

Filter Feeders & Destructive Mental Models ValueX Vail June 2023

John Zolidis
Quo Vadis Capital
john.zolidis@quovadiscapital.com




QUO VADIS
CAPITAL

DISCLAIMERS



**not investment advice; please
consult your advisor**

A fluffy orange and white cat is sitting inside a cardboard box. The cat is looking directly at the camera with wide, green eyes. It has its right paw raised to its forehead in a saluting gesture. The cat's fur is thick and soft-looking. The box is made of brown cardboard and is placed on a dark, textured surface.

**INTRO: What is the problem
investors are trying to solve?***

***no cats were harmed in the making of this presentation**

**We already
KNOW a stock
can only go up if:**

**1) the underlying
company's cash
flow and
earnings
increase; or**

**2) investors
become willing
to pay more for
its cash flow and
earnings**



A fluffy grey cat is lying in a cardboard box, looking towards the camera. The cat's fur is thick and soft, and its eyes are a striking yellow. The box is made of brown cardboard and is placed on a wooden surface. The text "Seems so simple yet we all have jobs? Why is it so hard?" is overlaid on the image in a white, bold, sans-serif font.

**Seems so simple yet we all
have jobs? Why is it so
hard?**

Invert the question:

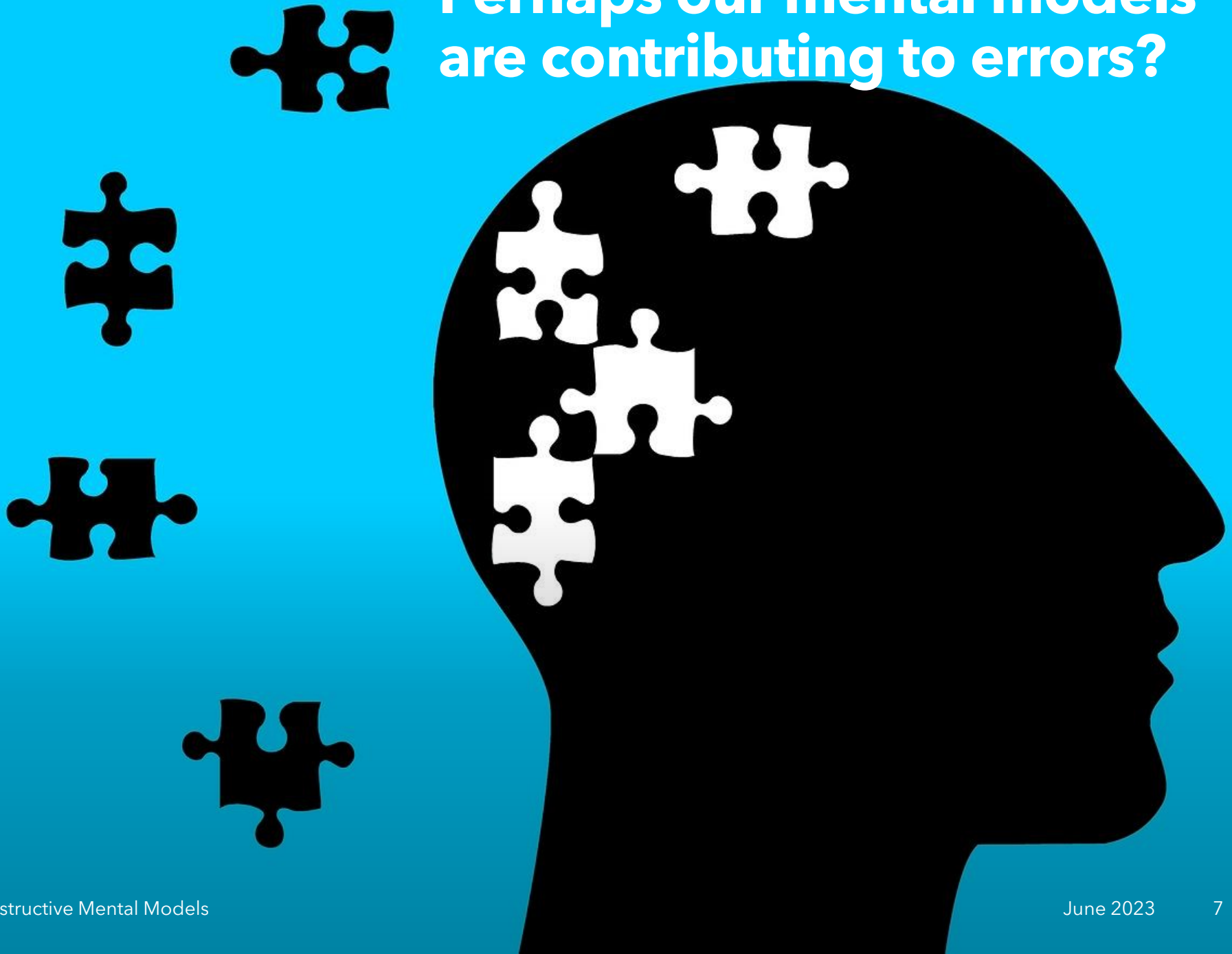
**Leaving aside
security analysis,**

**What are WE doing
that makes it harder
than it has to be?**

**And WHY are we
doing those things?**



Perhaps our mental models
are contributing to errors?



What's a Mental Model?

"You can't really know anything if you just remember isolated facts and try and bang 'em back.

