Confidence and Humility

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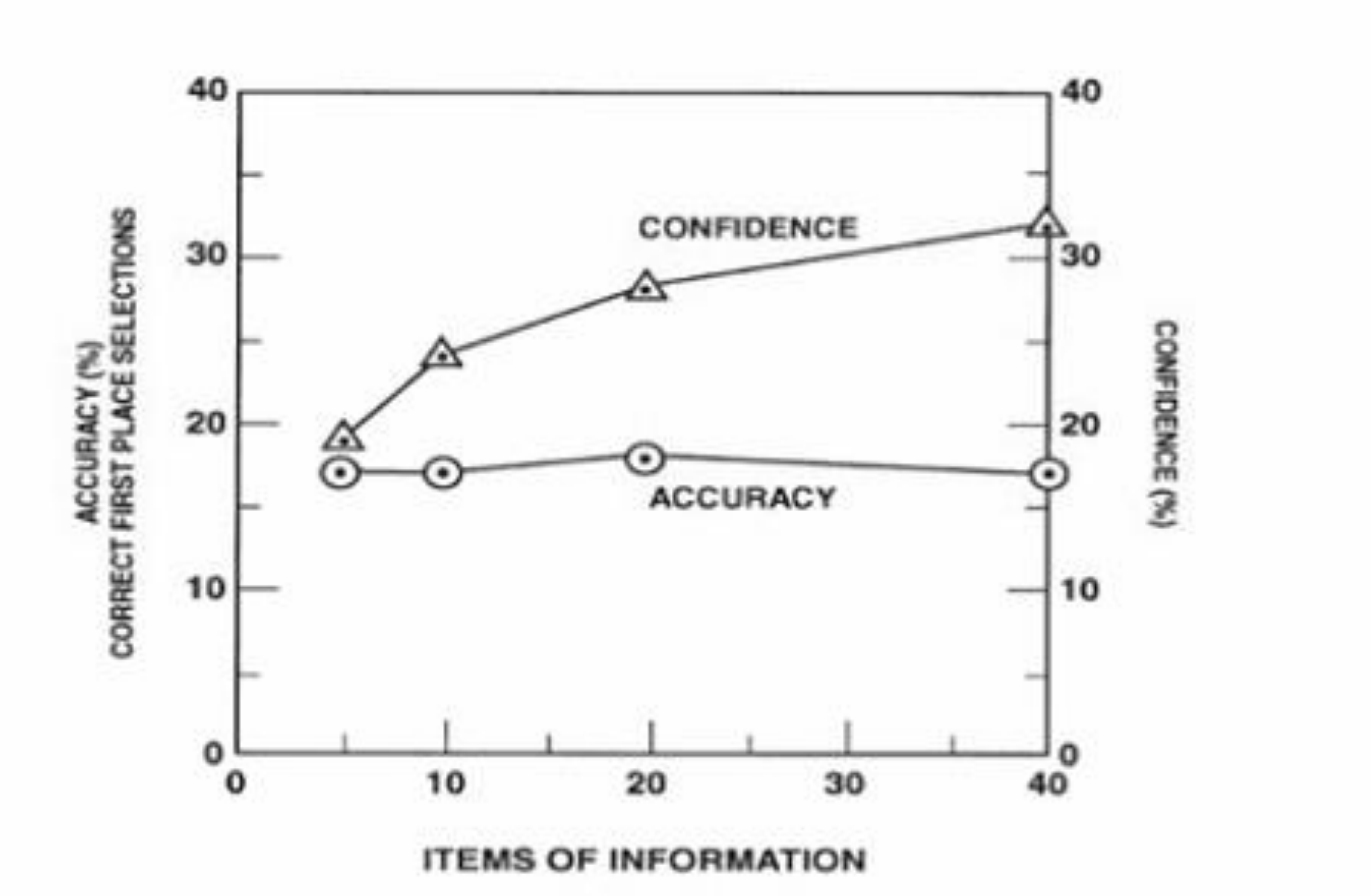
Long-term equity investing requires a delicate balance between confidence and humility. On the one hand, you need confidence to make investment decisions. On the other hand, you must have a healthy dose of humility, as you will often be wrong in your judgment. Surprisingly, research on horse betting can teach us a thing or two about striking this balance.

In 1974, world-renowned psychologist Paul Slovic conducted an experiment in the horse-betting field. Slovic gathered professional horse betters and gave them varying amounts of information about the horses. The betters had to estimate their level of confidence about the correct first place ahead of the race. Slovic found that the betters' confidence in their own estimation ability increased as the volume of information about the horses increased. However, their accuracy in correctly guessing the winner was flat with increasing information. An increasing amount of information did not lead to better decision-making, only higher confidence. This can be shown in the figure below***:



Back to investing
This study offers important insights for investors looking to make long-term equity investments. Although some investors may believe that having an exhaustive understanding of every single aspect of a company is commendable, it can actually be counterproductive. Focusing excessively on details like the intricacies of the production process or the technical specifications of every product offered by a company's numerous subsidiaries may not be as beneficial in the long term.

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Like horse betting, decision fatigue often sets in because the more information you gather, the more conflicting signals you receive about the potential investment. Moreover, too much information leads to overconfidence, as investors begin to look only for information that confirms their investment hypothesis.

When it comes to building a rocket, every single detail requires attention. However, long-term equity investing is not as complex as rocket science.

As the American writer Mark Twain famously said, "It ain't what you don't know that gets you into trouble. It's what you know that just ain't so."

Our experience

As investors, it is vital to understand that more information does not always translate to better decision-making. Instead, you need the right type of information. Focusing on the essential information pillars like capital allocation, decentralization, and people does, in our experience, the heavy lifting in sound decision-making.

At REQ Capital, we have a robust investment philosophy and a strategy focused on the three pillars above. We consciously miss some details to avoid decision fatigue and overconfidence. We believe our approach and experience can help strike the balance between the confidence and humility needed for long-term equity investing.

In conclusion, while we may not be horse betting experts, we can still learn a thing or two from the world of racing. Remember, it's not about having all the information but the right information when it comes to long-term equity investing. We can make informed investment decisions that align with our investment philosophy and strategy by admitting what we do not know and focusing on the right information.

Sources:

«The Perils of More Data» by David Widmar and Sarah Hubbart (31st of May 2022)

**https://ma.tt/2017/11/adam-robinson-on-understanding/

*** Page 53 in «Psychology of Intelligence Analysis»

**** https://medium.com/@bobclarodock/how-can-confidence-kill-investment-returns-cd9fd5b13ae (Bob Dockendorff)