Ian Cassel - 16 Essays

You Need To Do What Others Don't

IAN CASSEL SEPTEMBER 14, 2017

The hardest part of achieving 10-20+ baggers is having the patience and conviction to hold through multi-year periods of underperformance. Patience is your biggest asset when investing in a great business. Time always pushes out the weakly convicted and creates opportunities for those with a long-term perspective. The greatest flaw in the short-term investor is they think great business performance is always linear. The truth is that even great businesses suffer growing pains, and so do their stocks.

The investor that always worries about "next quarter" will sell at any sign of imperfection. Since no company is perfect, this means they will always sell too soon. Short-term investors will accept a 20% gain because they didn't spend the time to develop the conviction and foresight to see the next 500%.

The second hardest part of achieving 10-20+ baggers is holding stocks that sometimes look expensive by traditional metrics. If your aim is to hold a great business for a long time, you are going to have to get used to holding a business that isn't always "cheap". This is a topic that David Gardner talks about in this Invest Like the Best podcast.

Whether it's holding a great business whose stock doesn't move for months or years, or holding one that doesn't look "statistically cheap", there is an art to holding. The simple answer is you focus on the business, not the stock.

A successful long-term investor today needs to be incredibly focused on knowing what they own better than others. This means they cannot depend on others for their due diligence. You need to do the work. You can borrow someone else's stock ideas but you can't borrow their conviction. A multi-baggers journey is filled with the corpses of highly intelligent-articulate naysayers. There isn't one great stock or company that wasn't credibly doubted all the way up (H/T @EdBorgato). Put on your armor of diligence and conviction so you can hold a great company when you find one.

Thirty years ago the best investors had the biggest funnels of information. Today the best investors have the best filters of information. They know what is important and knowable, and they don't become distracted by the noise around them. Sometimes important information comes from sources that aren't obvious.

I recently dug into a CEO's past so deep that I ended up networking my way back twenty years to his college roommate. The key takeaway from the college roommate was that the now CEO was always incredibly honest and had high integrity. This is from a roommate that likely saw him in many different forms (studying, dating, sports, drunk, etc). The college roommate told me a story from twenty years prior about how he and the now CEO broke a chair at a college party. The following morning the now CEO walked a mile to the person's house and paid them for the damage. He didn't have to. No one knew he broke the chair. Now this type of conversation might seem insane to most investors. But is it insane to do a background check on the integrity of the leader you've invested 5-10-20% of your net worth? I don't think so. Do you think that uncovering such a nugget or differential insight, albeit from 20 years prior, gives me an edge? Yes, I believe so.

If you want above average returns, you need to do what average investors aren't willing to do. You need to gain perspectives that average investors aren't willing to gain because it's just too hard, too uncomfortable, and takes too much time. It's easier to sit in an office and crunch numbers than it is to get on a phone or plane and talk to people. If you aren't willing to do so, then don't complain about being average.

In Ron Baron's Q2 Letter at Baron Funds, he talks about going the extra mile for research:

As part of our ongoing effort to gain further insight into Tesla's prospects, we recently met with Dr. Ion Yadigaroglu, a venture capitalist. Ion is an engineer with a doctorate in physics from Stanford. Ion has been programming since he was eight years old! Ion's dad is a prominent nuclear scientist. So much for Ion's creds. When Ion studied at Stanford graduate school, his roommate founded eBay. Ion's $1,300 investment in the eBay startup became worth millions. In 1992, at the dawn of the Internet, Ion met Elon Musk. Elon had come to

Palo Alto to research battery technologies in Stanford's labs. Elon dropped out after only six days! Further, while at Stanford, Ion was the teaching instructor for JB Straubel, Tesla's CTO and chief engineer. Ion believes JB and his team are better at battery technology than anyone else. It was lucky for Ion that he met both Elon and JB. Ion invested in Tesla when it was just beginning, and so far has made a lot more than he did in eBay. After meeting Ion, we concluded it was lucky for Elon and JB they met Ion as well.

Our meeting with Dr. Yadigaroglu is one example of Baron Funds' differentiated primary research approach. Few institutional investors have met with Elon and JB. Fewer still, we're guessing, have met with the co-founder's teaching instructor at Stanford. We believe fewer and fewer in the investment industry are performing even the most basic research on businesses. There is a reason for this. During the past 15 years, boosted by virtually instantaneous communications, computer algorithms, and the increasing popularity of ETFs, securities trading volumes have multiplied exponentially. As computers and software have replaced traders and marketplaces, brokerage commission revenues have fallen dramatically. Brokerage commissions historically have been used to pay for investment research. Ergo, investment research budgets have been cut significantly; there are now far fewer financial analysts; and "price discovery" and markets have become less efficient.

We believe the fewer people who do research, the more valuable the fundamental research we conduct and the more likely it is that we will continue to outperform. This is although we cannot guarantee that we will. One Tesla executive with whom I speak regularly recently remarked to me, "It is amazing to me how little most people know about Tesla."

One of my golf friends recently remarked, "I love to play poker with people who think the game is all about luck." My friend wins so often and so much, he thought he was going to be asked to leave his game. One of our mutual friends who plays in that game marvels how this individual "knows" what cards are in his hand without seeing them. "It's about mathematics and 'reading the table,' studying how your opponents bet their hands," my friend explained to me. Which is just like world championship bridge. Teams that compete in bridge study books several inches thick on "conventions" and practice diligently. Based on my observation, people who earn lots of "masters points" don't earn them because they are lucky.

Just like anything else, the harder you "work," the "luckier" you get. We think the same goes for investors who earn returns significantly greater than those of the market over the long term.

Fearless

IAN CASSEL JULY 3, 2018

When I was younger I would immediately take big positions. If I liked something, I would go all in. I was fearless.

This strategy worked until it didn't.

Today I buy a third to a half of a full position after due diligence and I'll add more as management executes. Inexperience almost always underestimates risk. The more you experience the more you respect what you are up against.

But it's a balancing act.

Investing's greatest lessons can't be taught in a book or in a classroom. They have to be experienced and often times the teacher is loss. And losses can be painful.

The most painful part of loss isn't financial but mental. The battle scars left behind can paralyze you. The spirit of courage you were born with turns to fear. Fear slows you down. Indecision can be an investors biggest adversary.

You can't let past failures and losses steal your courage to act when you spot an opportunity. It's hard for scared money to make money, especially when investing in emerging small companies like microcaps.

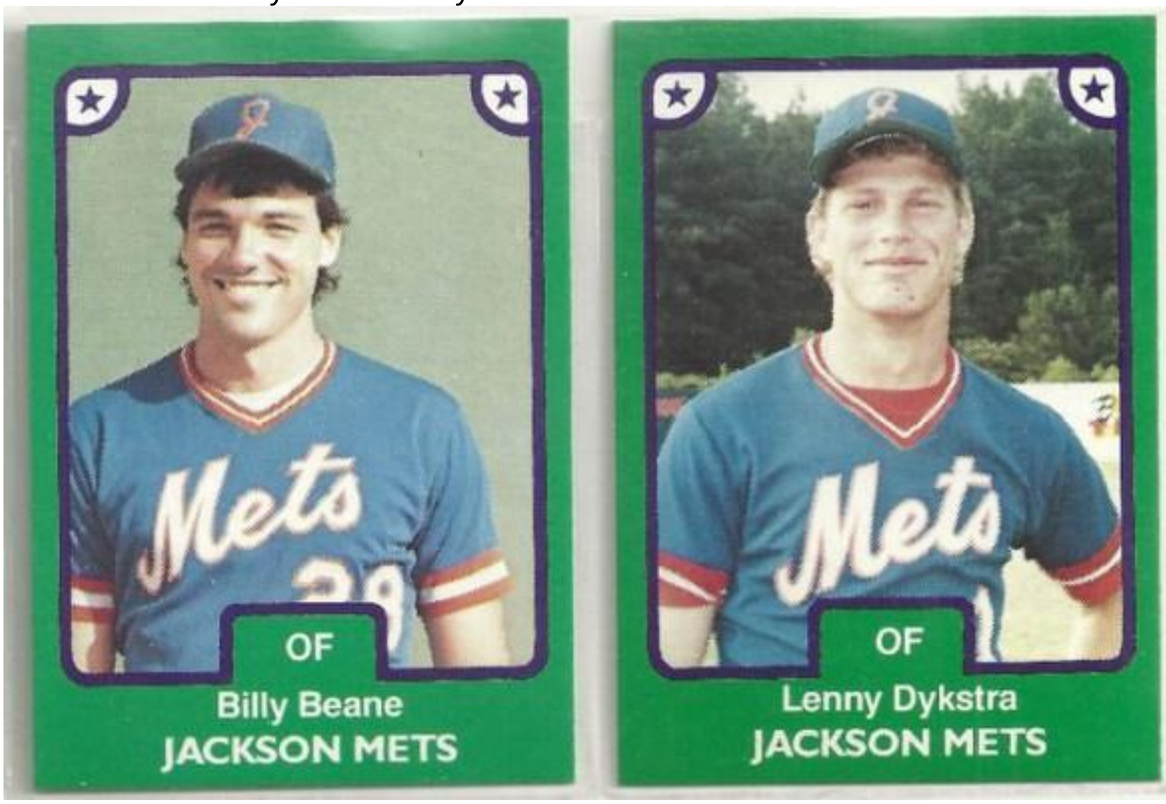
Here is an excerpt from the book, Big Mistakes – The Best Investors And Their Worst Investments, by Michael Batnick:

A team of researchers studied brain-damaged individuals with normal IQ's. The parts of the brain responsible for emotions was damaged, which limited their ability to experience ordinary feelings such as stress, regret, and anxiety. The Wall Street Journal reported on this link in 2005:

The study suggests the participants lack of emotional responsiveness actually gave them an advantage when they played a simple investment game. The emotionally impaired players were more willing to take gambles that had high payoffs because they lacked fear. Players with undamaged brain wiring, however, were more cautious and reactive during the game, and would up with less money at the end.

The findings above shouldn't surprise anyone, and I think it could be applied to business, life, and even sports. Think about how much you could accomplish if you were fearless.

In Moneyball, author Michael Lewis chronicles the life of Billy Beane, a General Manager of the Oakland Athletics. Beane utilized sabermetric principles to run the financially strapped team in an extremely effective way.



In 1980, Billy Beane was drafted in the first round by the Mets, the same year Darryl Strawberry was drafted. Beane looked like Mr. Baseball and was perceived as having an extreme amount of talent, but he never lived up to the hype hitting just .219 with 3 homers in 301 at bats across eight seasons.

