# Twitter Thread by Ram Bhupatiraju



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**Excellent article on Investor psychology & Market cycles based on Howard Marks' "Mastering the Market Cycle".**

**cc: @dmuthuk @Gautam__Baid**

My fav pts ■

**Mastering the Market Cycle : Howard Marks**

"There are opportunities for us to tilt the investment odds in our favor by understanding the tendencies of markets and the reasons they wax and wane. By contrast, failing to understand the nature of markets may leave us too optimistic or pessimistic at precisely the wrong time."

"It is important to understand our investment environment and position our portfolios accordingly. This involves balancing the aggressiveness and defensiveness in our positions based on the future tendencies of markets (which is based on the cycle phases we observe today)."

Markets may misprice assets on a risk-adjusted basis as society swings along the pendulum of psychology.

**Understanding risk**
Risk in practice refers to the likelihood of permanent capital loss and the likelihood of missing out on potential gains. The latter is also known as opportunity risk. Risk implies we are unsure about what's about to unfold next and that there is a range of potential outcomes. We must always keep risk in mind when making decisions. This requires us to focus on both the tendencies and ranges of potential outcomes.

**Thinking in cycles**
Most investors do not have a proper appreciation for the features and significance of market cycles, and what it implies about future tendencies. Similarly, most investors have not lived through many cycles or read sufficient financial history to develop such knowledge advantages. Too often they see the investment environment as isolated events in the moment.

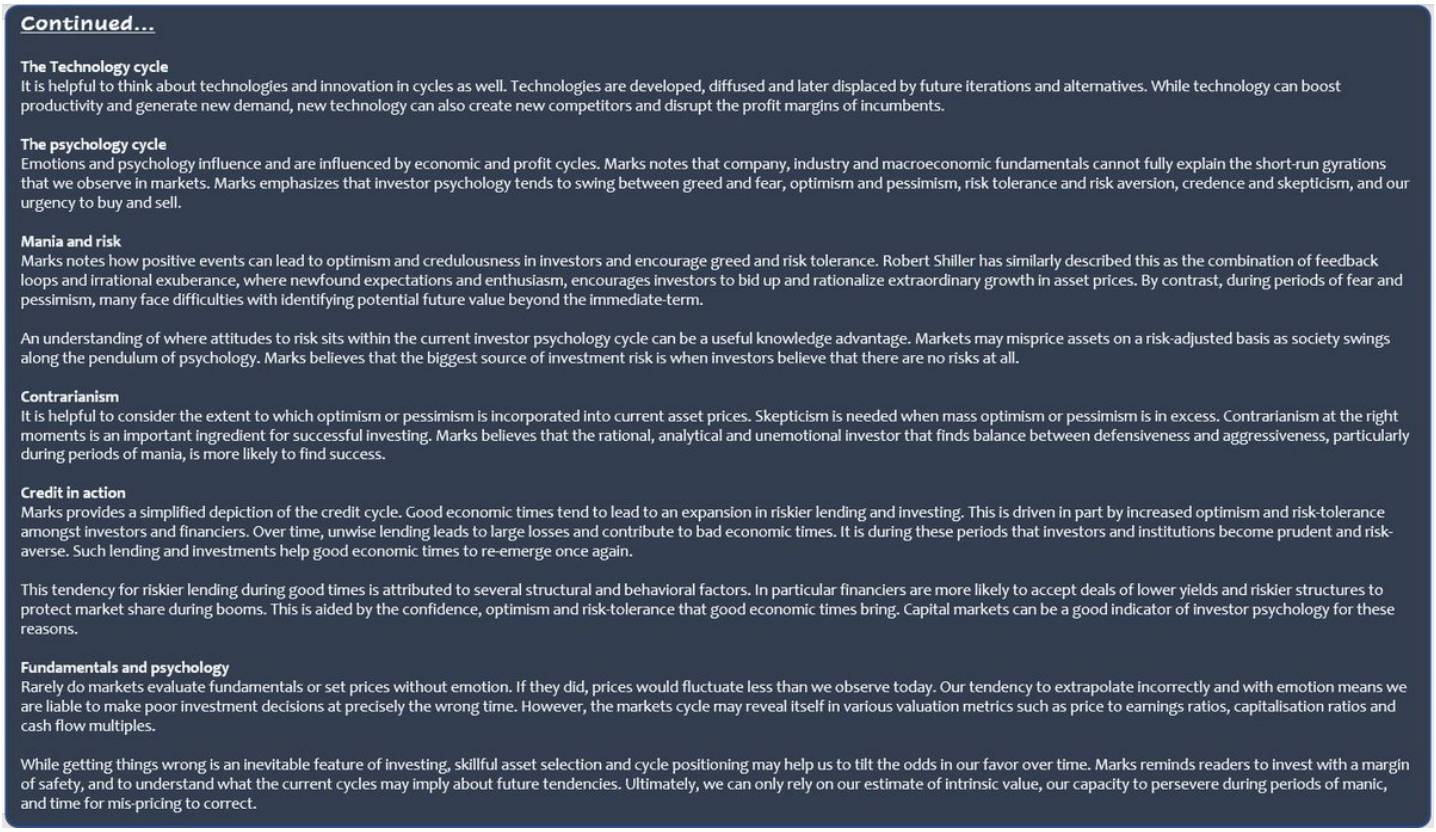
**The nature of market cycles**
Market cycles are like pendulums or tides that move back and forth. While their reasons, timing and degree of change may vary, Marks believes they are an inherent feature of the investing environment. Like a pendulum in motion, markets are unlikely to remain at fair-value indefinitely. Rather, it swings from underpriced to overpriced and vice versa.

