The earliest images of boats appear on Egyptian rock drawings dating back to 6000 BC. The boatmen powered and directed these maiden vessels by shoving long sticks against the river bottom or paddling the water with planks; their active efforts propelled the craft. The first record of a ship under sail appears much later, on an Egyptian pot dating to 3200 BC. The addition of the sail to the vessel enables it to receive power from the wind; as a result, the boatman’s primary roles are now to direct the ship and enjoy the ride.

Even after harnessing the power of the wind, however, the Egyptians, and all civilizations since then, retain both modes of travel—rowing and sailing. The early Egyptians, for their part, passed down the knowledge that sailboats do not work very well in certain environments; when there is no wind, the only way to make progress is to row. Even today, many sailboats carry at least a paddle or other means of power in case the weather changes. Likewise, every investor should be prepared with investment strategies that row when favorable secular bull market winds either become unfavorable or shift into a secular bear market stall. By further exploring the concepts of rowing and sailing as they apply to investing, this chapter helps investors develop the appropriate investment philosophy and strategy based on their assessment of the future market environment.
Sailing and Rowing

Most investors, especially those with traditional stock and bond portfolios, profit when the market rises, and lose money when the market declines. They are at the mercy of the market, and their portfolios prosper or shrink as the market’s winds blow favorably or unfavorably. They are, in effect, simple sailors in market waters, getting blown wherever the wind takes them.

And yet, as chapter 9 demonstrates, there is another, more consistent, way. The absolute return approach seeks consistent profitability, even under unfavorable market conditions. The absolute return approach works to reduce volatility and risk in the pursuit of steady returns.

Sailing

In sailing with a fixed sail, the boat moves because it grabs the wind; it grabs the environment and advances or retreats because of the environment. Relative return investing corresponds to this fixed-sail approach to sailing. When market winds are favorable, portfolios can increase in value rapidly. When the winds turn unfavorable, losses can accumulate quickly. Bull markets are the friends of relative return sailors, and catching the favorable bull market winds and continuing to ride them are the secrets to making money in a bull market.

The traditional approach to investing in stocks and bonds is known as asset class investing. An asset class is a series of securities whose price tends to move in a similar direction based on external market conditions. For example, stocks and bonds each are individual asset classes. Harry Markowitz’s Modern Portfolio Theory (MPT) encourages investors to hold diversified portfolios of stocks and bonds to realize the general trend of the market. Over longer periods of time, both stocks and bonds have produced solid investment returns for investors who held onto the portfolios and rode the trend in the market.

As discussed in chapter 5, those returns tend to come over intermediate periods characterized by secular bull or secular bear markets. During the periods of secular bull markets, an investor can enjoy the plentiful gains in the market simply by holding portfolios of the rising asset classes. Much like the sailor, the investor does some directing and generally enjoys the ride. MPT and the traditional approach to
investing provide a few simple rules about diversification and patience, which, in the long term, should provide success.

Rowing

Rowing, as an action-based approach to boating, is analogous to the absolute return approach to investing. The progress of the boat occurs because of the action of the person doing the rowing. Similarly, in absolute return investing, the progress and profits of the portfolio derive from the activities of the investment manager, rather than from broad market movements.

When the secular bull market changes into a secular bear market, the investor can either wait for the next secular surge or grab the paddle. Without rowing, the boat would eventually achieve the historical progress that investors expect over the long run. By its definition, the long-run average is the average of periods of secular bull markets and secular bear markets. Historically, however, the secular bear markets have lasted for five, ten, and as much as twenty-year periods. For investors with shorter horizons of only a decade or two, a strategy of patiently watching a flapping sail during a stalled market may not be satisfactory. Further, in some secular bear cycles, there are periods of being pushed backwards into investment losses. At times, investors who desire to avoid losses or generate gains may need to grab the paddle. Examples of rowing strategies can include buying undervalued securities while selling overvalued securities short, exploiting temporary mispricings or market inefficiencies, investing in producing assets such as royalty trusts or timber, and selling options on core investment positions.