In crazy times like today, all one could and actually should ask for is sanity. Yes, sanity – a clear mind free of noise to deal with the insanity that is thrust upon us by a volatile and noise-making machine also known as the stock market.

We find ourselves glued to the computer screens or CNBC waiting to find out what the Dow’s next tick is going to be. Unfortunately, we are left with only a headache and wasted time. What’s next? Here is my advice: read. Read books that will bring you sanity, the ones that will snap you back into the discipline of an investor and out of the sorry shell of a nervous observer of the daily stock market melodrama. The following books are excellent choices and come with plenty of sanity and sage advice.

I originally wrote this list of recommended books last year; recently, I updated it and added a few more books. I hope to keep adding to it every year. It contains six sections: Selling, Think Like an Investor, Behavioral Investing, Economics, Stock Market History, and Books for the Soul. I hope you enjoy it.

Selling

I’ll start with *It's When You Sell That Counts*, 3rd edition, by Donald Cassidy. Selling is usually as popular as candy the day after Halloween. During secular bull markets selling is frowned upon as buy-and-hold turns into investing religion. And since selling violates the “hold” covenant of that religion, the investor who buys and sells is labeled a nonbeliever, or even worse, a trader (if you say “trader” fast enough it sounds like “traitor”).

In secular bull markets, on average, sell decisions are not as rewarding as hold decisions, as market valuations are expanding and even second-rate dogs (stocks) start looking like pedigreed cocker spaniels. Every investor is now a “long-term” investor and sell becomes a four-letter word. But being a long-term investor is not about the longevity of your hold decisions, but rather it is an attitude. Holding a stock because you bought it is a fallacy; you should only hold a stock if future risk-adjusted return warrants it.
Warren Buffett has been mistakenly promoted (though, I’d argue, demoted) into deity status in this buy-and-hold temple. Let's correct this mistake. Warren Buffett became a buy-and-hold investor when his portfolio and positions got big enough, pushing $60 billion, so that selling became a difficult undertaking. In his early career, before “Oracle of Omaha” was his moniker, he was a buy-and-sell investor. As he joined the boards of some of his biggest holdings (like Coke and Washington Post), it made selling even more difficult.

One doesn’t need the benefit of hindsight to know that at 55 times earnings Coke was tremendously overvalued in 1999. Coke, like the majority of Buffett’s top public holdings (Washington Post, Procter & Gamble, Johnson & Johnson, and many others), did not go anywhere for a decade. I dare you to take a look at his top public holdings and tell me whether he would have done a lot better if he had sold them when they became fully valued (or slightly overvalued). In most cases, that would have been a decade ago.

Emotions assault us from different directions when we face a sell decision: If it is a losing investment, we want to wait to break even. This is the wrong attitude. Our purchase price and sell decision should not be related (the only exception begin tax selling). Or when it comes to selling a winner, we want to sell only at the top. Again this is the wrong attitude: the top is only apparent in hindsight, when it is usually too late.

We should sell the stock when it reaches our price or valuation target, determined at the time of purchase. We (our emotions and false goals, to be exact) are our biggest enemy when it comes to investing, and especially selling. Cassidy’s wonderful book has been written to fix this. Its objective is to recalibrate your mind and free you from the imprisonment of past decisions, to break you free from the buy-and-hold state of mind and turn you into a buy-and-sell investor.

OK, this is a bit of a long introduction to this book, but it’s a terrific and a very important work. A proper sell discipline will decide between great or mediocre returns for even the best-crafted buy decisions. Pros may want to skip a few chapters, but it is an important read for everyone, especially in today’s environment.

Think and behave like an investor

The following books should help you to think like an investor, forcing you to think beyond stock tickers and focus on what is under the hood: the businesses and the people who run them. The first one is The Essays of Warren Buffett. It’s a compilation of Warren Buffett’s letters to shareholders from annual reports dating back to the 1970s. Before this book came out (or at least before I was aware of its existence) I had my graduate students at University of Colorado read Buffett’s annual reports, which as you may expect were very repetitious. His wisdom doesn’t vary that much from year to year. This book organizes the main concepts and removes annoying redundancy.
Another good book is *The Entrepreneurial Investor*, written by my friends at West Coast Asset Management. It accomplishes many objectives of Buffett’s essays, plus has plenty of cultural references, humor, and common sense. All of these things make it a fun and enjoyable read. I made this book suggested reading in my graduate investment class.

*The Super Analysts* by Andrew Leeming is a book I think few people have heard of. The author interviews successful investors (not academics), and they discuss their approach to investing and analysis of common stocks and some specific industries.