Here is a highly entertaining excerpt where Billy Beane compares himself to teammate Lenny Dykstra and why he (Billy) failed as a baseball player (*source:* *Intelligent Fanatics*):

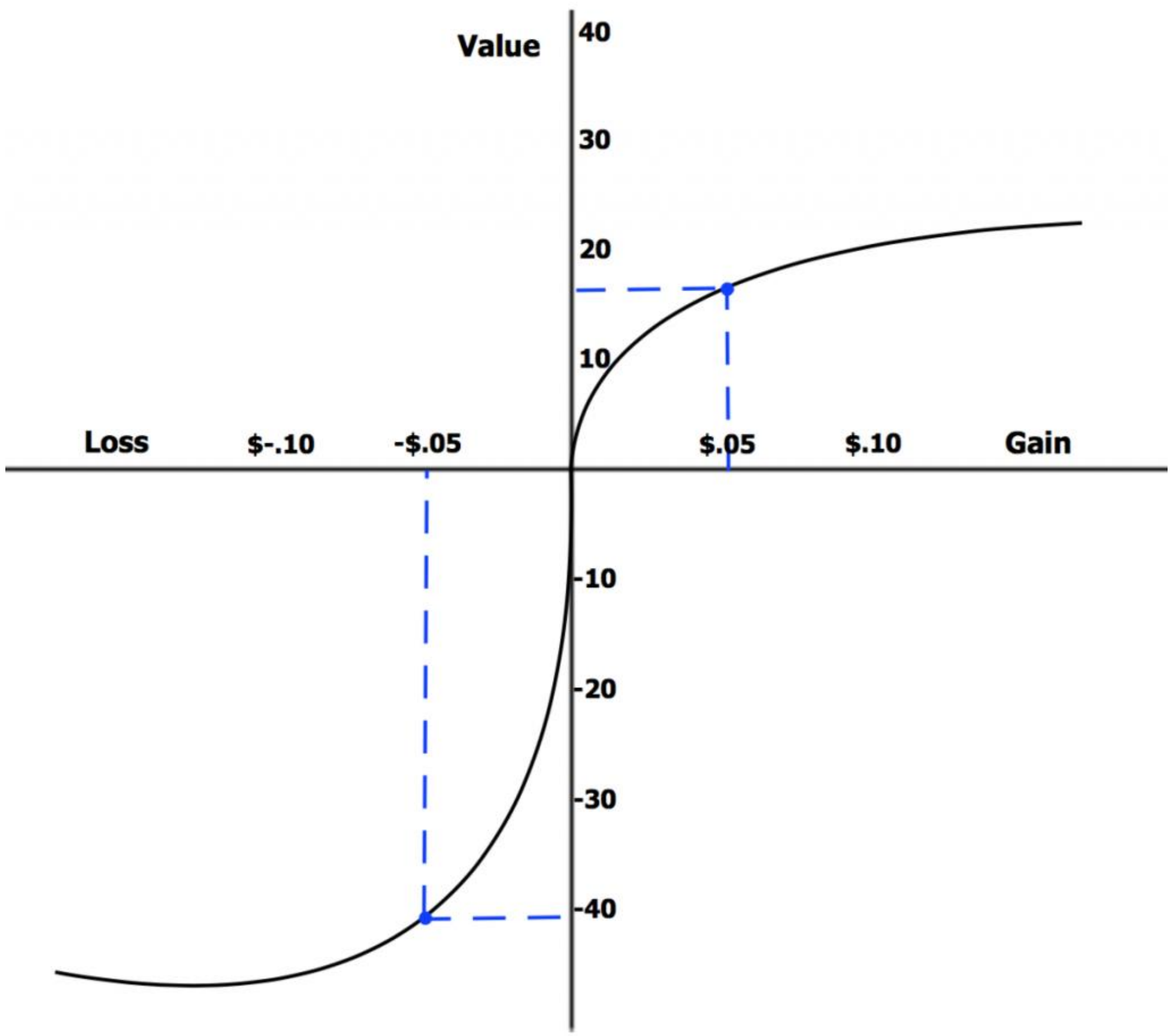
Physically, Lenny didn't belong in the same league with him. He was half Billy's size and had a fraction of Billy's promise – which is why the Mets hadn't drafted him until the 13th round. Mentally, Lenny was superior, which was odd, considering Lenny wasn't what you'd call a student of the game. Billy remembers sitting with Lenny in a Mets dugout watching the opposing pitcher warm up. 'Lenny says, "So who's that big dumb ass out there on the hill?" And I say, "Lenny, you're kidding me, right? That's Steve Carlton. He's maybe the greatest left-hander in the history of the game." Lenny says, "Oh, yeah! I knew that!" He sits there for a minute and says, "So, what's he got?" and I say, "Lenny, come on. Steve Carlton. He's got heat and also maybe the nastiest slider ever." And Lenny sits there for a while longer as if he's taking that in. Finally, he just says, "Shit, I'll stick him." I'm sitting here thinking, that's a magazine cover out there on the hill and all Lenny can think is that he'll stick him."

The point about Lenny, at least to Billy, was clear: Lenny didn't let his mind screw him up. The physical gifts required to play pro ball were, in some ways, less extraordinary than the mental ones. Only a psychological freak could approach a 100-mph fastball aimed not all that far from his head with total confidence.

“Lenny was so perfectly designed, emotionally, to play the game of baseball,” said Billy. “He was able to instantly forget any failure and draw strength from every success. He had no concept of failure. And he had no idea where he was. And I was the opposite.”

I’ve come across a lot of investors whose past battle scars and experiences knocked them out of the game. They weren’t necessarily knocked out financially, they were knocked out mentally.

Research has shown that negative events impact us more than positive ones. Negative emotions generally involve more thinking, and the information is processed more thoroughly than positive ones. In addition, bad events wear off more slowly than good ones.



LOSS AVERSION IS DISPROPORTIONAL TO GAIN SATISFACTION

The same can be said with investing. It is what Daniel Kahneman and Amos Tversky first coined as loss aversion. You are more upset about losing $100 than you are happy about gaining $100. In fact, in many cases you are 2-3x more upset about losing $100 than you are happy about gaining $100. We then we go out of our way to avoid negative events and outcomes even if there is a greater probability of a positive outcome.

What does it look like?

You can't think rationally. You are indecisive, and it cuts both ways. You can't act but you also can't decide not to act. You just sit there second and third guessing your research and intuition. When this happens you are done.

"Experience is what you got when you didn't get what you wanted."
– Howard Marks

How do we gain experience without losing our fearlessness? Every investor is different, but let me give you a few points that have helped me through the years.

- **Build a foundation that won't crumble**. Discipline is when your values and long-term goals change your short-term behavior. This process gives you the foundation for success, not only in investing but life. Picture where you want to be and have the self-awareness to eliminate the bad habits and people that are holding you back.

- **Be patient. Focus on the process not the outcome**. Give yourself the time to go through the process to be who you want to be. The process is often filled with disciplined boring days. The outcome can take months or years, so in the meantime keep a journal of your process and keep refining it.

- **You are not going to be right all the time.** If you accept this fact, which few do, it will take the weight of the world off your shoulders. Perfection is not your goal. It's not batting average that is important, it's slugging percentage. Most of the greatest investors ever, a bulk of their lifetime gains came from 10-20 successful investments. 10-20 successful ones out of hundreds of investments made. Ben Graham made more money when he broke his rules (GEICO) than he did adhering to them (the rest of his portfolio). You are not going to be right all the time.

- **Own your mistakes, but don't dwell on them**. Just like Lenny Dykstra, being dumb in the right areas can be your biggest asset. Especially with black swan events. Sometimes sh!t happens. You don't need to beat yourself up over it. Control what you can control. Don't let a single loss take you out of the game.

- **Gains and losses tend to happen in bunches**. The more concentrated you are the higher the likelihood you will go through long stretches when nothing seems to be working in the portfolio. You need to align your life, emotions, spending, and your investors (if you manage other people's money) in a way that affords you the time to be successful.

- **Don't talk openly about your positions unless you can turn your back on the crowd**. The more public you become with your positions, the harder it is to let go of a position if the story changes. You can't let the weight of public opinion slow you down.

- **Don't worry if no one likes your investment idea**. If the company is profitable and growing and not diluting the crowd will eventually come back to it.

- **Amateur investors focus on the stock price. Professional investors focus on the business**.

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- **Compare new opportunities against what you already own**. A new addition to the portfolio needs to be better than what you already own. Raise the average, otherwise you are diluting your returns.

- **Don't compare yourself to others.** Let other investors run their race. Too much time is wasted watching stocks you would never buy at any price and then beating yourself up over not owning them when they advance. Howard Marks says, "To be a disciplined investor you have to be willing to stand by and watch other people make money on things that you passed on".

- **Evolve or go extinct**. Do not rest on your laurels. Stop reliving the memories of when great businesses could be purchased at 3-5 PEs. Those days are over.

> What worked 10-20 years ago might not work today. What works today might not work in 10-20 years. Keep learning and evolving.

Many investors are fragile. When you apply pressure to an object that is fragile it shatters. I believe the best investors are antifragile. They become stronger under pressure and stress. They weren't born this way, but their lives and philosophies were built on a solid foundation that wouldn't crack under pressure. They cared little for public opinion. They learned from mistakes and drew strength from every success. Mr. Market could never connect with a knock-out punch because they wouldn't stand still long enough. They were always learning, moving and evolving. Their resources accumulated as the result of prudence, patience, and occasional aggression when the odds were in their favor. They were decisive. They were fearless.

"Experience tends to confirm a long-held notion that being prepared, on a few occasions in a lifetime, to act promptly in scale, in doing some simple and logical thing, will often dramatically improve the financial results of that lifetime. A few major opportunities, clearly recognizable as such, will usually come to one who continuously searches and waits, with a curious mind that loves diagnosis involving multiple variables. And then all that is required is a willingness to bet heavily when the odds are extremely favorable, using resources available as a result of prudence and patience in the past."
— Charlie Munger

(H/T Vivek Mashrani for this quote)

All it Takes is One

IAN CASSEL NOVEMBER 6, 2018 BLOG, EDUCATIONAL 1 COMMENT

It is incredibly humbling, inspiring, and a bit scary when you realize that one great investment can make your year, decade, and even career.

In 1980, Stewart Horejsi was having doubts that his business would survive. His company, Brown Welding Supply LLC, had been in business for 50 years, but they were slowly losing market share to the competition.

Horejsi heard about Berkshire Hathaway in John Train's "The Money Masters". He was frustrated with the growth prospects for his business, so he took some cash and bought 40 shares of Berkshire Hathaway at $265. Two weeks later he bought 60 shares at $295. A month later he bought 200 shares at $330 per share.

He went to the annual meetings when there were less than a dozen people in attendance. He actually made his friends go too because he was worried the company would stop having them because attendance was so low.

‘I kept running the [family] business, but I just kept buying Berkshire. I can’t really believe I put so much into one issue, though,’ he said.

His 4,300 Class A Shares are now worth $1.4 billion.

In 1999, legendary fund manager Bill Miller ran into some Amazon executives at the Santa Fe Institute. The institute is a think tank, and Miller sat on its board. He spoke to the executives for hours. Leaving the meeting he said, “[Amazon] has incredible economies of scale, which will eventually become apparent.”

He started buying Amazon in September 1999 when it was $80 per share. Then, after the dot-com bubble crashed the stock plummeted. Miller didn’t sell. He bought more at $20, $10, and $7. It was 15% of his fund. Everyone said he was out of his mind.

In early 2002, he made a bold prediction about Amazon. “If we’re right,” he declared, “we think we’ll make 50 times our money over ten years.”

No one was listening. We know what happens next. Miller still holds shares that he purchased in 2001.

In a recent presentation, Investing is Hard, I shared with you the story of Masayoshi Son, the founder of Softbank. Masayoshi Son is said to have made The Most Successful Investment in the History of Mankind. His $20 million investment in Alibaba in 1999 is now worth $120 billion. A 6500x return.

Perhaps what is even more important is this one investment bailed him out of many failed investments. In fact, the Alibaba position today is worth more than the entire market cap of Softbank.

I give you these investing examples not to endorse going all in on one company.

For every story like Stewart Horejsi there are thousands of other stories where people lost most of their money going all in on one company.

For every story like Bill Miller averaging down and down and down into a contrarian position, there are thousands of others that averaged down into profitless companies that lost everything.

