IN PRAISE OF THE UNREASONABLE

A word to investors: *Fear the Reasonable*. Fear it because the average person's capacity for irrationality isn't remotely as dangerous as their ability to rationalize.

As Merriam-Webster puts it, to rationalize is "to bring into accord with reason." Hence, when we rationalize something we essentially *make it reasonable,* and human beings are very adept at making ideas reasonable. Hazardously adept, really, because what is reasonable, or can be made to *sound* reasonable, frequently has very little relationship with what is in reality probable or accurate – particularly when it comes to investing.

If almost *any* prospective investment, however suspect, can be made to sound reasonable or plausible, the smart investor minimizes risk by only investing in what is *unreasonably probable*.

Given how almost uncontrollably receptive we are to superficially sound arguments, there are few challenges as daunting as avoiding those numberless investments that *seem* reasonable but result in losses. Generally speaking, only an unreasonable person rejects what most others judge entirely plausible or reasonable. And yet successful investing depends upon exactly that – not being seduced by outsized risk and eventual losses masquerading as prudent, reasonable investments. Ultimately, it takes an unreasonably skeptical, careful person to maintain what most would consider an excessive, unreasonably rigorous standard.

It's not easy being unreasonable. In a country where the behavior of the majority serves as the reference point for what is deemed reasonable, being unreasonable carries the uncomfortable connotation of not simply disrespecting the consensus but also being morally wrong. The Reasonable, after all, forms a cornerstone of the American legal system. Most civil wrongs (known as *torts*) are defined relative to what is literally referred to as the "reasonable man standard"; transgressions are identified as a departure from the average individual's actions.

One unavoidable consequence of this conceptual framework is that it makes it technically impossible for the majority to act recklessly or irresponsibly. How could the majority do so if recklessness is defined in opposition to the majority's own actions? Theoretically, the consensus can render any act reasonable – regardless of how irresponsible or absurd.

If enough people do or believe it, *anything* is reasonable.
The average will not indict itself.

Misery may love company, but company generally confers legitimacy. This is especially true in the investing arena. Regardless of how devastating the losses, if 80% of all mutual fund managers own a given stock, then owning it can only be reasonable. Transparently ill-advised, perhaps. Financially devastating, possibly. But irresponsible, never. Providing one stays with the herd, being wrong is more reasonable than being right.

What else was Chuck Prince, then CEO of Citigroup, articulating when he said in 2007, "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance"? Apparently anticipating the meltdown, he *still* refused to part with the consensus. The obvious implication of his statement is that he felt pressured to conform, but the subtext is more alarming: That it was *reasonable* to worry more about how exiting the profit orgy early might appear than how the impending implosion might impact Citigroup, its employees and its shareholders.

Poster boy or parable, the lesson Prince exemplifies is unmistakable: Whether accountable to a vast and varied constituency or solely to oneself, successful, responsible investing not infrequently depends upon unreasonable behavior.

Smart investors understand this to their marrow. It's one of the reasons why they never underestimate even their own ability to rationalize the superficially reasonable. However experienced, their success persists because they maintain an abiding respect for their hard-wired susceptibility to the Reasonable and the comfort of the consensus. This unusually aggressive form of humility is frequently met, ironically, with hostility – who are *they* to question the prevailing view, the wisdom of the crowd? Those who lash themselves to the mast of their own defensive doubt seldom have much company. But if safe and steady profits are the objective, better to endure gains in solitude, even derision, than commiserate in losses.

Better, in other words, to be unreasonable.

Steven R. Grey (2009)

