

A Reading List for 2010: Part 2

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Updated for 2010 and in time for the holidays, here is the latest installment of my recommended books. I originally wrote this list in [2008](#) and again [last year](#). I intend to keep adding to and revising it every year. It contains seven sections: Selling, Think Like an Investor, Behavioral Investing, Economics, Stock Market History, Risk and Books for the Soul. The first three sections were presented [last week](#) and the remaining four are below. I hope you enjoy it.



In these crazy times, all one could ask for is sanity. Yes, sanity – a clear mind, free of noise, to with which to face the insanity that the volatile, noisy stock market thrusts upon us. We find ourselves glued to our computer screens or CNBC, waiting to find out what the Dow's next tick is going to be. What do we get out of it? Only a headache and wasted time.

Here is my advice: read. Read books that will bring you sanity, the ones that will snap you back into the mindset of investor and out of being a nervous observer of the daily stock market melodrama. The following books are excellent choices and offer plenty of sanity and sage advice.

Economics

Politicians, God rest their souls, always try to appeal to the lowest common denominator. They try to “protect” us from evildoers by insisting on minimum-wage laws or rent controls, or by threatening windfall taxes on oil companies. They paint themselves as heroes fighting for the little guy against the evil-doers. All they are doing, however, is feeding on the economic illiteracy of the average Joe. Given this reality, the following books should be required reading in high schools and colleges: [Basic Economics](#) by Thomas Sowell and [A World of Wealth](#) by Thomas G. Donlan. Another excellent book is economic romance - [Invisible Heart](#) by Russell Roberts. No I did not go soft on you here, in fact I have to admit, the “romance” part of this novel did not appeal to my sentimental senses, but the discussion about capitalism and free markets is Milton Friedman worthy.

[Atlas Shrugged](#) by Ayn Rand is a novel, not an economic tome, but it accomplishes a lot more than most economics books ever do. It vividly illustrates what happens to the



economy when the invisible hand of capitalism is replaced by the “fair” and “compassionate” hand of socialism: The economy collapses.

Ayn Rand immigrated to the US from Russia in 1927 when she was 22, when her father’s business was seized by the Russian government, ostensibly for the greater good. I left Russia 64 years later, a decade after Rand died, and my family suffered a lot less than hers. However, we (as well as millions of thinking Russians) both saw the ugly consequences of socialism.

In *Atlas Shrugged*, Ayn Rand defines her individualist philosophy. Individualism is not a politically correct term in our society. One doesn’t make a lot of friends by advertising his selfishness and greed. So call it anti-collectivism, where independence, self-reliance, and individual pursuit of happiness are superior goals, as opposed to collectivism, where the pursuit of communal and national goals is often undertaken at the expense of individual liberty.

[According to Jennifer Burns](#), who published Ayn Rand’s biography, Rand’s popularity surges during every political cycle when the merits of our political system are being debated. Winston Churchill said it well: “Capitalism is the worst of all possible economic systems, with the exception of all the others.” I hope we only see the alternative system to capitalism – a compassionate socialism that is often offered to us as an alternative to our dispassionate system – only in the pages of *Atlas Shrugged*.

You may think Alan Greenspan had a hand in today’s crisis. I know I do. He took interest rates down to incredibly low levels and kept them there for too long, causing the real estate bubble. He also did not think Wall Street needed regulation. But that doesn’t make his book, [The Age of Turbulence](#), any less of an excellent read. It is not written in Fed-speak. It seems that Sir Alan, after he left the Fed, learned how to use English in a very clear and engaging way. This is not just another autobiography, either. The book goes far beyond that. It covers the workings of the Fed, lessons on macroeconomics and history, and relays Greenspan’s unique perspective on American politics as an insider who served under or worked with the last eight presidents.

Stock Market History

I’ve really enjoyed reading [Stocks for the Long Run](#) by Jeremy Siegel, but it took me a while to recognize how dangerous this book is.

It is well written and provides a good overview of the performance of different asset classes over last two centuries. But the book needs a different title, maybe something like “Stocks for the Really, Really... Really Long Run.” That way, it would not lure investors into a false sense of security when it comes to stocks. Probably unintentionally, Siegel’s book preaches that the stock market is always a buy, no matter what valuations are, and that a 7% real rate of return is a birthright for stock investors, no matter if the stock market is



extremely cheap or ridiculously expensive. This is very true if your time horizon is 30 years or you plan to live forever. It is also true if you can tolerate seeing your portfolio go nowhere for a decade or longer. Unfortunately, most of us don't have that idealized time horizon. We need to pay for our children's educations, weddings, boats, etc. I don't know anyone who has the patience to see their portfolio of stocks do nothing for decades.