For every story like Masayoshi Son who made over 100 investments during the dot-com bubble, and a couple of those investments saved him from complete disaster, there are thousands of others that didn’t get so lucky.

The fascinating thing is some of the best investment returns will come from positions where you had the least conviction.

Mr. Market has a maddening sense of humor. Time and time again he will make the positions you have the least conviction in perform the best and the positions you have the most conviction in perform the worst. It's the markets way of forcing you to respect the game.

The beauty of microcap investing is these businesses are small. If management executes there is a lot of room to run to the upside. Because they are small you'll have plenty of time to own more of the management teams that are executing.

You don't need to go all in on one to generate alpha. A basket of 6-10-15 positions will give you ample shot to get the big one. All it takes is one.

Slow Down

IAN CASSEL DECEMBER 11, 2018

The biggest impediment to long-term wealth creation is your desire to get rich as quickly as possible.

You are going to run into people that got rich quickly by taking a lot of risk. Most of them know they got lucky, and unfortunately many of them lose it all. Why is that? Because their luck took them to a place that their character and process couldn't keep them.

Unfortunately most microcap investors are attracted to high risk situations and the wrong leaders. Many investors like to be sold. They like big bold short-term catalysts and promises. Most microcap investors would rather have a 5% shot at a 500% return in the next in 6 months rather than a 85% chance at a 100% return in the next 36 months.

I get caught up in it as well. For me, it's when I'm down in an investment or have lost money in an investment. It's human nature when you lose money quickly you want to make it back twice as quick. Don't make a bad decision compound.

Slow down.

Here is a question that helps refocus me on what is important:

Where can I conservatively double my money in 3-years?

This might sound boring to most microcap investors. It isn't.

If you double your money in 3-years it is a 26% compounded annual return. If you can do that over the long-term you are one of the best investors on the planet.

A big misperception is when people think “multi-bagger” means ascending quickly in a short period of time. Just like a fine wine, they often take their time to mature and develop.

In a previous article I wrote, We investors are such fickle creatures. Immediately after we are done buying a position, our enthusiasm starts to fade. We would have cursed the stock if it would have moved higher as we bought our position, but now that we are done buying, we curse it for not immediately moving higher.

When you feel yourself getting impatient, slow down, recalibrate and ask yourself:

Am I still in positioned in investments that can conservatively double in 3-years?

Instead of focusing on where you can make 500% in the next 6 months, invert that and find situations where you can’t lose over the next few years. The latter is often times where you will find the next great winner.

Rocket Ships

IAN CASSEL FEBRUARY 13, 2019

Investors are always looking for the perfect opportunity. A good business you can buy at less than tangible book value. Why not throw in a couple long-term tailwinds and short-term catalysts. Sign me up. I’ll take two.

But in reality you won’t find too many perfect situations. Microcap investing is by an large a game of acting on imperfect information. Often times an opportunity is an opportunity because the conditions aren’t perfect yet.

As you gain experience you get better at identifying the good that can become great, understanding weaknesses that can be overcome, and identifying situations with unique optionality.

I thought I would spend some time talking about microcap portfolio construction. My thoughts on this have changed quite a bit over the years. I’m a firm believer that If your strategy or thought process hasn’t changed in 10 years you aren’t learning. You need to constantly evolve to stay in the game.

My portfolio today is made up of a diverse set of companies. There are product companies and service companies. There are deep value stocks and story stocks. There are profitable and unprofitable companies. There is even a mining company. “My goodness Ian, you have a family. Don’t you know mining is where capital goes to die.” The mix of companies I just described probably sounds chaotic.

If you were to ask a healthy person what they had to eat last week – to list the foods they ate during the entire week. I'm sure it would look like chaos. But you would quickly be able to divide the foods into groups. A well balanced diet consists of dairy, vegetables, fruits, grains, and protein. The food groups are important, but so is the portion sizing. This is how I think about portfolio construction.

My portfolio looks like chaos, but it isn't. I divide my holdings into groups or categories. Each category serves a purpose and in the right proportions supplies a slightly different set of optionality to the portfolio.

I'm trying to invest in intelligent fanatic led businesses that are misunderstood by the market place. I'm looking for situations whose stocks can conservatively double in three years. That is the goal.

Over the years I've found that these misunderstood situations generally fall into three groups or categories:

- **Good to Great Businesses**

A business that dominates an expanding niche market and whose happy customers continuously pull them into underserved markets. Proven management that has either created their market or have taken market share away from competitors. A product or service that is needed by a diverse set of customers. They are called Good to Great Businesses because they are a good businesses that I believe can turn into a great businesses. For discussion purposes I don't call any microcap a great business until it ascends out of the microcap arena. These companies can often go misunderstood if earnings are depressed due to reinvestment or if management is not promotional. As long as they keep growing and earning more money they will be found by institutions. This is the largest category of my portfolio.

- **Turnarounds**

A stagnant or declining business whose management is making strategic steps to transition to growth. This normally means cutting cuts, selling off non-core assets, and focusing on a growth vertical where they have a competitive advantage. These situations usually take more time to turn than most shareholders can stomach. The opportunity is to understand the turnaround process and to accumulate when you see the signs of it turning. Successful turnaround investments are companies you initially buy based on the balance sheet (deep value valuation) but eventually trade based on the income statement (growth valuation). This is the second largest category in my portfolio.

- **Rocket Ships**

A situation that offers rocket ship type returns. The issue is rocket ships rarely take off on time or even at all. A recent NASA study showed that 39% of space shuttles take off on time. NASA utilizes the best checklists in the world 30 days prior to take off and the result is still a low takeoff percentage. Half the delays are technical malfunctions, and the other half are weather related. The same can be said for rocket ship stocks. The key to rocket ship investing is finding those rare situations where you won't lose much money if the launch is delayed or doesn't take off at all. These are small strategic investments. You never bet the farm. Rocket ships are the smallest category in my portfolio. But if one does take off, it can take the entire portfolio with it.

I own companies in each of these categories. In all three categories I try to only invest in leadership that exudes many of these intelligent fanatic principles and values:

- Mission Driven
- Beginners Mindset
- Learning Machines
- Intrinsically Motivated – Inner Scorecard
- Capacity to Suffer – Personal Sacrifice
- Prevailed through Adversity (GRIT)
- Obsessed with Eliminating Risk
- Large ownership – Low Salary
- Frugal
- Lead by Example – Blue Collar Founders
- Teachers
- Employee First Mentality

My strategy has evolved. I try to utilize the full arsenal of investing disciplines. I think too many start investing a certain way and feel forced to continue down that path – to stay in their lane. "I'm a deep value investor." "I'm a growth investor". "I'm a special situations investor". "I'm a Buffett Disciple". You don't need to label yourself. If you study the best investors ever they have almost opposing investment strategies. Don't be afraid to be unique. Be afraid if you're not. The key to investing success is thinking different and better.

Buy And Verify

IAN CASSEL MAY 30, 2019

The "Coffee Can Portfolio" approach to investing might work for larger companies, but it's the surest way to go broke in small microcap companies. Small microcaps evolve in different ways, and a lot of the ways aren't good ways. You can't buy and forget, you need to buy and verify, and the smaller the company the more often you verify.

Microcaps are like three year old children. They can be totally unpredictable. One moment they are cuddling with you on the couch and the next minute they are trying to burn your house down. It's why you have to watch your microcaps like you watch your small children. Closely.

Due diligence doesn’t end with your purchase of a stock. It is just beginning. Your initial due diligence might get you invested but it’s your maintenance due diligence that will keep you invested. Especially with microcaps, don’t take your eye off of them. Situations can change in an instant. Know what you own at all times.

We all want to compound capital at high rates. Time and interest are the primary components of the power of compounding. Over a lifetime you will likely own 10-20 big winners and hundreds of losers. Your future returns will be decided by how well you can hold onto the handful of winners while cutting the plethora of losers. Losers are a waste of your time. I’m still a full-time investor today not because of my gains, but because of the losses I didn’t take. A big part of investment success is identifying the losers quicker.

When you know a company really well you can almost feel the pulse of the company. It has a rhythm. And you can feel when it changes. How do you find the pulse?

Study the Market

Understand the tailwinds or themes that are pushing demand. Will it continue? For how Long? What could disrupt it? How are things evolving? e.g. smaller, faster, cheaper, more transparent, etc. Subscribe to trade journals or industry publications. Set up Google Alerts for key phrases and news.

Study the Customers

Why would they choose one company over another? Is it price, service, features? What type of customer best fits the company you are looking to invest in? How many competitors are in that subset of customers and does your company really have the best solution?

Study the Competitors

Understand the competitive landscape and how each of the major players differentiates themselves. If competitors are public companies, study their financials and listen to their conference calls. Follow the competitive news flow. If they are private competitors – Are they growing? Are they hiring? How do job openings compare to 6 months ago, 1-2 years ago? Keep a look out for anything disruptive. Even if it’s just optical disruption (not literal) it can make an impact on perception and stock price.

Study the Company and Culture

Great companies have happy customers and happy employees. Talk to management and a few people right below the C-Suite. Talk to a salesperson or two at the company. Ask them what would allow them to sell more? Talk to lower level employees to gauge the culture. Talk to people. Talk to people. Talk to people. Form relationships so you can check in from time to time.

The only thing more important than having a great investment thesis is knowing what will kill your investment thesis and having the decisiveness to act.

As you study the business write down a list of things, actions, events, that would impact your investment thesis. You should rank them by severity. When appropriate and in the right way, go over the list with management to get their thoughts. You might learn from them that some of the items on the list are more or less important than you originally thought. This list will likely evolve the longer you own an investment. Some items will move up or down the list or drop off completely while other items will be added.

When you do the work you find the pulse of the company. You then need to check the pulse regularly and verify all the areas we outlined above to watch for any sudden changes. The key is identifying these things before the rest of the market. Keep that list of potential thesis killers front and center.

You are looking for external and internal tells. An external tell is when something outside of the company has changed. An internal tell is when something inside the company has changed which could impact your thesis.

The other day I tweeted my top three biggest investing mistakes.

There have been several occasions where I did the work and could feel the pulse of the company change for the worse but didn't sell. 100% of the time it was a mistake not to sell. In some of these instances I had anchored my ego to the position. When the facts and story change don't let your ego get in the way of selling.
All successful investors have two things in common. They are extremely disciplined and they understand the downside of their investments even more than the upside. A big part of winning big is only losing small.

Evolve or Die

IAN CASSEL OCTOBER 23, 2019

Every successful investor has gone through situations that have rattled them to their core – that made them question their strategy, their abilities, everything. It happens after something you really believe in lets you down. Don't worry, you aren't alone. It happens to EVERYONE.

In 2007, fund manager Mark Sellers, gave a speech to a group of Harvard MBA students titled: So You Want To Be The Next Warren Buffett? How is Your Writing?

In his speech, he lead with, "I'm not here to teach you how to be a great investor. On the contrary, I'm here to tell you why very few of you can ever hope to achieve this status."

If you read past the sentence above you would eventually make your way to a list of seven traits which Sellers believed were imperative to becoming a great investor. But before he gave the list he had another clenched fist gut shot to the aspiring investor:

“The way I see it, there are at least seven traits great investors share that are true sources of advantage because they can’t be learned once a person reaches adulthood. In fact, some of them can’t be learned at all; you’re either born with them or you aren’t.”

