Value and process key for Kentucky Derby, stock picks

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The 144th Kentucky Derby will run May 5th. This year's "Run for the Roses" will feature partiers in fancy attire and hardcore handicappers and casual bettors alike wagering huge amounts in hopes of cashing a winning pari-mutuel ticket.

Referring to picking stocks, Warren Buffett famously said, "price is what you pay, value is what you get." As it turns out, the same can be said for betting the Derby. So says Michael Mauboussin, a Wall Street strategist and author.

In Maboussin's book, **The Success Equation—Untangling Skill and Luck in Business, Sports, and Investing**, he argues skill and luck have varying degrees of importance along the continuum from pure luck (think lotteries) to pure skill (think chess). He introduced the ***paradox of skill***, the idea "as skill improves, performance becomes more consistent, and therefore luck becomes more important."

Rightly or not, individual investors are known as the weak, "dumb money." To a large extent, individuals have either abandoned the stock market or sought comfort with the herd in index funds, leaving a group of strong, highly-skilled, "smart money" professional investors in need of luck as they battle one another.

Maboussin believes when you're in a game when success is ***probabilistic***, you should focus on ***process, not outcome***. Investors focus on performance because that's what you can see and spend. It's relatively easy to assess results and difficult to evaluate process. However, over the short-term you can do everything "right" and still get a bad result and vice-versa. While luck determines short-term outcomes, ***skill and process*** determine long-term success.

According to Maboussin, "In a pursuit such as blackjack, where luck is very important, you have to adopt a process that you can trust and not worry so much about the outcome of each hand. Your ***only*** chance of winning is to adhere to the rules that you know work. Your skill can't change the odds; it can only be applied to make sure that you play the cards properly."

The "intrinsic value" of a stock is its various possible future values, weighted by the probabilities of those outcomes. For value investors like us, the skill is in accurately assessing the possible outcomes and probabilities and the process is assembling a portfolio of stocks trading at a significant discount to intrinsic value.

Steven Crist, the former Owner/Publisher of *Daily Racing Form*, the horseplayers' *Wall Street Journal*, wrote "**Crist on Value**," https://vintagevalueinvesting.com/drf-legend-steven-crist-on-value-investing-and-horse-betting/ which Maboussin called "one of the best 13 pages on investing I have ever read."

Maboussin suggested substituting "stock" wherever Crist said "horse." "The issue is not which horse in the race is the most likely winner, but which horse or horses are offering odds that exceed their actual chances of victory…Under this mindset, everything but the odds fades from view. ***There is no such thing as 'liking' a horse to win a race, only an attractive discrepancy between his chances and his price (odds).***"

Further, "Sticking to your guns is easier said than done, but it is the ***only*** way to win in the long run. The horseplayer who wants to show a profit must adopt a cold-blooded and unsentimental approach to the game.

"This approach requires the confidence and Zen-like temperament to endure watching victories at unacceptably low prices by such horses. If all of this seems to calculating and joyless, by all means feel free to enjoy yourself at the races betting horses you fancy regardless of their price. You'll have plenty of company, and the rest of us could use your money."

As Howard Marks of Oaktree Capital puts it, "it has been demonstrated time and again that no asset is so good that it can't become a bad investment if bought at too high a price. And there are few assets so bad that they can't be a good investment when bought cheap enough."
