Knowing yourself leads to improved performance

INVESTMENT STRATEGY

By Jon Kanitz

The last time I was in paradise (Phoenix, Arizona, that is) I caught a televised interview of chess master Garry Kasparov. Fortunately I had pen and paper handy for this gem: "To improve your play, you must analyze your decisions and your decision-making process. You must analyze and confess your mistakes in order to understand them and improve your system of play."

Given my background in analytic philosophy, I see nothing wrong with making distinctions. Yet I have come to the conclusion that all of the various fields of human knowledge are connected and have deep theoretical foundations in the scientific method.

At its borders, accounting merges with economics, mathematics and, increasingly, politics. At its borders, law merges with economics, politics, history, and sociology. Military knowledge has frontiers on physics, chemistry and biology. In Canada, in the past few years especially, medicine got political. Investing has frontiers on accounting, economics, mathematics and psychology via behavioual finance.

What Kasparov said about chess could be said equally about investing. In fact it is so general that it applies to any activity insofar as it is susceptible to various standards of rationality. And there is an old saying in Wall Street parlance that if you don't profit from your investment mistakes, someone else will.

Chess masters are able to consider up to 100 moves within seconds. However, in 1997, Kasparov, the world's best example of a chess master, was defeated by Deep Blue, IBM's best example of a silicon-minded player. That system of computers could handle a few billion possibilities.

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While it is difficult to imagine that a chessboard could ever contain a few billion possible moves, it is somewhat easier to imagine that all of the financial markets in the world combined could present such a number. If Warren Buffett is the world's best investment master, then it is likely that he, with his powers, is roughly the equivalent of Kasparov.

Although it is the human condition to be limited by 100 moves instead of a few billion, the best human decisions are deeply considered while, presumably, the computer-generated decisions are superficial. This distinction applies at a lower level to the difference between Buffett and Kasparov on one hand, and the mass of mankind on the other, who lead lives of quiet desperation.

Every book I've read about Buffett stresses how deeply considered his investment decisions are. In retrospect, many of his decisions look easy, such as buying Coca-Cola back in 1989 and 1998. Reading about Buffett is sometimes edifying, but it is more frequently depressing.

If you are cynical, perhaps you believe that investment markets are too illogical to be compared with chess. This is a popular view. It was, for example, the opinion of London-based Seth Klarman at the height of the Internet craze when he said, in effect; don't invest if you are rational. However, Klarman's view then should not be over-generalized to the point of contradicting Buffett, who attributes his success as an investor to taking advantage of the irrationality of Mr. Market.

The Mr. Market analogy originated with the intellectual patriarch of value investing, Dr. Benjamin Graham. At Columbia University, he instructed Buffett to take advantage of the mood swings of Mr. Market, in being greedy when others are fearful and fearful when others are greedy. Mr. Market is your adversary, not your partner.

In both investing and in chess, you are effectively on your own. The chess analogy ends there except insofar as it may be applied in self-criticism, as Kasparov explains.

In that domain, the whole business of analyzing your decisions and your decision-making process in order to understand them and improve your system of play enhances clarity.

The veteran physicist looks at some apparatus and sees an x-ray tube. The neophyte sees glass, metal, wires, reflectors, lamps and buttons.

Investing still goes on, though in a new context and a clarified status. Investing falls into place as a chapter of natural science. It studies a natural phenomenon, namely, a physical, human subject.

This human subject is accorded certain inputs of information, and in the fullness of a lifetime delivers as output a constant flow of investment decisions.

The relation between the meager inputs and the torrential output can be studied for approximately the same reasons that have always prompted a scientific inquiry, namely, in order to see how evidence relates to theory, and in what ways one's theory (or 'investment philosophy') transcends any available evidence.

Given this new setting, we can understand the difference between good investment decisions and bad investment decisions as deeply considered and superficially considered. The veteran physicist looks at some apparatus and sees an x-ray tube. The neophyte sees glass, metal, wires, reflectors, lamps and buttons.

One investor's observation is another investor's closed book. Buffett's investment decisions are deeply considered because his observations of financial markets are made within the infrastructure of value investing.

Kasparov's moves are deeply considered because his observations of the chessboard are made within a cortical infrastructure capable of projecting up to 100 possible moves. As Blaise Pascal said, "To foresee is to rule."

Thus construed, the common denominator shared by investing and chess playing is the notion of a deeply considered decision process.

For me this reflection alleviates part of the discomfort of linking investing to game theory. It would seem that there are no other meaningful connections, but that's just too bad for us interdisciplinarians.

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A trust can shield the most vulnerable people

FINANCIAL PLANNING

By PETER MERRICK and PETER TRAYNOR

In Canada, anyone with a disability may be entitled to government support payments. For example in Ontario, the Ontario Disability Support Payments (ODSPs) is the provincial program set up to provide money for those with disabilities (physical, mental or both). It serves people who have limited prospects of finding employment due to their disability.

Although ODSP is a well-intentioned initiative, and a necessity for a society that perceives itself as just and socially responsible, it has inherent flaws.

What are the flaws?

Government support payments at first glance would appear to offer an obvious financial remedy, helping alleviate the hardships of the disabled, and the predicament in which parents of disabled children can find themselves. However the law in Ontario, as in other provinces, states that a person with disabilities must be deemed to be living in poverty in order to qualify for support payments.

Liquid assets over $5,000 will effectively disqualify an otherwise justified recipient from receiving ODSP benefit payments. The rule in effect requires the liquidation of all assets of disabled individuals if they are to be awarded any ODSP benefits. In short, the sentiment appears to be, 'Come back and see us when you have burned through your inheritance.'

A father's lasting gift

In the late 1980s, a very loving and forward thinking father in Guelph, Ont. named Leonard Henson approached his lawyer, George Goetz, to create a legal solution that would transfer enough of his estate to his disabled daughter, Audrey, that she would be cared for throughout her life, even after his death. The salient issue was that if the assets were transferred directly to Audrey, she would be sufficiently well off that she no longer qualified for assistance from the provincial Social

MERRICK

TRAYNOR

Services Ministry.

After some thought, Goetz creatively drafted a will for Henson that relied upon an 'absolute discretionary trust' to transfer income to Audrey. Ingeniously, she would not technically own the assets. Though the Social Services Ministry objected vigorously, by 1989 the Ontario Court of Appeal approved the solution crafted by both Henson and Goetz, to the great benefit of the disabled and their parents and guardians nationwide. The modern era of the Henson Trust began.

Funding method

The most effective method for setting up a Henson Trust is to fund it through the proceeds of a life insurance policy that insures the life of the disabled person's parent or guardian. The purchasing of life insurance by most parents and guardians on their own lives presents the most efficient and practical mechanism upon their deaths to fund Henson Trusts.

Other considerations

Several aspects of the Henson Trust should be explored thoroughly by the parent or guardian of a disabled child. The most important consideration before setting up this form of trust is to determine who will be appointed the trustee. This decision should not be taken lightly.

The trustee should be a person or entity that the parent or guardian can put their ultimate trust in. Parents or guardians must believe that their appointed trustee to the Henson Trust will always do what is in the best interest of the disabled child. Another major consideration when appointing a trustee is their ability to make wise investment choices while managing trust assets. In many cases where the trustee does not have sufficient skills to manage the investments within the trust, they will have had an investment manager appointed to manage the money.

If you or your clients are seriously considering creating a Henson Trust, it is of the utmost importance to consult first with a certified financial planner and an estate lawyer who are experienced with all the nuances of setting up, managing and winding down Henson Trusts.

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