Here is an abbreviated list of the seven traits:

1. Ability to buy stocks while others are panicking and sell stocks while others are euphoric.
2. Obsessed about playing the game and wanting to win.
3. The willingness to learn from past mistakes.
4. An inherent sense of risk, based on common sense.
5. Confidence in their own convictions and ability to stick with them, even when facing criticism.
6. Keep both sides of their brains working, details and big picture.
7. The ability to live through volatility without changing your investment thought process.

16 months after giving this speech Sellers closed down his fund.

“I truly love the art of investing, but managing people’s money has taken a large toll on my demeanor and psyche,” Sellers said in a letter obtained by The New York Post. “I feel downright miserable.”

“I have found myself neglecting my personal life (friends, family) in order to put 100% of my energy into managing the fund. I can’t continue to do that; it isn’t healthy.”

Sellers and his wife would move to Grand Rapids, Michigan and open several bars and restaurants and live a much happier life.

“The restaurant-bar business is a lot more fun. It’s not the day-to-day volatility and stress of managing other peoples’ money. This seems like a walk in the park to me after doing that.”

We all have our breaking points.

On a rainy day in 2016, I had planned to tell my wife I was burnt out. I was done.

I had been a full-time private investor for seven years, and before that it might as well been full-time. Sitting at a computer staring at stocks was all I’ve done since I was a teenager. I had carved out a nice little niche in microcap stocks. But I felt unfulfilled. I was becoming the person I didn’t want to be. A miserable lonely person.

It had been a few years since I had a winner, and the longer it went the shorter my time frames became. The hardest part about owning a concentrated portfolio isn’t financial risk but thinking about your positions too much. The shorter your time horizon the more you need your positions to perform to your expectations. The market doesn’t work this way.

Whether it’s relationships or stock positions, when you hold anything too tight you are going to lose them. You grip them tight because you want them to be who you want them to be instead of who they are. In reality you should be doing the opposite. Give them some room to breathe. Some room to disappoint you but still hold on. Some room to exceed your expectations but not sell.

An hour before my wife was supposed to come home that day I snapped out of my mental rut. I wrote down a list of things that I needed to do to keep me in the game.

I sold my biggest loser in the portfolio. Your biggest loser is always the position you think about most. It has the most mindshare. I had to free up my mind and some capital to focus on new things.

For 15 years I had always been a very concentrated investor – holding 3-4-5 companies. This is a great way to start investing but it’s an easy way to end your career in investing. Sellers himself was primarily in three companies when he shut down his fund. The fewer positions you hold the more you think you are in control when in reality you have less control. You have no room for error.

Investing is a mind game. You need to have a win, even a small win, in the portfolio every so often to keep you positive and sharp. If you are in a rut as a concentrated investor, increase your chances of winning and add a couple positions. It also lets you breathe and your positions breathe a bit. You aren’t staring at them “needing a win”. You can just let it happen. I added three more positions.

The third area that I changed was I stopped thinking like a scientist and started thinking like an artist. In the first few years of my career I was mainly a story stock investor. I paid very little attention to fundamentals. I then pivoted to mining for a few years and then life sciences, and then to quality businesses.

In 2013-2016 my portfolio was very bland and one dimensional. All different shades of the same color. There was no evidence in my portfolio of my earlier years, where quite frankly I did very well. So I repainted my portfolio and used all the colors I had at my disposal. Today my portfolio looks like a hot mess. There are mining companies beside life science companies beside story stocks beside deep value companies and quality businesses. But this is my painting and it’s who I am.

After I made these changes I started winning again. I got my confidence back. Great investors evolve or go extinct. Don’t spend the next 10 years bragging about the returns you had 20 years ago. Stay in the game. Challenge your convictions. Make your own painting.

“Why do I come in at 7 every morning, can’t wait to get to work. It’s because I get to paint my own painting and I like applause.”

– Warren Buffett

Unbreakable

IAN CASSEL JUNE 20, 2019

Successful investing is hard work because it means disciplining your mind to do the opposite of human nature. Buying during a panic, selling during euphoria, and holding on when you are bored and crave action. Investing is 5% intellect and 95% temperament. You often have to turn your back to the crowd and stand on your own. It takes strength. It takes courage. If you are a normal passive investor that invests in a bunch of diversified ETFs and mutual funds you only have to worry about market volatility. But if you are a stock picker you have 10x the emotional load. You have to be a rock. You must be unbreakable.

From 1999-2000 I was a Psychology major in college. I was getting more and more into investing and felt a degree in psychology would probably help me more than a finance degree. Then I realized I would have to go to school for another 1,345 years (slight sarcasm) to get a Graduate and PhD so I could eke out a living. I changed my major to Economics. I didn’t realize it then but I was about the get a PhD in Market Psychology. At the time I was also working for a financial advisor so I could pay my way through college. When the technology bubble burst and stocks plummeted I had to answer the phones in the office and talk to clients. They were highly emotional. I also lost 80% of my own money during the crash after making a ton flipping technology stocks on the way up.

By late 2001 most of my mid-cap tech portfolio turned into microcaps. I was already looking at smaller and smaller companies and was trying to make my money back. I stumbled upon an article on XM Satellite Radio. This is when my love affair with microcaps started. You can read about it [HERE]. I ended up putting the $10,000 I had left into XM and it went from $1.78 to $34.00 in 14 months. It was all luck, but I felt smart.

From 2002-2005 I learned microcap investing from losing my money and making it back and by listening to a few mentors I met on public stock message boards. I laugh when I think about some of the experiences. Let me tell you a fun one.

In 2005 Hurricane Katrina hit Florida and Louisiana. It was devastating. New Orleans was under water. $125 billion in damage. The government sent resources, aid, and paid whatever was necessary to get it cleaned up as soon as possible. Disaster remediation companies were sent in and made a lot of money. A microcap company was going to do a rollup of the disaster remediation space. The first acquisition was the 2nd largest disaster remediation company in the US. The company just did $180 million in revenues and earned $60 million in profits cleaning up after Katrina. I purchased shares. It went up 10x in 9-months. I rode the stock the whole way back down. A seven figure lesson. I was broken.

I have other entertaining stories like this. Some are too crazy to repeat. I wouldn’t trade them for all the money I lost. An investor must experience the highs of success and lows of failure several times before they can exploit these emotions in others.

I've been a full-time private investor for over 10 years. When you support yourself on your own capital it adds an additional layer of emotions. You have to produce. Your family's livelihood depends on it. You can't let them down. I talk about this [HERE]. Most professional investors don't know what it's like to sell stocks to pay bills. When you are supporting yourself on your own capital there is no such thing as savings. It's just different degrees of spending. To make it work you need to be extremely disciplined. You can't be broken.

When a group of graduate students visited legendary investor Michael Steinhardt one of the students asked him for his best piece of advice. Steinhardt replied, "I'm your competition."

I would like to share with you some lessons I've learned that anyone can put into action to be a better investor. They are so simple that few people actually do them, but if you do you will have edge on almost everyone. You will be unbreakable.

Unbreakable when the markets are falling

What is the worst case scenario? We hit a market environment like 2008 and your portfolio is down 50% in a year and you don't have any cash. This was the scenario for 90% of professional investors. What can you control about this situation? You can't control stock prices. The answer is CASH. If your portfolio was down 50% but you had cash to deploy how bad would it be? Half as bad. A quarter as bad. It wouldn't be that bad right? Right. A bear market is only bad if you can't take advantage of it. The difference between having cash and no cash is confidence vs despondence.

December is a great month to bargain hunt in microcap stocks. Why? Tax loss selling. Illiquid microcaps that were losers during the year are sold off even more aggressively in December as investors take the loss for the year and move on. I've often thought you could make almost your entire year's returns being patient and watching beaten down names in December. Many of the stocks might be losers but their businesses are just fine and can rebound quickly. Very few investors have the discipline to have cash to take advantage of the December sell off in beaten down companies.

When you have cash you have confidence. When you don't have cash you are just like everybody else. Cash is a position.

Unbreakable when your stocks are falling

Over a lifetime you will have as many losers as winners. The key is letting your winners run and cutting your losers as quickly as possible. As Andrew Stanton of Pixar says, "Be wrong as fast as you can." Losing money has deep psychological effects on our thinking. Losing can lead you to make more bad decisions. A series of bad decisions can set you back a long time.

In golf they have a statistic called the Bounce Back percentage. Bounce Back is a statistic that shows the percent of holes that scored over par immediately followed by a hole that scored less than par. This stat shows a players ability to "Bounce Back" to good performance after a bad hole. In 2018, Dustin Johnson had the highest bounce back percentage at 29.3%. When Dustin had a bad hole (a bogey), 29.3% of the time he followed that bad hole with a good hole (a birdie). As an investor you also want a high bounce back percentage.

When you lose money you want to make it back twice as quick because you anchor yourself to your original cost basis and your original expectations for returns. Let me give you an example. You buy a stock at $5 that you think can be $10 in a two years. Instead the stock drops to $2.50. At $2.50 you are still thinking about $10. Perhaps the story changed in that stock and you sold, but you are still anchored to that $10 and the desire to now make a 4x return. You start looking for stocks you can make a 4x return instead of a 2x return which are inherently more risky. When you are down in an investment or sell a loser you need to purposefully slow yourself down.

Unbreakable with your largest positions
My largest positions aren't the ones I think I'm going to make the most money from. My largest positions are the ones where I don't think I'm going to lose money. — Joel Greenblatt

Instead of making your largest position the one you think can go up 500% in the next 6 months, your largest position should be the one where you can't lose over the next few years. Ironically, the latter is where you will often find the next big winner.

Unbreakable while waiting

The stock market is similar to life. Wrong decisions are often punished quicker than right decisions are reinforced. Successful investing is delayed gratification. . It is called "delayed" because we always expect the reward sooner than we get it.

How many of your successful investments occurred in the timeframe you originally predicted? How many times do you ever remember saying, "Well that happened a lot sooner than I thought?" Exactly. Not often enough. A majority of my successful investments took longer, in many cases a lot longer than I originally expected. It just proves that even when we are right our timing and expectations are wrong.

Unless you buy a stock at the exact bottom (which is next to impossible), you will be down at some point after you make every investment. Your success entirely depends on how dispassionate you are towards short term stock price fluctuations. Behavior matters.
– Joel Greenblatt

When you finally realize it's impossible to be right in the short-term it frees you up to be right in the long-term. Your time horizon can be your biggest competitive advantage. Let others fight over pennies while you hold for dollars. The key to holding is focusing on the business, not the stock. If you own businesses that are growing, earning more money, and not diluting the market will eventually come back to them and push their stocks higher. Also read Conviction to Hold and The Art of Holding.

Unbreakable Self-Awareness

I'm going to be honest with you. A weakness of mine is optimism bias. When I find a company I like I generally think it can get a lot better. I'm self-aware enough to acknowledge this. There are other people that believe that any good situation can get worse. These people love to look through the filings and can find a misplaced comma in a 100-page document. They love finding discrepancies. It gives them joy. They also happen to be really good at financial analysis and picking up on red flags. I have a few friends that fit this mold and I have them help me from time to time. I'm not ashamed to admit it. I can utilize them for their strengths and it frees me up to focus on my strengths.

Know your strengths but also know your blind spots. Acknowledge your weaknesses. Fill the holes.

Unbreakable You

I learned investing by losing money, making it, losing money, making it. Investing's best teacher is loss. These lessons will stay with you a lifetime and help you develop an investment strategy that is unique to you. Many of the best investors ever have almost opposing investment strategies. Don't be afraid to be different.

Stop trying to prove that your investment strategy is the best one for everyone else. It just needs to be the best one for you. I explain my thoughts on portfolio construction [HERE]. The way I think about things will be different than you. It doesn't mean my way is better than yours. The best strategy for you is the one that keeps you in your winners the longest.