That is why Siegel's book should only be read alongside the following antidote: [Unexpected Returns](#), which is a truly terrific book by Ed Easterling. Unlike Siegel, Easterling shows that even though stocks are a great investment for the (really, really) long run, they have periods when their returns are unspectacular. Ed calls these periods bear markets. I call them range-bound or sideways markets, which is just a difference in semantics. Those bear (sideways) markets take place after secular bull markets.

Risk

What is the appropriate way to look at risk?

The following two books, [Fooled by Randomness](#) and [The Black Swan](#), are by Nassim Taleb. These books address the risk associated with rare events.

Fooled by Randomness is my favorite nonfiction book, period. I've read it at least five times. This book turns upside down the way we are taught to look at risk. Nassim rebels against the current establishment of finance that measures risk with elegant formulas that receive Nobel Prizes but lack common sense.

Any model that solely focuses on past observations and dismisses outcomes that lie outside of what happened in the past is worthless and dangerous. One way of understanding how randomness works is by studying alternative historical paths. This means more than just focusing on what took place in the past. Observed history was actually just one of many possible outcomes. One should focus on what *could* have taken place, what alternative paths might have existed. With that added insight, we can then predict and prepare for what might happen in the future.

Let's take the current crisis: Wall Street and the rating agencies dismissed the possibility that housing prices might decline nationwide. That hadn't happened since World War II, and everyone assumed that meant it wouldn't happen in the future. On that leap of faith, Wall Street took subprime (risky) mortgages originated in different parts of the country, lumped them together in mortgaged-backed securities, and – voila! – declared the risk to be diversified away. Junk was turned to gold. Since rating agencies used the same underlying assumption – housing never declines nationwide – they announced to the world that the junk was AAA and should be bought in truckloads – and it was. We know how this story ended.



The Black Swan is a follow-up to *Fooled by Randomness*. Nassim takes a lot of the concepts discussed in *Fooled by Randomness* and explains them in greater detail, providing new and unexpected insights. I have to warn you that *The Black Swan* is not an easy read. This book, which has more insights per page than most, is not a beach read. If you're looking for a Cliff's Notes version, [in this lecture](#) Nassim covers major concepts described in both books in great detail.

In the second edition of *The Black Swan*, Nassim added a section that talks about how Mother Nature deals with black swans through redundancies. One way to avoid catastrophic failure is spare parts – we get two lungs, two eyes, and two kidneys, and each has more capacity than we ordinarily need. Taleb writes:

“An economist would find it inefficient to maintain two lungs and two kidneys: Consider the costs involved in transporting these heavy items across the savannah. ... Also, consider if we gave Mother Nature to the economists, it would dispense with individual kidneys: since we don't need them all the time, it would be more “efficient” if we sold ours and used a central kidney on a time-sharing basis.”

This reconfirms of why I'd like to own stocks with “sub-optimized”, debt-light (cash rich) balance sheets, as Taleb eloquently puts it “Debt implies a strong statement about the future, and a high degree of reliance on forecasts”.

Books for the Soul

What would you do and what would you share with others if you only had months to live? This is the theme of the following two books: [Tuesdays with Morrie](#) by Mitch Albom and [The Last Lecture](#) by Randy Pausch and Jeffrey Zaslow. In both books, terminally ill teachers share their life lessons with readers. Pausch, who sadly passed away last year, also gave this [great lecture on time management](#); and [here is his last lecture](#).

Another book I'll add to this category is [The Snowball: Warren Buffett and the Business of Life](#), by Alice Schroeder. This is an authorized biography of Warren Buffett. I am not sure this is the best book to read if you want to learn to invest like Mr. Buffett, but it gives a fascinating view of his life. There are many great lessons we can learn from Mr. Buffett that go far beyond investing, for example about honesty and treasuring one's reputation. But I thought this book was important for a very different reason: It shows that Warren Buffett is not a perfect human being and that we can also learn from the maestro by not repeating his mistakes. He achieved his unparalleled success in his business life at the expense of his personal life.

I find myself wanting to work 24/7. I bring my laptop home, or start reading *The Wall Street Journal* on iPad at the dinner table – my work life starts pushing out my personal life. This book made me realize that no professional success is worth regretting 20 years down the



road that you didn't spend enough time with your kids. Unfortunately, Buffett has that regret.

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