If the facts don't hang together on a **latticework of theory**, you don't have them in usable form."

Charlie Munger



Mental Model vs. Heuristic

A **heuristic** is an analysis shortcut - a quick approximation to arrive at an answer that replaces a more difficult process that would potentially provide more accurate results

A **mental model** is more like a concept or framework that filters or determines the way a new piece of information or a problem is approached



Why do investors' models go sour?



Factor #1

Investors are overwhelmed with data & "info,"

**Believe in the need to process it all,
Want to do it expeditiously**

A photograph of Leonardo DiCaprio in a white polo shirt, holding a glass of red wine. The background is a blurred blue and white pattern, possibly a window or a wall. The text is overlaid on the lower left portion of the image.

Factor #2
Industry structures, esp. sales-driven,
organized around incentives
reinforcing effect

A stylized illustration of a mushroom with a human face in the background, rendered in shades of green and black. The mushroom is the central focus, with its stem and cap clearly defined. The background features a faint, cracked texture, possibly representing a face or a map. The overall aesthetic is dark and somewhat ominous.

Factor #3
Unholy symbiosis of financial media & social forces with human psychology

When Mental Models Turn Sour

The problem with mental models lie not in whether they are right or wrong – by definition, all models are simplifications. The problems [...] arise when they become implicit – when they exist below the level of our awareness.

