A slightly different style of investing:

Traditional investing is all about asset allocation based on macro economic outlook and then drilling down to security selection. That’s a bit too fuzzy for my liking. Investing capital should be a more disciplined activity since it puts that capital at risk. The risk should always be well compensated by the prospect of returns. Thus, unless there is a very good reason to invest, capital should not be invested. There is a real cost to not being invested, but this is a relatively more certain cost, being the difference between short term cash rates and inflation. The short term cash rate will depend on the investor’s level of access and short term risk appetite. Deposit rates, LIBOR, or overnight repo rates are good proxies. This cost of not being invested can also be thought of as an option premium paid to not have exposure. It is the option to invest in the current period.

An investment would require a clear and present rationale, an event or a catalyst to justify it. Valuation itself is not sufficient. It is an important factor. Most successful value investors don’t just buy value; they buy value with a catalyst in mind. Sometimes, these investors not only have a catalyst in mind but they are active catalysts themselves. Distressed debt investors are a classic example, where the debt of a distressed business is bought with a view to reorganizing the business and the liabilities of the company in order to unlock value. Merger arbitrage is another example where the takeover code, anti trust regulation and other regulatory legislation drive investments to their fruition or deal-break.

The disciplines of event driven and distressed investing should be applied to traditional investments as well. Tighter

definitions of investment rationale should be demanded by investors when they are asked to place capital in harms way.