Thoughts on "Extraordinary Popular Delusions and the Madness of Crowds"

"Extraordinary Popular Delusions and the Madness of Crowds," written in 1841, is a favorite book of mine that I reread every few years. Along with being entertaining, the underlying message about human psychology is an important one. While technology and investment markets have changed a lot, the structure of human brains has not, and markets will always be inefficient because people will continue to be emotional. In the face of this emotion, the rational investor will always have an edge.

The most important factor in investment success is having the right psyche. You could memorize every word of Ben Graham's books and every letter Warren Buffett has ever written, but without the right mental detachment from investing you likely won't have success. Lots of people say they are long-term investors, but then they want to make money every year. As Charlie Munger says: "The big money is not in the buying and selling, but in the waiting."

Currently, we think the bond bubble we've been seeing for a number of years is beginning to show signs of popping, and that we are in the early stages of a huge shift from bonds into stocks. We have thought for a few years that folks need to start losing some meaningful money in bonds before they decide that investing in a company like Costco is a better idea than owning ten year bonds at little, or perhaps even negative, interest rates. While investment performance can never be guaranteed, if you invest in a $100 stock earning $8, you are getting an 8% rate of return, and it is likely to be a real rate of return because many companies can raise prices and have their asset values go up to compensate for any rise in interest rates and inflation. On the other hand, for the tens of trillions of dollars that have flowed into negative yielding or de minimis yielding bonds in the past seven years losses can mount quickly if interest rates start to rise. Please keep in mind this is an investment comment and not a political one, but we think that due to the recent election, a number of likely policy changes in the U.S. will push interest rates higher and incentivize investors to shift from bonds into stocks.

It is remarkable the extent to which people don't learn from history.

We hope you enjoy this book as much as we do – it is relevant to politics and international relations just as much as to investing – and it is a good read as you sit by the fire with a mug of cocoa!

With Warmest Regards,

Chris Gottscho

Things to Note

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