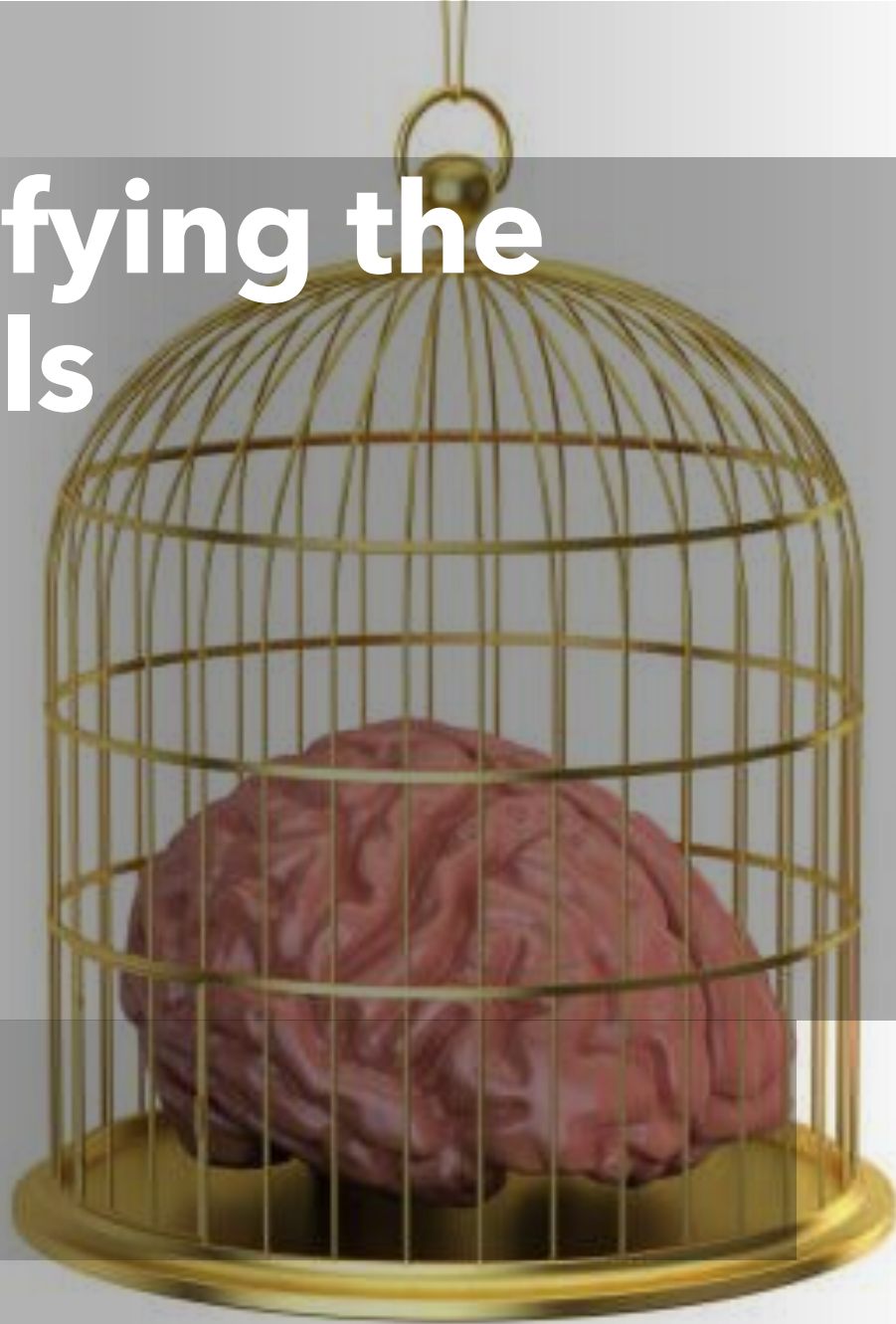
Peter Senge, The Fifth Discipline

When Mental Models Turn Sour

Because we remain unaware of our mental models, the models remain unexamined. Because they remain unexamined [...] as the world changes, the gap between our models and reality widens, leading to increasingly counterproductive actions.

Peter Senge, *The Fifth Discipline*

Identifying the models



#1 Misguided by Stars





Mini-quiz: What do the following figures have in common?

1. # days for the moon to circle the earth?

2. # days for Mars to circle the Sun?

3. # days for Venus to circle the Sun?

4. # days for Earth to circle the Sun?



What these figures have in common is that none represent the ideal period to evaluate investment returns.

(Answers: 1) 27.3 days, 2) 687 days, 3) 225 days, 4) duh.)