Sometimes what you do doesn't make sense to others. I like to invest in management teams that have skin in the game. What is interesting is you can find empirical research that shows that high insider ownership, founder ownership, CEO ownership doesn't yield greater returns. If the evidence shows it doesn't matter, then why is it still important to me? When I know management has to live with the consequences of their decisions it helps me stay invested longer and hold through the volatility.

I've studied many great investors. Great investors aren't super human. They are super self-aware. They are disciplined and do the simple things that other people don't do. They embrace being different because it doesn't matter what other people think. What matters is returns.

I recently launched Intelligent Fanatics Capital Management, a firm dedicated to the smaller half of the microcap ecosystem. I now manage a few outside accounts and help others gain some intelligent exposure to this unique investment class. I received some great advice from some phenomenal managers when I was setting up the firm. Since I launched I've spent the better part of two months scaring away the wrong investors. The right investors are as important as the right investments because the wrong investors won't let you stay in the right investments. Be very picky with your investors. Don't be afraid to say no. You need operate a strategy like it's a single unit. You must be unbreakable.

Use Your Edge

IAN CASSEL JULY 3, 2019

In 1997, Peter Lynch wrote a great article entitled, Use Your Edge. I've posted an excerpt of it below.

So, what advice would I give to someone with $1 million to invest? The same I'd give to any investor: Find your edge and put it to work by adhering to the following rules:

- With every stock you own, keep track of its story in a logbook. Note any new developments and pay close attention to earnings. Is this a growth play, a cyclical play, or a value play? Stocks do well for a reason and do poorly for a reason. Make sure you know the reasons.
- Pay attention to facts, not forecasts.
- Ask yourself: What will I make if I'm right, and what could I lose if I'm wrong? Look for a risk-reward ratio of three to one or better.
- Before you invest, check the balance sheet to see if the company is financially sound.
- Don't buy options, and don't invest on margin. With options, time works against you, and if you're on margin, a drop in the market can wipe you out.
- When several insiders are buying the company's stock at the same time, it's a positive.
- Average investors should be able to monitor five to ten companies at a time, but nobody is forcing you to own any of them. If you like seven, buy seven. If you like three, buy three. If you like zero, buy zero.
- Be patient. The stocks that have been most rewarding to me have made their greatest gains in the third or fourth year I owned them. A few took ten years.
- Enter early — but not too early. I often think of investing in growth companies in terms of baseball. Try to join the game in the third inning, because a company has proved itself by then. If you buy before the lineup is announced, you're taking an unnecessary risk. There's plenty of time (10 to 15 years in some cases) between the third and the seventh innings, which is where the 10- to 50-baggers are made. If you buy in the late innings, you may be too late.
- Don't buy "cheap" stocks just because they're cheap. Buy them because the fundamentals are improving.
- Buy small companies after they've had a chance to prove they can make a profit.
- Long shots usually backfire or become "no shots."
- If you buy a stock for the dividend, make sure the company can comfortably afford to pay the dividend out of its earnings, even in an economic slump.
- Investigate ten companies and you're likely to find one with bright prospects that aren't reflected in the price. Investigate 50 and you're likely to find 5.

Controlling the Pendulum of Emotions

IAN CASSEL FEBRUARY 27, 2020

When I read long-form investing articles I copy and paste the portions I connect with into word documents and categorize them into folders. I've accumulated around 500 files in 85 different categories. I have files for "ROIC", "long-term", "concentrated", "position sizing", "averaging down", "averaging up", "fear", "jealousy", "over-confidence", etc. It is honestly a tangled mess of folders and files, but it's my tangled mess. I go back to them often for research and reflection.

Joe Koster of ValueInvestingWorld.com recently shared a passage from Howard Marks memo "On the Couch", from January 2016. I ended up reading the entire letter and was drawn to Marks idea of the "investment pendulum" or what I would call the pendulum of emotions. Given the volatile state of the market I thought I would share a few excerpts that I've reflected on and filed away.

Excerpts from On the Couch:

One of the most notable behavioral traits among investors is their tendency to overlook negatives or understate their significance for a while, and then eventually to capitulate and overreact to them on the downside. I attribute a lot of this to psychological failings and the rest to the inability to appreciate the true significance of events.

As negatives accumulate – whether they surface for the first time or just are finally recognized as significant – eventually a time comes when they can no longer be ignored, and **instead they come to be treated as being of overwhelming importance.**

Especially during downdrafts, many investors impute intelligence to the market and look to it to tell them what's going on and what to do about it. This is one of the biggest mistakes you can make. **As Ben Graham pointed out, the day-to-day market isn't a fundamental analyst; it's a barometer of investor sentiment. You just can't take it too seriously.** Market participants have limited insight into what's really happening in terms of fundamentals, and any intelligence that could be behind their buys and sells is obscured by their emotional swings.

Almost 25 years ago, in my second memo ("First Quarter Performance," April 1991), I introduced the concept of the investment pendulum:

“**Although the midpoint of its arc best describes the location of the pendulum “on average,” it actually spends very little of its time there**. Instead, it is almost always swinging toward or away from the extremes of its arc. But whenever the pendulum is near either extreme, it is inevitable that it will move back toward the midpoint sooner or later.”

One of the most significant factors keeping investors from reaching appropriate conclusions is their tendency to assess the world with emotionalism rather than objectivity. Their failings take two primary forms: selective perception and skewed interpretation. In other words, sometimes they take note of only positive events and ignore the negative ones, and sometimes the opposite is true. And sometimes they view events in a positive light, and sometimes it’s negative. But rarely are their perceptions and interpretations balanced and neutral.

Investor psychology rarely gives equal weight to both favorable and unfavorable developments. Likewise, investors’ interpretation of events is usually biased by their emotional reaction to whatever is going on at the moment. Most developments have both helpful and harmful aspects. **But investors generally obsess about one or the other rather than consider both.**

It all seems so obvious: investors rarely maintain objective, rational, neutral and stable positions. First they exhibit high levels of optimism, greed, risk tolerance and credulousness, and their resulting behavior causes asset prices to rise, potential returns to fall and risk to increase. But then, for some reason – perhaps the arrival of a tipping point – they switch to pessimism, fear, risk aversion and skepticism, and this causes asset prices to fall, prospective returns to rise and risk to decrease. Notably, each group of phenomena tends to happen in unison, and the swing from one to the other often goes far beyond what reason might call for.

That’s one of the crazy things: in the real world, things generally fluctuate between “pretty good” and “not so hot.” But in the world of investing, perception often swings from “flawless” to “hopeless.” The pendulum careens from one extreme to the other, spending almost no time at “the happy medium” and rather little in the range of reasonableness. First there’s denial, and then there’s capitulation.

To explain why these bipolar episodes occur, I want to spend a little time on some of the factors behind investor psychology. For the most part they’re easily observed and dissected, and not mysterious. I discussed some of them in “It’s Not Easy”:

Emotion is one of the investor’s greatest enemies. Fear makes it hard to remain optimistic about holdings whose prices are plummeting, just as envy makes it hard to refrain from buying the appreciating assets that everyone else is enjoying owning. Confidence is one of the key emotions, and I attribute a lot of the market’s recent volatility to a swing from too much of it a short while ago to too little more recently. The swing may [result] from disillusionment: it’s particularly painful when investors recognize that they know far less than they had thought about how the world works. It’s important to remain moderate as to confidence, but instead it’s usually the case that confidence – like other emotions – swings radically.

The difficulty of understanding events, their significance and their potential ramifications comes in good part from the kinks in investors' psyches, and it contributes to – and feeds back to exacerbate – investors' responses. **Thus investors tend to emphasize just the positives or the negatives much more often than they take a balanced, objective approach.** And they tend to become optimistic and eager to buy when good news, positively interpreted, has forced prices up . . . and vice versa. All of this is obvious (especially in retrospect), and thus equally obviously, understanding and dealing with it presents a potential way to improve results.

Notions of market efficiency – the idea that most assets are priced "right" – are based on belief in investor rationality and objectivity. But certainly those traits are little seen in real life. "Inefficiencies" – in everyday language, "mispricings" – stem from biases against one asset or in favor of another: legal, cultural, informational, and especially behavioral and emotional. The first three of these exist much less nowadays than they did 30 or 40 years ago, but the latter two still rear their head from time to time. And I'm sure they always will.

My Prescription

To help investors deal with their potential for "human error," this shrink would prescribe a number of elements that can help with the task:

· The first essential element in coping with markets' irrationality is understanding. **The importance of psychology and its influence on markets must be recognized and dealt with.**

· The second key lies in controlling one's emotions. An investor who is as subject as the crowd to emotional error is unlikely to do a superior job of surviving the markets' swings. Thus it is absolutely essential to **keep optimism and fear in the appropriate balance.**

· Emotional self-control isn't enough. **It's also important to have control over one's circumstances. For professionals, that primarily means structuring one's environment so as to limit the impact on them of other people's emotional swings. Examples include inflows to and outflows from funds, fluctuations in market liquidity, and pressure for short-term performance.** At Oaktree we never fail to appreciate the benefit we enjoy from being able to reject "hot money" and limit our funds' redemption provisions.

· And finally there's contrarianism, which can convert other investors' emotional swings from a menace into a tool. Going beyond just fending off emotional fluctuation, **it's highly desirable to become more optimistic when others become more fearful, and vice versa**.

Deserving It

IAN CASSEL JUNE 18, 2020

It’s frustrating watching investors get a better price than you when they did half the work you did. You did the work. You held on when no one else would. You deserve to gain the most for what you’ve been through. They don’t deserve it, but that isn’t how the world works. Timing and luck matter.

Sometimes the most painful positions aren’t the ones that go down but the ones that go nowhere. Earlier this year, I realized a big win in the portfolio during the darkest days of the COVID-19 decline. I was in this stock for 3.5 years waiting and waiting and waiting. Then in one day it went up 300%. Literally, in one day. I guarantee that few people on this planet knew this business better than me and it went up for reasons I never foresaw.

A few weeks before the stock took off, I mentioned the company to a buddy of mine. He spoke to management and bought a slug of stock 30% below my cost basis. Not only did he make more than me in just a few weeks, but he exited at a higher price. I called him the day the stock rocketed, and he hadn’t even realized the stock was up. This gentleman has a net worth 20x mine and it just wasn’t even a priority to even care about it. He ended up waiting until the next morning to sell when the stock was up another 100%.

The experience made me laugh because I’ve always felt you need a certain degree of complacency to get a multi-bagger. You need to do the work but at the same time YOU CAN’T CARE TOO MUCH. When you need something to happen it rarely does. You need to give your positions and yourself room to breathe. When you hold onto something too tight you will never be able to let them take off. Stocks rarely perform in the time frames we predict, and it’s why the market only works for investors that have patience.

I Hope This Inspires You

IAN CASSEL SEPTEMBER 10, 2020

In 1997, on my 16th birthday, my parents sat me down and gave me a choice.
They told me they had saved approximately $20,000 for my college education. They had also co-signed paperwork so that I could open an account with their financial advisor. I could choose what to do with the money.

I had always been interested in money and the stock market. Technology stocks were starting to make daily headlines in the business section of newspapers. I called the financial advisor and he sent me a few analyst reports to review. I bought $5,000 worth of one technology stock. It doubled in two months.
I was hooked.

I filled out applications to a few private and public colleges. I realised I could spend all my money on one semester at a private college or attend a less expensive public university, live at home and commute, work part time, and continue to invest. I chose the latter path. I was in love with investing.

