundlach, many of these insights will seem familiar. However, for nearly everyone there is something in this post —and others — that will be novel and interesting. From a blogger's perspective I can say with confidence that each of the editions take far more time to compile and edit than you would think, and for that reason alone are worthy of note.

Celebrity in the investing world is a bit of mixed blessing. At its best it gets you a "dozen things learned" write-up. At worst it gets you a quick takedown of your talking points. The launch of Tony Robbins's new book, *MONEY Master the Game,* was conducted with a degree of public relations precision rarely found these days. Once Robbins's book hit the shelves, it attracted attention from skeptical bloggers, including most notably Barry Ritholtz at *BloombergView* and Ben Carlson at *A Wealth of Common Sense*.

In "Backtesting Tony Robbins' All-Weather Portfolio," Carlson analyzes Robbins's preferred portfolio and shows that it was nothing all that unique. Robbins's all-weather portfolio's past performance is highly dependent on the strong recent historical performance of the bond market. So rather than having to take Robbins at his word, readers are able to take an informed look at his advice, especially prior to buying his book.

One of the things that has changed most since I began blogging is that writers focus much more now on the behavioral challenges facing investors, both novice and experienced. It is helpful to see, written in plain English, that the markets are a challenge for all investors, not just us.

James Osborne, at Bason Asset Management, in the well-named post "Diversification Sucks," notes a frequent challenge for diversified investors. Diversified investors inevitably experience disappointment because there is always an asset class in a diversified portfolio that is underperforming at any point in time. The behavioral challenge is not to abandon a thoughtful portfolio construction because of the dissonance that comes with inevitable asset class return dispersion.

In nearly every linkfest I write, I like to include some non-financial items as well. Today it seems like we are all spread thinner than ever before. This is due in part to our inability to say "no" to professional and personal requests. Shane Parrish at *Farnam Street,* in his post "Eight Ways to Say No with Grace and Style," highlights some valuable lessons on taking charge of our calendars.

This skillset is apt because it applies also to our consumption of financial media as well. We all need to be conscious consumers of content, finance-related as well. There is no shortage of "junk content" that provides us with a short-term high like that found in junk food. Conscious consumers, on the other hand, seek out content that provides us with lasting lessons as opposed to sound bites. The challenge as always is identifying nutritious content. Hopefully posts like this can help you in that process.

If you enjoyed this post, visit Viskanta's daily writings at* Abnormal Returns *and consider subscribing to the* Enterprising Investor*.

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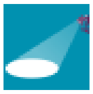

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