*You Can Be a Stock Market Genius* by Joel Greenblatt is one of those books that should be read more than once. Joel shares very unique approaches about how to find undervalued stocks. On top of being a very good investor, he has a healthy sense of humor. Joel also has written *The Little Book That Beats the Market*. I plan to read this book with my son when he gets older, as it is a great introduction to investing. At the end of the book Joel offers a “magic formula,” a screen that has beaten the market over a long period of time.

The magic screen is very simple: buy low price-to-earnings stocks that have a high return-on-capital. Low P/E is an indication of cheapness, while high return-on-capital is an indication of competitive advantage (at least in the past) and the possibility to grow earnings at high rates. Here is the book’s Web site, which provides a weekly list of stocks that score high on both measures.

*The Business of Value Investing: Six Essential Elements to Buying Companies Like Warren Buffett* by Sham Gad. Wiley sent me the manuscript to review, and it happened to arrive on my birthday in June. I opened the manuscript when guests showed up at the door; I set it on the kitchen table. My niece, a recent graduate from business school, who had little interest in investing, picked it up, and I did not see her for the whole evening. She loved it! It is hard to make value investing interesting, but Sham did. I’ve read it too, and thought it was an excellent introductory book to value investing.

*Pilgrimage to Warren Buffett’s Omaha: A Hedge Fund Manager’s Dispatches from Inside the Berkshire Hathaway Annual Meeting* by Jeff Matthews. This is not another biography of Warren Buffett, but rather the most insightful and critical (fair and balanced) analysis of Buffett and Berkshire I’ve ever read. I also encourage you to read Jeff’s musings on his blog; I’ve been reading it for years.

*The Little Book That Builds Wealth* by Pat Dorsey. Michael Porter wrote *Competitive Strategy* a few decades ago; quite deservingly it turned into a bible of industry analysis at all business schools and taught in all management programs. Pat Dorsey took Michael Porter’s concepts and in this very little book applied them directly to investing. To be honest, if this book had been out when I was teaching my investment class, I’d be using it instead of Michael Porter’s (sorry Michael), as it is written for investors.

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More Mortgage Meltdown: 6 Ways to Profit in These Bad Times. This book was written by Whitney Tilson and Glen Tongue, who are excellent investors. I’ve seen their presentation that is the core of this book several times; in fact you can download the latest version here. Investment ideas of how to profit from today’s crisis have already played out for the most part; so this book will not give you fish, but understanding their analytical process will teach you how to fish.

Behavioral Investing

The right temperament is crucial in investing. Being a critical thinker and knowing how to value stocks is important, but it is all a waste if your emotions get the better of you. The following books will help you to recognize the shortcomings of your hard-wiring and help you to devise strategies to deal with it.

Psychology of Investing, by John R. Nofsinger, is short and to the point. You'll become an expert on behavioral investing in about an hour. Well, not quite, but close.

Why Smart People Make Big Money Mistakes And How To Correct Them, by Gary Belsky and Thomas Gilovich. This is a fun and easy read. It also addresses how shortcomings in our wiring impact money decisions, like buying cars and stereos.

Your Money and Your Brain, by Jason Zweig, is another selection. I have to admit that the two books above cover many topics in this book (though this one offers new angles and insights) and are likely to be more exciting reads, but Chapter 10 is what makes this book a must-read: it addresses happiness – yes, happiness. Although, as most of us know, money doesn’t buy happiness (unless you are starving or living on the street), money spent on acquisitions – things – brings a burst of happiness that quickly fades away. Think of your level of happiness when you bought the car of your dreams. Money spent on experiences – being – brings a higher utility of happiness. Recollecting experience brings happiness. I plan to reread this chapter at least a couple of times a year. Zweig also provides a list of things you can do that will make you happy, and none of them require you to spend a penny, which is a big positive in today’s economy.

Reminiscences of a Stock Operator, written in 1923 by Edwin Lefevre, gives a first-person perspective of the fictionalized tale of the early years of the great trader Jesse Livermore. It is rumored that this book was actually written by Jesse Livermore and edited by Lefevre.

Though traders and value investors fish in the same pond – the stock market – and they may even catch the same fish at times, their approaches and analytical timeframes are diametrically different. However, they do share a common element: both are done by humans and thus are impacted by emotions. This book provides a great introspective

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Another lesson I learned early is that there is nothing new in Wall Street. There can't be because speculation is as old as the hills. Whatever happens in the stock market to-day has happened before and will happen again.