By 2000, I was a sophomore in college and working part time for a financial advisor. We had over 1,000 clients, so we were a sizeable office. My job was that of a glorified secretary who worked on marketing materials and answered the phone. The money I made working was enough to pay for my college tuition. The $20,000 from my parents I turned into $120,000 riding the technology bubble.

I didn't realize I wasn't skilled – I was lucky. A monkey could have picked winning stocks in that environment.

I enjoyed working for the financial advisor. It kept me close to the markets. The financial advisor liked having me there as well. By my second year on the job I was having discussions with him about becoming a financial advisor upon graduation. He even agreed to give me some of his clients to get started.

When the technology bubble burst, so did my portfolio.

By 2001, my portfolio of small–midcap technology companies fell so much they turned into microcaps. My $120,000 was now $8,000. I was financially and emotionally bruised.
Adding insult to injury, my day job consisted of answering calls from emotional clients and calming them down before sending them to my boss. I didn't realize that, in addition to my undergraduate degree in economics, my day job would give me a master's degree in psychology.

It's often how we navigate the valleys in our lives that dictates our future direction. From this point forward I would solely focus on microcap stocks. I also realized I didn't want to be a financial advisor. It is hard enough navigating your own emotions when investing, let alone the emotions of others. My goal from that point forward was to become a full-time private investor.
I achieved this goal seven years later in 2008. I first read Free Capital in 2014 and immediately connected with it. I could see pieces of my own story scattered throughout the book. It was the first book written for me. I loved how each investor's journey and strategies were unique. At its core Free Capital is a book about financial independence and doing it your own way.

The first step to becoming financially independent is realizing money is about freedom not consumption – and this freedom can be achieved by anyone. I think a lot of people make the mistake of thinking they need enough money to do nothing. This is incorrect. You just need enough to do whatever you want. The power is having a choice.

You achieve financial independence by saving more than you spend, and investing those savings into an area where you have an advantage. For me it was microcap stocks, the smallest public companies in the world. For you it might be another area of the public markets or maybe even real estate, or some other area of expertise. Through skill and prudence, you get to a point where you finally have a choice. The choice might be to work less to spend more time with family, or go back to school, or start your own business, or perhaps even take a job that pays you less but gives you purpose when you wake up in the morning.

The financial media loves to glorify asset gatherers and managers – those who have built extreme wealth collecting fees by managing the capital of others. There is nothing wrong with this. In fact, today I manage a few outside accounts in addition to my own capital. But I believe the true financial test is turning a small amount of money into a larger amount of money and then supporting yourself on that capital over the long term. This is what the investors in Free Capital managed to do. Their stories remain inspirational.

To be successful as a full-time private investor your strategy and lifestyle need to be in harmony. When you support your family by managing your own capital it's a different mental game. If you take a big loss managing other people's money it hurts your bonus. If you take a big loss when you're a private investor you hurt your family.

Becoming a full-time private investor is the pinnacle of financial achievement. Why? You don't need the help of others for anything. You don't need a boss. You don't need clients. You don't need customers. You don't need their money. You have your own.

In early 2009, a few months after I became a full-time private investor, a friend invited me to a cocktail party in New York City. This was during the depths of the financial crisis. I was able to book a room at the Waldorf Astoria Hotel for $200 per night. A year earlier it was $800 per night. No one was spending money during this time, not even the rich.

I was one of 20 guests at the party. The guestlist was comprised of fund managers, analysts, and other financial professionals. I think they were the last 20 people who still had jobs on Wall Street. What I remember from that night was getting into an argument with a fund manager. I told him I was a full-time private investor. He gave me this look like I was beneath him. He said, "So I guess you weren't good enough to keep your job." I fired back, "You know what you call a fund manager? Someone who can't support themselves on their own capital." I left the party and enjoyed a $20 vodka tonic at the Waldorf. (Drink prices hadn't changed from a year earlier.) Most of the people at that party would lose their jobs.

Here is a fact that few in the financial world want you to know. Individual investors have an edge over investment managers, advisors, analysts, or anyone forced to prove how smart they are to others. You don't need to have an opinion on everything. You don't have distractions. All you have to do is focus on making a few good investment decisions per year and living a great life. One of my mentors is a successful private investor. I won't call him a full-time private investor because he still has a day job. He works his day job not because he has to but because he likes it. His non-financial job offers him lots of autonomy, so he can focus on his investing when he needs to. His job also shields him from questions from family and friends if he were to quit his job and 'retire'. What most don't know about him is he has grown his portfolio from $100,000 to over $50 million over 20 years. You would never know it. He still lives in the same house, still has the same friends, still has the same life. One of his biggest worries is people finding out what he's done and looking at him differently.

You don't hear much about full-time private investors because publicity doesn't benefit them. In fact, publicity hurts them. Full-time private investors like the fact that even family and friends don't quite know what they do for a living. They like the fact that they've built up an extensive knowledge level in a niche of the market where it doesn't benefit them to arm-wave their successes. The advantage of the private investor is you can go places bigger money can't, and build up investment knowledge in an area where few others bother. You can live a comfortable life fishing the same small pond because you know where the fish are. The ability to fit into society, live below your means, and do so under the radar is a big advantage.

When I started dating my wife it took her a solid six months to understand what I did for a living. She just saw me working from home, on the phone, and occasionally making trips to “visit companies”. It didn’t help that I bought a new Porsche 911 the same week we started dating. I was coming off a big win and going through an immature materialistic phase. I’m pretty sure she thought I was a drug dealer. To this day, explaining what I do for a living is excruciating. It’s easier to tell them I’m unemployed; then they look at my wife in sympathy.

Several full-time private investors from Free Capital – including Vince, Peter, Eric, Vernon, Taylor, Sushil, and John Lee – focus on UK smallcaps and microcaps. Did you know that Warren Buffett, Peter Lynch, and many other great investors started in microcap and smallcap stocks as well? I also exclusively invest in the microcap arena. The reason why I and others focus on this area is because it’s one of the only places in the public markets where a small, astute investor has a clear structural advantage. It is impossible for larger institutions to invest in these small companies until these stocks rise and become more liquid. Great investors don’t follow the institutions; they invest where they are going to go.

A few of the investors in Free Capital had to change how they invested as their capital grew. Managing $10,000 is different than managing $1m, is different than managing $10m, is different than managing $50m. Sushil, for instance, only held ten UK small caps when he was younger. As his capital grew, he had to expand the amount of companies to 60 companies. Similarly, I used to invest in six companies, and now I’m in 12–15 companies. If you were to tell me ten years ago I would be investing in 15 companies I would have told you that would be impossible. I would have said, “How could someone keep track of that many companies and know them well?” What I would tell my younger self is: As you gain experience you realize knowing every detail about your investments isn’t the advantage. The advantage is knowing what is important and what isn’t important. I own more companies today because I’ve gotten better at focusing on what is important. I can get similar returns without the risks I was taking a decade ago.

Learning and evolving is a big driver of long-term success as a full-time private investor. All the investors in this book have evolved their strategies. If you are still investing exactly the same way you did ten years ago you aren’t growing. Challenge your convictions. Surround yourself with people who share your values but think differently. I run into a lot of investors still talking about the wins they had 15 years ago. Don’t spend the next ten years bragging about the returns you had 20 years ago. Keep learning and evolving.

My hope is that, with this third edition of Guy Thomas’s Free Capital, more people will read this book and be inspired by it. Financial independence can be achieved by anyone. The great thing about investing is you can reach your goals in a variety of different ways. Some of the greatest investors ever had almost opposing strategies. Don’t be afraid to be unique. Don’t be afraid to be different. I guarantee your journey won’t be a smooth one. Learn from your losers and draw strength from your winners.

As you grow your capital you will reach a pivot point when you feel you finally have a choice to do what you want in life. Some of you will choose to keep your day jobs because you love them. But some of you will choose to finally break free from a job and routine that have been holding you back. Either way, you will know what it truly means to have free capital.
This was written as the foreword for the upcoming 3rd Edition of Free Capital: How 12 private investors made millions in the stock market

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Always Be Thinking Ahead

IAN CASSEL JANUARY 15, 2021

In 2020, many of us outperformed. But to be honest — 2020 was a year that made most of us look a lot smarter than we are. All you had to do was own some technology stocks, not sell them, and you were up 50%+. Apple (AAPL), the largest public company in the world, was up 80% in 2020. Amazon (AMZN), the second largest public company in the world, was up 76%. Tesla (TSLA) was up 740%. I communicated to my IFCM investors in my Q4 Letter, "We don't want to downplay our accomplishments, but truth be told we aren't sitting around hand slapping and grab-assing about the past. We are focused on the future and this is where we will spend the remainder of this letter."

"Make your portfolio reflect your best vision for our future. Always be thinking ahead. Be optimistic. Think about the world that you want to create, because sure enough your dollars and mine, our capital, is helping shape the world."
– David Gardner, Co-Founder, The Motley Fool

David Gardner spoke at our virtual MicroCapClub event this past September. His optimism and enthusiasm were quite apparent when he talked about his portfolio and strategy. It made me evolve my thinking in some ways. In the past I've invested in some good businesses with good fundamentals, but I didn't connect with the product or service. Naturally I would focus too much on the quarterly financials because that's why I was investing in them….for the next set of numbers. I've concluded these types of investments are a distraction.

If you aren't excited about the future, you are in the wrong investments. You need to own investments whose mission, management, and products/services excite and energize you. Why? It's the only way you will be able to hold them. I've added this concept as an overarching filter to my diligence process. I exited a couple positions in 2020 that didn't meet this standard. To achieve a multi-bagger in the portfolio, you have to hold a multi-bagger in the portfolio. Holding can be excruciating. Especially winners. I know it's hard to believe given the market conditions so far in 2021, but my largest position is down 40% since the beginning of the year. Nothing has changed with the business, it's the normal ebbs and flows of holding a winner.

Here is what a multi-bagger looks like over several years:
$1 – $2 – $2 – $3 – $2 – $3 – $4 – $6 – $6 – $12

$1 to $12 in 10 years. This is a 28% compounded annual growth rate (CAGR). This is a phenomenal return. Investors love to consolidate success down to one number. The bad thing about representing growth as a CAGR is it smooths out the volatility and pain to achieve it. High CAGRs aren't smooth linear lines ascending to heaven. They are rollercoasters.

You will have to hold while the stock doubles in a year. You will have to hold as the stock pulls back 50% from its highs. You will have to hold as the stock goes nowhere for months, quarters, maybe years, as fundamentals backfill into a higher stock price. You will have to hold as expectations get too high or management goes through growing pains. You will have to hold as the stock is cheap and expensive. You will have to hold while the stock is loved and hated by other investors.

Through this war of emotions and volatility you still need to determine which companies deserve to be held. Portfolio turnover is the price of progress. In many ways microcap investing is like trying to find future NFL quarterbacks while they are still in high school. It's a tough business, but it isn't impossible. You can spot high integrity talent even at a young age. You won't be right all the time. But you have to be willing to make smaller bets and follow their progress. If they develop in the right ways, you buy more. If they evolve in the wrong ways, you sell and move on.

We play a game of slugging percentage, not batting average. The institutional agenda is to never be wrong (batting average) instead of focusing on power laws (slugging percentage). It's why everyone and their brother is a "compounder investor". It sounds good and you won't look dumb at cocktail parties. But the perfect stock today often times looked imperfect in the past. You have to take on a little risk (You might look wrong!) to hit the big ones – so size them accordingly.

