

OUTSIDE THE FLAGS

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March 2014

Not Rocket Science

When the media raises the subject of beating the market through astute stock picking, the name Warren Buffett is usually cited. But what does this legendary investor actually say about the smart way to invest?

Buffett is considered to have such a track record of picking stock winners and avoiding losers that his annual letter to shareholders in his Berkshire Hathaway conglomerate is treated as a major event by the financial media.¹

What does he think about the Federal Reserve taper? What could be the implications for emerging markets of a Russian military advance into Ukraine? What does an economic slowdown in China mean for developed markets?

Buffett has a neat way of parrying these questions from journalists and analysts. Instead of offering instant opinions about the crisis of the day, he recounts in his most recent letter annual a folksy story about a farm he has owned for nearly 30 years.²

Has he laid awake at night worrying about fluctuations in the farm's market price? No, says Buffett, he has focused on its

long-term value. And he counsels investors to take the same sanguine, relaxed approach to liquid investments such as shares as they do to the value of their family home.

“Those people who can sit quietly for decades when they own a farm or apartment house too often become frenetic when they are exposed to a stream of stock quotations,” Buffett said. “For these investors, liquidity is transformed from the unqualified benefit it should be to a curse.”

While many individuals seek to ape Buffett in analyzing individual companies in minute detail in the hope of finding a bargain, he advocates that the right approach for most people is to let the market do all the work and worrying for them.

“The goal of the non-professional should not be to pick winners,” Buffett wrote in his annual letter. “The ‘know-nothing’ investor who both diversifies and keeps his costs minimal is virtually certain to get satisfactory results.”

1. “Buffet Warns of Liquidity Curse,” Bloomberg, Feb 25, 2014.


2. Berkshire Hathaway Inc. shareholder letter, 2013, www.berkshirehathaway.com/letters/2013ltr.pdf.

As to all the predictions out there about interest rates, emerging markets, or geopolitics, there will always be a range of opinions, he says. But we are under no obligation to listen to the media commentators, however distracting they may be.

“Owners of stocks... too often let the capricious and irrational behavior of their fellow owners cause them to behave irrationally,” Buffett says. “Because there is so much chatter about markets, the economy, interest rates, price behavior of stocks, etc., some investors believe it is important to listen to pundits—and, worse yet, important to consider acting upon their comments.”

The Buffett prescription isn’t rocket science, as one might expect from an unassuming, plainspoken octogenarian from Nebraska. He rightly points out that an advanced intellect and success in long-term investment don’t necessarily go together.

“You don’t need to be a rocket scientist,” he has said. “Investing is not a game where the guy with the 160 IQ beats the guy with 130 IQ.”³



“Outside the Flags” began as a weekly web column on Dimensional Fund Advisors’ website in 2006. The articles are designed to help fee-only advisors communicate with their clients about the principles of good investment—working with markets, understanding risk and return, broadly diversifying and focusing on elements within the investor’s control—including portfolio structure, fees, taxes, and discipline. Jim’s flags metaphor has been taken up and recognized by Australia’s corporate regulator in its own investor education program.

3. “The wit and wisdom of Warren Buffett,” *Fortune*, November 19, 2012, management.fortune.cnn.com/2012/11/19/warren-buffett-wit-wisdom/.

Diversification neither assures a profit nor guarantees against loss in a declining market. Investing involves risks including potential loss of principal and fluctuating value.

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