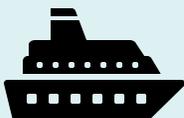


*Even experts are prone to mistakes so training beyond a point doesn't help. Technology creates its own complexity too and hence it is difficult to find a solution just by changing or upgrading technology*



## OVERSEEING OVERSIGHT!

*"If making mistakes is the inevitable cost of striving, correcting mistakes – and learning how to avoid repeating them – is the best measure of a learning organization"*

– Charles Ellis

David Blair, born on November 11, 1874, was a British seaman working with the company – White Star Line (WSL). During the early 20th century, WSL was one of the most prominent shipping lines in the world, providing passenger and cargo services between the British Empire and the United States. While its competitors believed in making ships that were fast, WSL concentrated on making large luxurious ships with high service standards. David had the opportunity to work on the largest ship in the world at that time, the RMS Titanic. He was involved during the ship's test runs and was chosen to be the ship's Second Officer during her maiden voyage from South Hampton to New York City. On April 10, 1912, when the ship was ready for departure, the shipping line decided to make a change. They decided to replace David Blair with Henry Wilde, the Chief Officer of Titanic's sister ship RMS Olympic. Henry had more experience than David and better skills at running large ships.

Due to this last-minute change, Blair had to pick up his stuff, execute the handover process and leave the ship in a hurry. Being in a rush, David did everything he had to, but forgot to handover a key to one of the cabinets to Officer Wilde. That key was the only key to the locked cabinet that held the binoculars on the ship. By the time David and the rest of the crew realized the mistake, the ship had sailed. On the night of April 14, 1912, Titanic hit a large iceberg. The ship, that was considered 'unsinkable', was badly damaged and descended to the bottom of the ocean. Out of the 2224 passengers and crew aboard, more than 1500 died, making the sinking, one of modern history's



**The investment checklist ensures that all the steps in the research process are properly executed**

deadliest peacetime commercial marine disasters. Fred Fleet, the seaman who was assigned the duty of lookout on that fateful night, survived, and said in an investigation, that if he had a pair of binoculars with him, he would have been able to spot the iceberg from far. This would have given the Ship's command bridge more time to steer away and possibly avoid the disaster.

## WE MAKE MISTAKES... QUITE OFTEN

To err is human but sometimes a small slip-up or a lapse in judgement can cost us dearly. This applies to investing as much as to any other field which relies significantly on human judgement. Broadly, the errors we make can be classified into two types:

*A) Errors due to ignorance:* We are quite likely to commit errors in situations we don't completely understand or problems we don't readily have a solution to.

*B) Errors due to ineptitude:* This happens when we have knowledge but fail to apply it correctly.

The second type is quite painful and frustrating. As we are generally dealing with complex systems, running with tight deadlines, multitasking, and swaying to emotions of greed, fear, overconfidence etc. we are highly prone to errors in category B.

Can we reduce these errors by increasing training or using better technology? Not much. Even experts are prone to mistakes so training beyond a point doesn't help. Technology creates its own complexity too and hence it is difficult to find a solution just by changing or upgrading technology. The answer lies in a simple tool called the "Checklist": Atul Gawande in his book, "The Checklist Manifesto" has provided a comprehensive view of the importance of checklists and how they improve outcomes. "They (checklists) provide a kind of cognitive net. They catch mental flaws inherent in all of us – flaws of memory and attention and thoroughness". Checklists reduce failure by compensating for potential limits of human memory and attention. They help to ensure consistency and completeness in carrying out a task.



*It is surprising that, despite having the potential to add immense value to the investment process, the checklist is rarely discussed in B-schools, investment firms, journals or forums*



## THE INVESTMENT CHECKLIST

*The checklist reduces the emotional aspect of investing by forcing you to think before you act. It results in a better decision-making process.*

*It is surprising that, despite having the potential to add immense value to the investment process, the checklist is rarely discussed in B-schools, investment firms, journals or forums. An Investment checklist is a set of questions or areas of enquiry that one has to complete before making an investing decision. Each individual investor or an institution can have a different checklist. It entirely depends on one's investment philosophy and process. The investment checklist ensures that all the steps in the research process are properly executed. It also helps improve decision making in the following ways:*

- **The investment checklist is like a gatekeeper of your portfolio:** *The elements or selection criteria(s) which are derived from the investment philosophy are placed in the checklist to gather targeted information, most important for the investment decision. For example: a fund following a value investing philosophy will have questions based on desired valuation criteria in the checklist. At the very initial stage of evaluation, the analyst or the investor can start with value related questions to determine whether to move ahead.*
- **Collection of past experiences:** *The checklist acts as a collection of past experiences especially mistakes. Keeping them in the checklist will ensure that the mistakes are not repeated. Infact, the document can also have learnings from others' experiences. A team of analysts may have certain unique experiences related to their sectors or stocks. Combining this knowledge that exists in the team and collating them in the checklist will increase the team's collective experience and maturity. This is true for investors who incorporate their past experiences in the checklist.*
- **Checklists reduce noise and channel attention towards important research areas:** *Discipline is difficult. Many investors, despite having determined their selection criteria, get swayed by*

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market noise. During such times, the checklist helps channel their attention to important areas of research.

- **Identifying and controlling biases:** A good checklist comprises of questions that probes areas where biases can creep in and can also help control them to some extent. A confirmation bias while buying a security for example can be handled by adding questions like “what are the arguments of analysts who have a sell rating on the stock?” Scenario analysis and Pre-mortem are steps that can be added to nudge towards better decision making. Going through an investment checklist before adding a company to the portfolio takes care of endowment effect.
- **Consistency and time saving:** By streamlining the steps to be followed and information to be gathered, the checklist helps in providing consistency to the research process. Analysts / Investors do not have to chart a fresh research course every time they start with a new company. Checklists also save time as they reduce errors and make the process more efficient.
- **Other benefits:** During company management interactions, keeping a checklist can guide the investor or analyst to ask the right questions or collect the right data points. Updating information is also easier and more systematic. A new recruit in the investment team can quickly grasp the essence of stock selection process in the investment firm by going through the checklist.

An investment checklist is a systematic way of thinking about investment research. It brings discipline and helps reduce mistakes. It also acts as a cognitive net to catch biases. By reducing errors, it enhances investment outcomes. It creates opportunity to generate higher alpha by giving the investor an edge... a behavioral edge!



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**ABOUT STOIC INVESTOR:**

*The word “Stoic” is used to describe someone who remains calm under pressure and avoids emotional extremes. For the purpose of this newsletter we refer to the “Stoic investor” as an investor who is realist (avoiding extreme optimism and extreme pessimism), resilient (withstand difficult conditions) and rational (who acts with logic and reason).*

**Disclaimer:**

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**Mutual Fund investments are subject to market risks, read all scheme related documents carefully.**