"Show me a guy who's afraid to look bad, and I'll show you a guy you can beat every time."
– Lou Brock
"It's not whether you're right or wrong, but how much money you make when you're right and how much you lose when you're wrong."
– George Soros

One of my investors recently asked me: What does a successful microcap portfolio look like in 5-10 years? A successful microcap portfolio should look "bigger". We aren't going to sell out of our winners just because they've grown into smallcaps — that sounds like madness. The key to outperformance is to hold your winners as long as you can. I would hope we are holding a few $500m to $2 billion market cap companies in the portfolio. I'd also expect us to hold a few more positions. As we slowly sell a little bit of our winners/ veterans we'll redeploy into some rookies. Success would be a deeper bench with some $40 million market cap rookies sitting beside some of our $1 billion market cap winners/veterans.

As microcap investors we always need to be thinking ahead, but not too far.

"Go as far as you can see; when you get there, you'll be able to see farther."
– J.P. Morgan

The Art of Catching Falling Knives

IAN CASSEL APRIL 4, 2023

The stock market's job is to find your breaking point. It normally happens when you are the most confident. Mr. Market walks up to you with a sh!t-eating grin on his face. He stands a foot away from you, looks you in the eye, "Oh you think you have conviction, isn't that cute. We'll see about that.” Then bam! Something you believe is down 40-50%. Nothing tests your conviction like falling stock prices.

At least once per year I’ll wake up to a position trading down 30% premarket. Some large holder wakes up grumpy and decides today will be the day to sell their entire position in an illiquid stock as quickly as possible.

I always wonder what sparks this rage filled seller. Did they wake up on the wrong side of the bed? Was it a nightmare about the stock? Did the seller find out the CEO flirted with his wife at a cocktail party? Did they get back from a meditative retreat where they became enlightened? Do they hate me personally?

The worst part is they are rude about it. The seller decides to slap some bids in pre-market trading. Indiscriminate pre-market selling scares all the longs. Are they raising capital? Did they lose a large customer? Is it a short report? Accounting irregularities? The market freezes. Everyone is thinking the same thing, “someone knows something”.

By the time the regular session opens for trading there is no bid support. The bid ask spread is a mile wide and Level 2 (market depth) looks literally like Level 2 – two levels of support to Zero.
While pointing at yourself in the mirror you say some positive words of affirmation, “I’m a man (or woman). I’m knowledgeable. I can do this.”

You swallow the throw up in your mouth.
You place a buy order below market hoping it doesn’t get hit. But it gets hit. As you stare at the executed trade notification, you throw up in your mouth again. “Well, I don’t need breakfast”.
I had two such situations occur in Q1 of this year. Two positions. Two forced sellers driving the equity down 40% in minutes in one and over a few days in another. It’s hard to catch a falling knife even if you know how. If you are a sizable investor that builds a relationship with management you text the CEO, “What is going on?”. If they text you back, you know it’s nothing. If they don’t text you back, you know it’s something.

The opportunity presents itself for seconds, minutes, hours, or maybe days. While most investors freeze, you are decisive. You buy the pain. The only reason you can find the courage is because you did the work others didn’t do and you trust management. 99% of the time in investing you need to be a stoic investor. The other 1% you need to be a savage.

Then the madness stops. The stock recovers. Everyone that wasn’t buying near the lows starts to buy 30% off the lows so they can mentally tell themselves they bought the dip even though they didn’t buy the real dip.

The art of catching falling knives is determining whether the fall is business or non-business related. If it is non-business related you buy. If it is business related you don’t buy or maybe even sell.

Falling knives can also occur over weeks or months during bear markets in microcaps. Microcap stocks become more illiquid as they drop over longer periods of time. Why? The long-term holders run out of money or conviction to buy more lower.

We've all been there in a position. It isn't a drawdown until you start hesitating to buy something you believe in lower. You loved it 20% lower but not 50%. When you are down 50% off the highs you start thinking, "Let me see how this shakes out first". It is in that moment in time you would rather buy it 50% higher than another 20% lower. You can't handle being any more wrong than you are right now. That feeling of mental and emotional exhaustion – that is the low in the stock.
This is so savage and true. Written in 1930.

"The day you sell is reasonably certain to mark the end of the decline, because you are not the only one who was finally scared into selling. You, being an average man, were merely representative."
Fred Kelly

Due Diligence – Get On The Ground

IAN CASSEL FEBRUARY 23, 2022

In the weeks following September 11th there was immense political pressure "to do something". Pete Blaber was part of a special forces unit that was the first to touch down in the Persian Gulf to prepare for combat in Afghanistan. The order from the top was simple. Find something to attack – a terrorist training camp, some tanks, Usama bin Laden's house, anything. The US Government had to make a statement.

The best they could find was an old airfield in the middle of the desert and an abandoned house of one of the Taliban leaders. To reach these empty targets they would have to go through/around the city of Kandahar, which was known as the "ring of fire". Satellite imagery showed enemy tanks were positioned around the city. It was also said the city was protected by rockets, missile launchers, anti-aircraft guns and thousands of capable Taliban soldiers. In addition, it was assumed the Afghan people were helping and supporting Al Qaeda and Taliban forces. Winter was approaching in Afghanistan which added to the rush to do something before it got too cold for ground movement.

To make matters worse – the newly constructed mobile US military base was stationed on a small desert island and the only way to reach these empty targets were large CH-47 helicopters. They would have to make an 8-hour journey (1,000 miles) to the targets. This would be the longest wartime helicopter mission in history. The problem with the CH-47 is they are loud, and the enemy can literally hear them coming from miles away. The mission sounded like insanity – especially given the targets were duds.

Pete and his team were dumbfounded. "For my comrades and me in the Unit, we were beginning to understand a stark new reality concerning our role in the global war against terrorists. Instead of rolling up our sleeves, immersing ourselves in the mission, and developing out of the box concepts and ideas for our country's most sensitive missions, we now found ourselves on the receiving end of the massive military decision-making hierarchy."

Pete was frustrated. Other units were frustrated. They decided to come together to formulate a plan and do real work into the situation. The goal was to convince headquarters to drop the empty target plan. Instead of relying simply on satellite imagery, they needed on the ground input from Afghans and input by someone who understood Al Qaeda. Pete knew he wasn't going to find the answers sitting inside a tent. "I had to take action to make action."

Pete and the other Units started reading everything they could find about Afghanistan and the current situation. Pete reached out to some old friends that used to be high ranking officials in the Government asking if they knew of anyone stateside with local knowledge of the situation in Afghanistan.

One of Pete's contacts replied that he had some Afghan American friends he met with weekly at an Afghan restaurant just outside of Washington D.C. One of these friends was an ex-Afghan general who had fought against the Soviets in the mid 1980's. Pete spoke to the old general over satellite phone the next day.
This is what he learned:

1. There were tanks surrounding the city but "very few, if any, were operational." In fact, most of the advanced technologies they thought the enemy had they didn't. Al Qaeda wasn't preparing defenses around the city.
2. The Afghan Locals hated Al Qaeda.
3. The Harsh Afghan winter averages mid 30's °F, not exactly harsh.

Pete explained, "Slowly but surely, a different picture was beginning to form for me and my comrades as we accrued more and more on-the-ground information. We began to challenge everything we thought we knew about the reality of the situation on the ground in Afghanistan." "Back in D.C both the secretary of defense and the president were expressing well-earned frustration with the dearth of intelligence being fed to them from a trillion dollars' worth of space-age intelligence technology. Ironically just a few miles away from the White House, across the Potomac River in Virginia, there were men sitting around a table in an Afghan restaurant who had better, and more accurate, intelligence."

When information was presented to senior officers it was immediately dismissed. No one wanted to listen. The empty targets would be destroyed.

When I read the story above, I couldn't help but see parallels with investing. We often feel the urge "to do something". We love to come to quick conclusions by analyzing what is on the surface (satellite imagery). But reality is much more nuanced. Sometimes what is easily seen is meant to distract us. 100% of investors can see what is on the surface. 5% are willing to dig below the surface to find the truth.

Here are four things we can learn from Pete Blaber when doing reconnaissance into a business:
Read Everything – When you are analyzing a company, competition, and industry read everything you can get your hands on. But you must realize this is what everyone else is doing. Don't fool yourself into thinking you know what is happening on the ground by reading secondary sources instead of talking to primary sources.

Utilize your Network – We like to fool ourselves, "I don't want to talk to other investors about my ideas because I don't want them to know what I'm looking at." We would rather be first and naive rather than second and educated. It makes no sense. Don't be afraid to ask your network, "Does anyone know anything about company XYZ?". We underestimate the power of our networks.

Talk to people on the ground, but not just one – Talking to on-the-ground experts are incredibly important. The rise of expert networks (Tegus, Stream by Mosaic, etc) is making this easier. When you are locating an expert or paying a firm to do this for you it's important you are finding the right expert. Your goal is to find experts with direct knowledge of an industry in addition to years/decades of tacit knowledge (knowledge that can only be expressed through long, in person meetings).

Not all "experts" are created equal. Some experts come into the conversation with certain motivations. For example, Ex-employees/previous management might be negatively biased towards a company or product. In addition, if an expert is being paid by an expert network it's in their best interest "to talk" to you and seem important. You need to be able to spot these biases. When you talk to experts it's important to talk to 5 or more.

Get on the ground – Make the extra effort to get on the ground yourself and talk to people. The types of subtleties, emotion, body language, you can only pick up on in person. 99% of investors won't make the effort to do this, so this is a real difference maker. I'm reminded of this great quote by pastor Craig Groeschel, "It's often the small things no one sees that result in the big things everyone wants."

Pete Blaber concludes, "Until we get on the ground input, we should expect that most of what we think we know will likely turn out to be incorrect or incomplete. This mind-set allows us to maintain our most prized freedom, the freedom of choice to change our minds and liberate our thinking from the commonsense blocking emotions of pride and hubris."

An Essay on Investing in Small Stocks

IAN CASSEL SEPTEMBER 2, 2021

There are a bunch of small stocks that will 10x over the next five years that are waiting to be found. Institutions can't buy them. Only you can. The opportunity in small stocks (microcaps) exists because institutions can't own them until they go up. It is the small retail investor's duty to find them and collect the reward for doing so.

When you find a winner, people will say you are wrong. When you hold a winner, people will say you are stupid. When you get rich from a winner, people will say you got lucky. You tell them you love being wrong, stupid, and lucky.

"You don't have to invest like a big bureaucratic institution. If you choose to invest like one, then you're doomed to perform like one."

- Peter Lynch

If you consider yourself stock picker – At some point in your life you are going to have to do the work others aren't willing to do and bet big on something you believe in. But it takes work and conviction. YOU must do the work and YOU must form the conviction. You will make mistakes. You will buy stocks you shouldn't. You will sell winners too soon. You will hold losers too long. But whatever you do don't blame others. When you blame others for your investing mistakes it proves you didn't do enough of your own work. Own your mistakes so you learn from them.

The idea of investing in small stocks sounds reckless. It isn't. The greatest advantage a microcap investor has is the rest of the financial world thinks you're an idiot for investing in small stocks aka "penny stocks" and that you don't think deeply about your investing process. Prove them wrong. Alpha is generated by being just a little bit different in a disciplined and thoughtful way.

My investment philosophy is quite simple. I study great stocks, great businesses, and great leaders – hundreds of them. I put in the reps to develop pattern recognition and then go find them when they are small. I want to invest in undervalued companies that will get overvalued. Great companies always trade at a premium because there is a scarcity of them. All great companies started as small companies and it's my mission to find them. This isn't easy. I've been doing this for 20 years and I'm still wrong quite often. Perfection is not the goal. If you aren't taking some small losses from time to time you aren't taking enough risk.