365 days does not correlate with the economic cycle the business cycle

Thinking in 365-day increments is a source of investment error

Very difficult to escape this due to industry incentives & media

Probably: Each investment may have its own most appropriate cycle





#2 Wise man problem

**Ironic detriment of
experience**

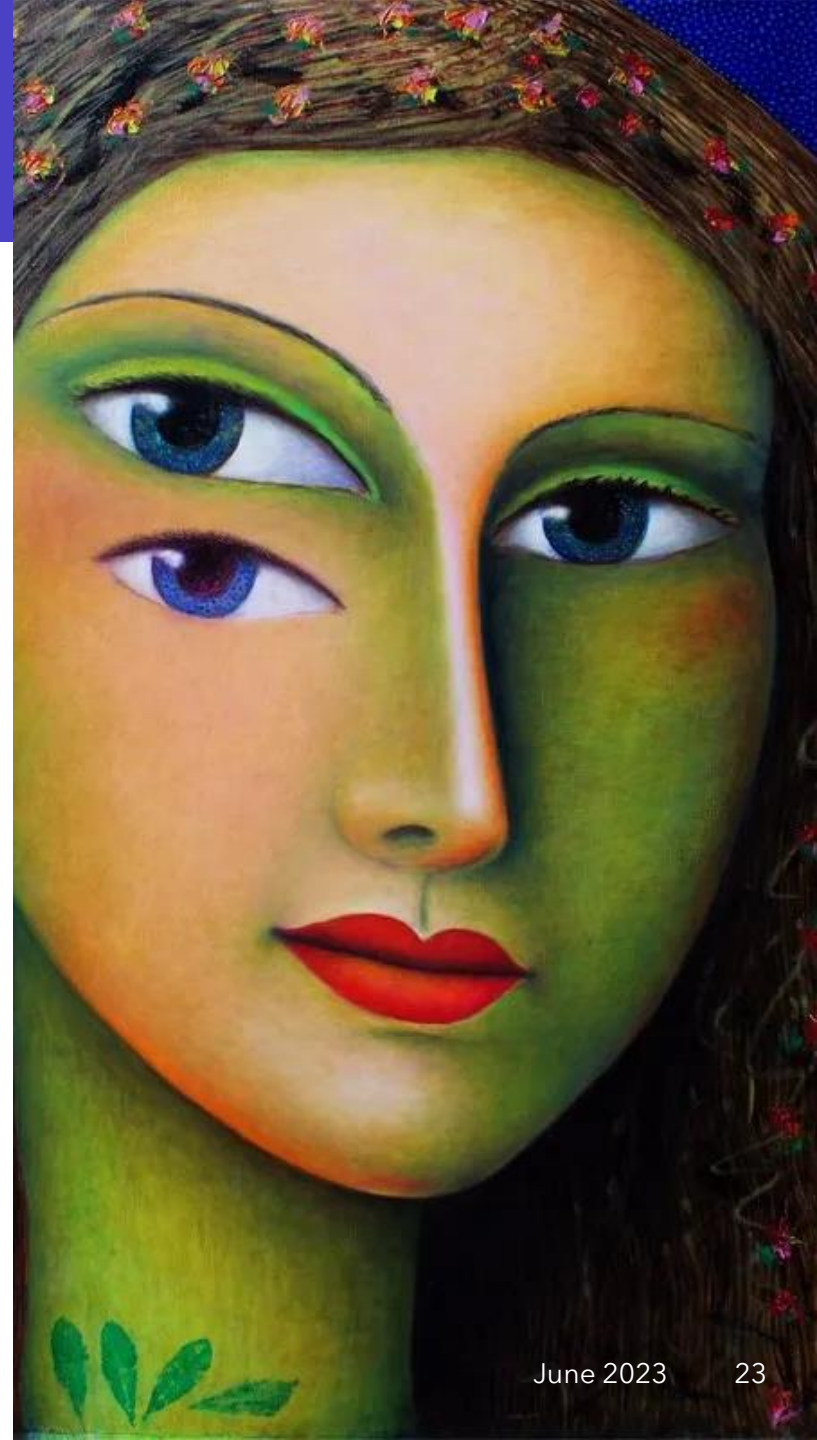
**Increasingly tempting
to forecast based on
what happened before**

**Low probability events
discounted, "haven't
seen that"**



Reference to previous conditions sets up investment error

What's different this time is exactly what you won't anticipate



#3 Analysis by Analogy





Many companies and situations have similarities

First response to new company is to compare to known business or situation

Focusing on the similarities misses what's different

Using a false analog sets up investment error

Better to approach each case as a unique object



The wise man problem and analysis by analogy both reflect pattern-seeking brain & desire to move quickly, making it harder to recognize change, unique situations or features



#4 Confusing noise for signal

**The pattern-seeking
brain wants to find
information in stock
price movements**

**However, much
volatility in prices is just
that**



**Stocks frequently over-
react to ST changes in
company performance
and external conditions**

**Making decisions
based on the false-
feedback loop from
prices is a source of
investment error**



$$\Delta x \Delta p \geq \frac{\hbar}{2}$$

#5 Conflating uncertainty



All Investing is about the future, not the present.