A man must believe in himself and his judgment if he expects to make a living at this game. That is why I don't believe in tips. If I buy stocks on Smith's tip I must sell those same stocks on Smith's tip.

The recognition of our own mistakes should not benefit us any more than the study of our successes. But there is a natural tendency in all men to avoid punishment. When you associate certain mistakes with a licking, you do not hanker for a second dose, and, of course, all stock-market mistakes wound you in two tender spots—your pocketbook and your vanity.

One of the most helpful things that anybody can learn is to give up trying to catch the last eighth or the first. These two are the most expensive eighths in the world. They have cost stock traders, in the aggregate, enough millions of dollars to build a concrete highway across the continent.

Another good book about Livermore is called *Jesse Livermore*, by Richard Smitten. I quoted this book in my book – here is the quote:

After several months of despair, Livermore finally summoned up the courage to analyze his behavior and to isolate what he’d done wrong. He finally had to confront the human side of his personality, his emotions and his feelings. . . . Why had he thrown all his market principles, his trading theories, his hard-earned laws to the wind? His wild behavior had crashed him financially and spiritually. Why had he done it? He finally realized it was his vanity, his ego. . . . The outstanding success of making more than $1 million in one day had shaken him to his foundations. It was not that he could not deal with failure—he had been dealing with failure all his life—what he could not deal with was success.
Economics

Politicians, God rest their souls, always try to appeal to the lowest common denominator. They try to “protect” us from evil doers by insisting on minimum-wage laws or rent controls, or threatening windfall taxes on oil companies. They sound like heroes fighting for the little guy against the evil doers. However, all they are doing is feeding on the economic illiteracy of the Average Joe. This is why the following two books should be required reading in high schools and colleges: Basic Economics by Thomas Sowell and A World of Wealth by Thomas G. Donlan.

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 perspective on American politics from an insider who served under or worked with the last eight presidents.

Atlas Shrugged by Ayn Rand. This is a novel, not an economics book; however, it accomplishes a lot more than most economics books could ever accomplish. 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 Russians) both saw the ugly consequences of socialism.

In Atlas Shrugged, Ayn Rand defines her philosophy: individualism. Individualism is not a politically correct term today (if ever) 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 pursuit of communal and national goals is often undertaken at the expense of individual liberty.

According to Jennifer Burns, who recently 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 on the pages of Atlas Shrugged.

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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 very 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.” This way, it would not lure investors into a false sense of security when it comes to stocks. Probably unintentionally, it preaches that stocks (and the stock market as a whole) are always a buy, no matter what valuations are, as they do better than other asset classes in the long run; 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 this long a time horizon. We need to send kids to school, pay for 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 with the following antidote: *Unexpected Returns*, which is a truly terrific book by Ed Easterling. Unlike Siegel, Easterling shows that despite stocks being 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 markets, which is just a difference in semantics. Those bear (range-bound) markets take place after secular bull markets.

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 risk and rare events (the Black Swans).

*Fooled by Randomness* is my favorite nonfiction book, period. I’ve read it at least five times. This book turns the way we are taught to look at risk upside down. 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, more importantly, 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 – the definite (since it already happened), observed history, but one that beforehand was actually still just one of many possible random outcomes. One should focus on what could have taken place, what alternative paths might have existed. This allows us to think creatively...
about what could have happened, and with that added insight to then predict and prepare for what might happen in the future.

Let's take the current crisis: Wall Street and rating agencies dismissed the possibility that housing prices might decline nationwide. This hadn't happened since World War II – well, then, it wouldn't happen in the future. Therefore, Wall Street took subprime (risky) mortgages originated in different parts of the country, lumped them together in mortgaged-backed securities, and – voila! – the risk had been 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 easy. This book has more insights per page than most, but is not a beach read.

In this lecture Nassim covers major concepts described in both books in great detail.

**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. Also, Randy Pausch, who sadly passed away last year, gave this [great lecture on time management](http://www.younger52.com); and [here is his last lecture](http://www.youtube.com/watch?v=pp2JzovdV7w).

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 very different and interesting view of his life. There are many great lessons we can learn from Mr. Buffett that go far beyond investing, such as about honesty and treasuring one’s reputation. But I thought this book was important for a very different reason, in that it shows that Warren Buffett is not a perfect human being and that we can learn from the maestro, but in a different way: by not repeating his mistakes. He achieved his unparalleled success in his business life at the expense of his personal life, unfortunately.

Especially in today's environment I find myself wanting to work 24/7 (and I probably do). This is truly a stock picker’s market. I bring my laptop home, read *The Wall Street Journal* at the dinner table, and 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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