"Nothing in the world is worth having or worth doing unless it means effort, pain, difficulty… I have never in my life envied a human being who led an easy life. I have envied a great many people who led difficult lives and led them well."

- Theodore Roosevelt

I'm a growth investor at heart. The two most important frameworks or mental models I try to apply is combining tailwinds (top-down) and scarcity (bottom-up). When these two are combined they become powerful drivers of returns.

A tailwind is a wind that blows in the direction you are going. When I think of tailwinds, I picture the jet stream pushing a commercial jetliner. In the United States there is a westerly jet stream above 30,000 feet. The winds can reach 100+ mph. Commercial jetliners will use the jet stream when flying west to east. A 6-hour flight can be made in 4.5 hours. The aircraft doesn't work as hard, burns less fuel, and still gets to the destination quicker because the jet stream naturally pushes the aircraft in that direction.

Another way to think about tailwinds is what venture capitalist Josh Wolfe of Luxe Capital calls undeniable directional arrows of progress. Simply put – investing in an area where technology is headed in a direction that is hard to stop. For example, we went from horses to horse drawn carriages, to cars, to electric cars, and soon to be autonomous cars. We're not going back to horses unless you are Amish and never stopped using them. Another example Wolfe uses is mainframe computers, to personal computers, to laptop computers, to computers you hold in your hand, on your wrist, and perhaps in the future linked to your brain. It is hard to deny the future is headed in this direction.

When you zoom out you can find these directional arrows of progress everywhere. They might be geopolitical tailwinds or industry focused tailwinds or technological tailwinds or a combination of them. When you find a tailwind that is hard to stop, and you combine this with best of breed business, idea, or technology then you find an investment that is hard to stop. Don't make investing harder than it needs to be. Invest where there is a tailwind. You will get to your destination quicker with less effort.

Scarcity is a powerful driver of price. Scarcity is when demand outstrips supply and prices go up and up and up. The most extreme examples involve a tidal wave of consumer demand hitting a single product category like tickle me Elmo dolls, or the Beanie Baby bubble, or even some of the meme type stocks of today. You see the effects of scarcity when demand is focused on one product, company, stock. We don't want to try to guess at the next superficial bubble, but scarcity also applies to quality businesses.

We want to invest in businesses that are unique – not businesses where there are 1000 others doing the same thing, selling a similar product or service. We want to invest in special businesses. Just like a Picasso, investors are willing to pay up for high quality that is scarce. Scarcity can be found in different forms throughout a business and stock. Illiquidity is the scarcity of shares. Illiquidity is very powerful when it's combined with a great business. Why? Investors are forced to pay up to own shares.

My primary hurdles for new investments:

1. A business that can grow through a recession.
2. A balance sheet that can weather a storm and act with occasional boldness.
3. A leadership team and organization that show signs of intelligent fanaticism ie Find management teams that deserve to be running much larger companies.
4. A valuation that can conservatively double in three years.

These hurdles focus on quality and survival as much as upside. The best companies have all three. I used to invest in shorter term, lesser quality situations that could 2-3-5x quickly, but they couldn't sustain those moves. Their stories, promises and momentum pushed their stocks to prices where their fundamentals couldn't keep them. They fell right back down. You will cut out 90% of the pain of investing in small stocks by focusing on profitable businesses.

I can't predict the short-term, so I do my best to underwrite the next 3 years. I talk to management and industry experts to form my expectations and to determine what the KPI's/variables are to track progress. I track quarterly progress against this 3-year objective.

Why 3 years?

First, if you ask management about 1-year goals, it's guidance. If you ask management about 3-year goals, it's strategy. Management will be more open in talking about strategy.

Second, you'll be one step ahead of most investors if you can simply look beyond "the next quarter". Most other investors are focused on the next 20% move in the stock. You need to stay focused on the next 100%+ move. Trying to get a multi-bagger by focusing on the next quarter is like trying to find an elephant with a magnifying glass. Zoom out. Track quarterly results against a 3-year thesis.

Third, anything can happen, good or bad, in a quarter or two. These are small business. A big order/contract win pulled in or pushed out of a quarter can distort reality. Give the next quarter or two some wiggle room. Hold your positions like a tube of toothpaste. Don't hold them too tight. No company is perfect. Give them enough room to disappoint you a little.

Fourth, the best companies are investing for the long-term in ways shareholders don't fully grasp or appreciate. It sometimes shows up as short-term underperformance as they invest in the future or go above and beyond for a customer.

80% of the time winners will exceed your expectations. I would implore you to not be so valuation centered. If a small company with a unique business and exceptional management team is attacking a big problem with a great strategy, then let them. If they are executing, the business is probably worth more than you think is reasonable. The goal is to find undervalued companies that can get overvalued. Let them get overvalued.

All my winners had one thing in common, I was always averaging up. Most of my losers had one thing in common, I was always averaging down. The best investments are the ones where the fundamentals accelerate, and the stock is a better risk reward higher than it was lower. Don't be afraid to average up. Often times the best place for new capital is buying more of the companies that make it look easy.

Holding losers is easier than holding winners. Why? Because losers always look cheap. Holding winners is not easy. You will have to hold while the stock doubles in a year. You will have to hold as the stock pulls back 50% from its highs. You will have to hold as the stock goes nowhere for months, quarters, maybe years, as fundamentals backfill into a higher stock price. You will have to hold as expectations get too high or management goes through growing pains. You will have to hold as the stock is cheap and expensive. You will have to hold while the stock is loved and hated by other investors. Holding winners is hard. The key is focusing on the business, not the stock.

I was listening to Patrick O'Shaughnessy's podcast with John Harris, managing partner of Ruane, Cunniff & Goldfarb. The firm's flagship Sequoia Fund has outperformed for 50 years in a highly concentrated equity portfolio. In the interview Harris mentioned that 10 big winners made up the bulk of their outperformance over 50 years. It was a good reminder that it only takes a few great decisions.

Harris also talked about his deepest regrets in investing. He mentioned his single biggest loss. He was short Volkswagen which means he was betting that the stock would go down.

The stock did the opposite going up 10x in one week. He lost 30% of the fund. The interesting part was this massive loss didn't even make his top five biggest regrets. Harris said all his biggest regrets were passing on investments that would become big winners.

It's fascinating to think that over a career you will pass on more winners than you will let into the portfolio. This is okay. Successful investing is a game of subtraction – looking at thousands of opportunities/companies and filtering the list down to a select few that have characteristics that you can believe in and invest through the volatility. But it doesn't make passing on winners any less painful.

When I reflect on my 20 years of investing experience, I can connect with what Harris was saying. I never think about the losers. All my biggest regrets were selling winners too soon. The ones I sold for a 100% gain only to watch them go up another 1,000%. Those are the mistakes that haunt me. Nothing screws with your head more than watching something you used to own outperform the things you own. Losers aren't as painful because you can only lose what you invested. When you sell winners too soon you can miss out on making multiples of your invested capital.

In 2015, JP Morgan did an analysis of the Russell 3000 Index. The Russell 3000 is a good proxy for the US Stock market. The study found that 2/3 of all stocks included in the Index underperformed the entire Russell 3000 Index as a whole. In March 2021, a further analysis of the index concluded: "The winners generate enormous excess returns, but the median stock ends up underperforming the Russell 3000 Index."

The JP Morgan study found that the "mega winners", stocks that produced 500%+ cumulative price returns vs Russell 3000 Index, drove the returns of the entire index. These mega winners made up for the 44% of companies included in the index that suffered "catastrophic stock price loss", defined as a 70% decline in price from peak levels and never recovered. This phenomenon is known as a positively skewed distribution. This is a fancy way of saying the most a stock can lose is 100%, but potential returns can be multiples more than 100%. In other words, one big winner can make up for a lot of losers and drive outperformance. Not selling your winners is crucial.

In May, I had the pleasure of speaking with Ho Nam, co-founder of Altos Ventures. Altos is one of the most successful, yet unknown, venture capital firms in the country. They manage $10+ billion across several funds. They differentiate themselves from other VC's by investing in capital efficient businesses. They don't follow the normal "growth at all costs" VC mantra, where other VC firms invest for high growth in spite of high losses. Altos focuses on companies that can get to profitability quickly. Why? It protects their downside. If the worst-case scenario is they own a piece of profitable business that didn't get as big as they thought they can still find a buyer for it.

Ho Nam and I had a great conversation about holding winners, averaging up, and structuring the firm to be able to facilitate this. Altos is most famous for their investment in Roblox (RBLX). They were one of the first outside investors in 2008. After this initial $1.5 million investment, they invested $400 million more into the company in subsequent funding rounds. When Roblox went public last year, Altos owned 21% of the company. They've since sold some, but their position is still worth several billion today. I can't imagine the pressures they had internally (from themselves) and externally (from their investors/LP's) to sell. 10% of successful stock picking is picking great stocks. The other 90% is not selling them.

It is easy to think of the Roblox example and think winners are these long linear stairways to heaven. But as many of us know, the biggest winners also have the biggest drawdowns. We study famous investors like Nicholas Sleep and Qais Zakaria from the now closed Nomad Investment Partnership and think to ourselves, "I'd be famous too if I just held Amazon and Costco the last 15 years". But you didn't and it wasn't easy. They bought Amazon aggressively in 2005 around $30 per share. The stock went to $80, and then fell back into the $40's during the 2008-2009 financial crisis. I'm sure they would tell you being up 150% in 2 years to being up 50% in four years in a position isn't fun or easy. They bought Costco in 2002 around $25 per share. It would rise to $70 by mid 2008, and then fall back to $42 in 2009. Going from being up 200% in 6 years to being up 80% in 7 years isn't fun or easy. Nomad's extreme outperformance was on the other side of average performance. Amazon would go on to 100x and Costco 10x.

At multiple points in time, with every winner, gaps will form between your expectations and reality. The question is whether you will fill those gaps with worry or trust. A friend of mine said "We are all looking for that one company that will change our lives. Most investors will find that company, but most will also let it go." I do believe that in most cases it's our own expectations that cause us to sell our biggest winners. We fall into our own bullish echo chambers and allow our expectations to get far too high. When management doesn't meet these expectations, we blame them even though it's our own fault. Find situations that are so good that even low expectations will yield big returns. The investor that holds their winners the longest, wins.

Friend and fund manager Josh Tarasoff recently wrote a brilliant paper on his investment philosophy. He talks about his goal of owning a self-driving portfolio – investing in companies which have a certain set of characteristics that allow you to simply invest for the long-term and not feel pressured to sell them. Producing a self-driving portfolio in microcap is extremely hard.

Microcap businesses are generally small and, in many cases, lower quality and more impressionable because they are small. Our intention with every purchase is to hold for years, but few ultimately earn that right. The select few that do will work their way to the top of the portfolio.

At IFCM, we own 11 businesses. The top three represent 50%+ of the portfolio. I would characterize these three as the self-driving portion of the portfolio. They have exemplary management teams, businesses, strategies, and opportunities that are so strong we will never sell them because they become "overvalued". I'm a firm believer your largest positions should be the ones whose management you trust the most – not necessarily the ones you believe to have the most immediate upside. History has proven I'm awful at timing what will move next, so I stopped playing that game. Stocks rarely perform in the time frames we predict, and it's why the market only works for investors that have more patience than they thought they would ever need.