Willing Losers

Charley Ellis is one of my favorite people in the investment business. He seems to always have a similar message but I still come back to that message over and over again because of the way he delivers it.

Ellis recently sat down for another chat with Ted Seides on the Capital Allocators podcast. He probably knows more about the asset management industry than just about anyone on the planet. Ellis takes Seides back to the 1960s to discuss how things have changed in the investment business since he entered back then.

One of the biggest differences Ellis highlighted was the lack of institutional investors controlling the market back then:

Ninety percent of trading was done by individuals. And who were they? They were nice people...who bought or sold once every year or two, usually in odd lots because that's how much money they had. And about half the time it was AT&T. And they bought because they'd been given a raise or a bonus or an inheritance and they sold because they were sending kids off to college buying a home or some other sensible purpose. And it had nothing to do with what's going on inside the market.

And they didn't know very much but that didn't matter. They were buying a few blue-chip stocks that they'd read about in magazines and stuff like that.

Were they hard to beat?

No way! They were easy to beat.

And the secret to successful active investing is to have what's called ***willing losers****.*

This relationship has flipped where now institutions control 90%-95% of trading while individuals don't have nearly the same impact they once did. It's kind of ironic that the willing loser label is slowly migrating from mom and pop to the professional and institutional crowds since there are fewer suckers at the poker table.

Day trading is an obvious example of a group with willing losers in the markets. There are some day traders that do make money but the majority of people who try their hand do not. Barber and Odean found that more than 75% of people quit day trading within two years. Most active stock mutual fund investors have been willing losers for decades.

This idea of willing losers extends beyond the investment world. There are plenty of other actions people take that put them at a disadvantage, making them a willing loser in many instances:

People who hold credit card balances. The average interest rate on credit card balances is 16% or so. These rates rarely change. Credit card companies make so much money from those who pay this interest that they're able to offer rewards that could be worth hundreds or thousands of dollars a year to cardholders who never carry a balance. In a way, those paying interest are subsidizing those who pay off their balance every month and collect the rewards points/dollars/travel perks for free.

People who sell their house in a short period of time. I'm on record saying I think a starter home is one of the worst purchases you can make (assuming you're planning on trading up in a relatively short period of time). The breakeven on purchasing a home is in the 5-7 year range when you factor in closing costs, taxes, fees, upkeep and interest payments on your loan. For a 30 year fixed rate mortgage, roughly 70% of your payments in the first 3 years go to interest on the loan, with the rest paying down the principal balance. It is possible to get bailed out by a rapidly rising housing market to make a quick starter home flip workable, but the deck is stacked against you based on all of the costs involved in home ownership.

People who don't save money at an early age. Investing money at an early age puts you at a huge advantage because you allow compound interest to do the heavy lifting for you. On the flip side of this coin, people who don't save and invest at an early age are putting themselves at a disadvantage. Waiting to save and invest means you'll have to contribute more money in the future to make up for lost time.

People who don't invest in themselves. One of the best investments you will ever make does not involve the markets but rather investing in yourself. Personal finance advice focuses a lot of its attention on saving and frugality but very little on improving your career prospects to make more money. If you're not willing to spend time or money improving yourself it's highly unlikely you'll get very far in your career. This could be something as simple as buying a book or two and implementing the ideas. Other ways to avoid being a willing loser in your own career would be attending conferences, additional courses, meeting new and interesting people, starting a side business, or simply spending time honing your craft by asking for constructive criticism in your current role.

Further Reading:
The First Rule of Personal Finance