**Financial amnesia**
Our inability to remember the past can enhance the strength of cycles. We are also quick to assume that this time is different. Furthermore, our asymmetrical attitudes to market gyrations can make it difficult to observe cycles in the moment.

**Human nature and randomness**
Randomness and human behavior contribute to the irregularity of cycles. Sometimes we develop simple explanations to make these events comprehensible, failing to recognize the full complexity and randomness that may characterize such events. Seeking such explanations may lead us to over extrapolate without evidence.

**Complex reflexive systems**
More generally, we should remember that financial markets are complex, reflexive systems. This is due in part to the nature of human participants in markets. Most good ideas in markets are unlikely to be infinitely or indefinitely scalable. Hence, ideas that generate abnormal profits tend to attract new capital that creates downward pressures on incumbent returns.

continued...




Excellent pts ■

✔■Mania and risk
"The combination of feedback loops and irrational exuberance, where newfound expectations and enthusiasm, encourages investors to bid up and rationalize extraordinary growth in asset prices.

By contrast, during periods of fear and pessimism, many face difficulties with identifying potential future value beyond the immediate-term.

An understanding of where attitudes to risk sits within the current investor psychology cycle can be a useful knowledge advantage.

Markets may misprice assets on a risk-adjusted basis as society swings along the pendulum of psychology.

Marks believes that the biggest source of investment risk is when investors believe that there are no risks at all.

✔■Contrarianism
It is helpful to consider the extent to which optimism or pessimism is incorporated into current asset prices. Skepticism is needed when mass optimism or pessimism is in excess. Contrarianism at the right moments is an important ingredient for successful investing

The rational, analytical and unemotional investor that finds balance between defensiveness and aggressiveness, particularly during periods of mania, is more likely to find success."

My 2 cents - For individual investors, it's a futile effort to predict the Macro but there's a lot we can glean from what is already happening in the Mkts, and how we can posture our Portfolio for offense/defense (on the edges), especially when there's excessive fear/froth in Mkt

Inability to predict the Macro shouldn't stop us from learning more about Business, Credit & Economic cycles and being aware that they can affect Markets in both directions, and impacting the discount/premiums to the Valuations of Companies (far away from their intrinsic values).