The source of uncertainty in the future is from things we don't know - the unknown unknowns

By definition this cannot increase or decrease

Normal speech, however, frequently conflates uncertainty in present conditions with future uncertainty

The future is always uncertain, “high visibility” is an illusion

The media and social forces frequently amplified perceived uncertainty

“high uncertainty” often correlates with attractive opportunities to buy at a discount

Making decisions based on perceived change in uncertainty is a source of investment error



#6 News junkie



**Feel the need to know
“everything”**

**Hours spent skimming
news, twitter and sell-
side reports is
counterproductive**



Accept uncertainty
Can't know everything

Focus time on knowables

**Overconsumption of
news leads to lack of
focus on LT and
investment error**



#7 Cabinet of Curiosities





Value investing by its very nature is contrarian. **Out-of-favor securities may be undervalued; popular securities almost never are. What the herd is buying is, by definition, in favor.** Securities in favor have already been bid up in price on the basis of optimistic expectations and are unlikely to represent good value that has been overlooked.

Seth Klarman, Margin of Error

Undervaluation may correlate with out of favor securities, but so does terrible companies.

Popular securities can be so volatile, they can frequently present attractive value

Too much focus on creativity misses obvious investment opportunities





**How do we get
out of this mess?**

Summing up themes

Challenges: 1) info overload, 2) pattern seeking brain, 3) dealing with uncertainty 4) industry structures, 5) media and social reinforcement

Instead: 1) reduce consumption of info (noise), 2) focus on unique and different, 3) accept existence of unknown unknowns, 4) escape industry structures & think long-term, 5) tune out unhelpful influences

Summing up themes

- #1 Investment performance and time horizons should not be determined by the stars or the sales department
- #2 The pattern-seeking brain, under time pressure, will discount unique info and unusual circumstances
- #3 Simultaneously, the brain is programmed to find signals in noise
- #4 All investing is dependent on future outcomes, but many conflate uncertainty in the present for a change in uncertainty in the future
- #5 Consuming all (or most) available information is counterproductive
- #6 There are no points for creativity in investing

Summing up themes

#7 Investment opportunity occurs when change is unrecognized ; but the pattern seeking part of the brain is trying to save you time by glossing over differences

#8 Market opportunities occur when investors focus on present conditions and near-term uncertainties, while social forces and the false-feedback loop from stock prices reinforce caution

disclosures

Quo Vadis Capital, Inc. ("Quo Vadis") is an independent research provider offering research and consulting services. The research products are for institutional investors only.

The price target, if any, contained in this report represents the analyst's application of a formula to certain metrics derived from actual and estimated future performance of the company. Analysts may use various formulas tailored to the facts and circumstances surrounding a specific company to arrive at the price target. Various risk factors may impede the company's securities from achieving the analyst's price target, such as an unfavorable macroeconomic environment, a failure of the company to perform as expected, the departure of key personnel or other events or circumstances that cannot be reasonably anticipated at the time the price target is calculated. Quo Vadis may change the price target on this company without notice. Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources Quo Vadis believes to be reliable; however, Quo Vadis does not guarantee its accuracy and does not purport to be complete. Opinion is as of the date of the report unless labeled otherwise and is subject to change without notice. Updates may be provided based on developments and events and as otherwise appropriate. Updates may be restricted based on regulatory requirements or other considerations. Consequently, there should be no assumption that updates will be made. Quo Vadis disclaims any warranty of any kind, whether express or implied, as to any matter whatsoever relating to this research report and any analysis, discussion or trade ideas contained herein. This research report is provided on an "as is" basis for use at your own risk, and neither Quo Vadis nor its affiliates are liable for any damages or injury resulting from use of this information. This report should not be construed as advice designed to meet the particular investment needs of any investor or as an offer or solicitation to buy or sell the securities or financial instruments mentioned herein. This report is provided for information purposes only and does not represent an offer or solicitation in any jurisdiction where such offer would be prohibited. Commentary regarding the future direction of financial markets is illustrative and is not intended to predict actual results, which may differ substantially from the opinions expressed herein. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur.

The analyst who is the author of this report does not have a position in shares of the companies that are the subjects of this report. However, Quo Vadis prohibits analysts from trading in a way that is inconsistent with opinions expressed in reports [subject to exceptions for unanticipated significant changes in the personal financial circumstances of the analyst].

This report may not be reproduced in part or in whole. Please do not redistribute this report.

Reg AC Certification:

All of the views expressed in this research report accurately reflect the research analyst's personal views about any and all of the subject securities or issuers. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the research analyst in the subject company of this research report.

www.quovadiscapital.com



Explore more presentations at VALUExVail.com