THE INVESTMENT WISDOM OF JOHN MAYNARD KEYNES (1883-1946)
Kings College, Cambridge University
Keynes at Cambridge

Letter to Lytton Strachey (1905)

Marshall is continually pestering me to turn professional Economist and writes flattering remarks on my papers. Do you think anything will come of it? I doubt it.

I want to manage a railway or organize a Trust, or at least swindle the investing public; it is so easy and fascinating to master the principles of these things.
The Bloomsbury Group
WWI and the Treaty of Versailles
Economic Consequences of the Peace

- It was a sensation and bestseller throughout the world
- Characterized the treaty as a “Carthaginian Peace”
- Germany treated unfairly and economic terms of the treaty will lead to ruin and maybe worse
Keynes in the 1920’s

He was for a time in bad odor among grave persons.

Roy Harrod (1950)

- Writing
  - Economic Journal, books, newspapers

- Teaching
  - Cambridge, consulting (National Mutual and Provincial Insurance)

- Investing
  - “A scientific gambler who played the cycle.”
Lydia and Maynard

The Bloomsbury Ballerina
Lydia Lopokova, Imperial Dancer and Mrs John Maynard Keynes

Judith Mackrell
Mr. and Mrs. Keynes – 1925
Investing in the 1920’s

Money is a funny thing...with...a little extra knowledge and experience of a special kind, it simply keeps rolling in.

Letter to Florence Ada Keynes (1920)

Win or lose, this high stakes gambling amuses me.

A letter to his father while off in Italy (1920)

Economists set themselves too easy, too useless a task, if in tempestuous seasons they can only tell us that when the storm is long past, the ocean will be flat.

A Tract on Monetary Reform (1924)
Investing in the 1920’s

…it may often profit the wisest (stock market player) to anticipate mob psychology rather than the real trend of events, and to ape unreason in anticipation...Thus, so long as the crowd can be relied on to act in a certain way, even if it be misguided, it will be to the advantage of the better-informed professional to act in the same way – a short period ahead

A Treatise on Money (1930)

There will be no further crash in our lifetime

From biographer Robert Skidelski (1926)
1929 Stock Market Crash

Wall Street did have a go yesterday. Did you read about it? The biggest crash ever recorded...I have been in a thoroughly financial and disgusting state of mind all day.

Keynes to Lydia
October, 1929
The Great Slump of 1930

“The other was not a dream. This is a nightmare, which will pass away with the morning.”

- The resources of nature and man’s devices are just as fertile and productive as they ever were. We are as capable as before of affording for everyone a high standard of life. We were not previously deceived. But today we have involved ourselves in a colossal muddle, having blundered in the control of a delicate machine, the working of which we do not understand.

- “The machine has merely been jammed as a result of the muddle.”
Magneto Trouble
The General Theory of Employment Interest and Money (1936)

- The classical theorists resemble Euclidean geometers in a non-Euclidean world who, discovering that in experience straight lines apparently parallel often meet, rebuke the lines for not keeping straight – as the only remedy for the unfortunate collisions which are occurring. Yet, in truth, there is no remedy except to throw over the axiom of parallels and to work out a non-Euclidean geometry.
The General Theory of Employment Interest and Money (1936)

- Classical economics rests on a fundamental error – that supply and demand factors would ensure full employment.

- Keynes viewed the economy as unstable and out of equilibrium in the 30’s because of under-investment and over-savings rooted in the psychology of uncertainty (see Ch. 12).

- The solution to inadequate private demand was deficit spending by the government.

- He believed in “managed capitalism” and that he was saving capitalism from socialism, communism and totalitarianism.

- Keynesianism laid the intellectual foundation for a managed and welfare-state oriented form of capitalism adopted by many countries in the post WWII era.
Keynes and WWII
Mr. and Mrs. Keynes – 1946
Investing in the 1930’s and Beyond

- As time goes on I get more and more convinced that the right method in investment is to put fairly large sums into enterprise which one thinks one knows something about and in the management of which one thoroughly believes.

  Letter to Francis Scott Chairman Provincial Insurance (1934)

- He argued that it was the “duty of serious investors to accept depreciation of their holdings...an investor should be aiming primarily at long period results and judged solely by these.

  National Mutual felt otherwise and Keynes resigned in (1938)

- I can only say that I was the principal inventor of credit cycle investment and have seen it tried by five different parties acting in detail on distinctly different lines over a period of nearly twenty years, which has been full of ups and downs; and I have not seen a single case of a success having been made of it.

  Letter to Richard Kahn (1938)

- The central principal of investment is to go contrary to the general opinion, on the grounds that if everyone agreed about its merit, the investment is inevitably too dear and therefore unattractive.

  Letter to Jasper Ridley (1944)
Memorandum for the Estates Committee,
Kings College Cambridge, 1938

- I am clear that the idea of wholesale shifts is for various reasons [impractical] and indeed undesirable. Most of those who attempt it sell too late and buy too late, and do both too often, incurring heavy expenses and developing too unsettled and speculative a state of mind.

- (1) a careful selection of a few investments...having regard to their cheapness in relation to their probably actual and potential intrinsic value over a period of years ahead and in relation to alternative investments at the time;

- (2) a steadfast holding of these in fairly large units through thick and thin, perhaps for several years, until either they have fulfilled their promise or it is evident that they were purchased on a mistake;

- (3) a balanced investment position, i.e. a variety of risks in spite of individual holdings being large, and if possible opposed risks (e.g. a holding of gold shares amongst other equities, since they are likely to move in opposite directions when there are general fluctuations).
End Part I: Biography and Personal Investing Style

Part II: Keynes the Institutional Investor
“His (Keynes) portfolios were idiosyncratic and approach unconventional. He was a leader among institutional investors in making a substantial allocation to the new asset class, equities. Furthermore, we document a radical change in Keynes’ approach to investment which was to the considerable benefit of subsequent performance.”

David Chambers (Cambridge University) and Elroy Dimson (London Business School) - 2012
Discretionary Portfolio: 1921 – 1946

Keynes vs. U.K. Equity Index

Keynes
Annual Return: +14.4%

U.K. Equity Index
Annual Return: +9.0%

Top Down vs. Bottom Up

Keynes the Investor
By switching approaches mid-career, John Maynard Keynes became a star. Average annual returns:

<table>
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<th>Results of 'macro' style</th>
<th>Results of fundamental stock-picking</th>
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Keynes U.K. market
1924-32 1933-46

Source: WSJ. David Chamber. University of Cambridge; Elroy Dimson, London Business School
Change in Strategy?

Turnover in Discretionary Portfolio

- **1921-29**: 55%
- **1930-39**: 30%
- **1940-46**: 14%
Keynes’ Concentrated Portfolio

Top Holdings as a Percent of Total Portfolio

- **1921-29:**
  - Top Holding: 15%
  - Top 5 Holdings: 46%

- **1930-39:**
  - Top Holding: 21%
  - Top 5 Holdings: 49%

- **1940-46:**
  - Top Holding: 11%
  - Top 5 Holdings: 33%

Keynes Major Investment Accomplishments

1. Among first to allocate the majority of an institutional portfolio to a new alternative asset class – equities

2. Changed course from top down to bottom up

3. Size and value tilts in portfolios – contrarian

4. Concentrated bets – know what you own

5. Terrific track record, in his spare time!

6. Portfolio worth £500,000 ($25 MM 2012) upon death
Keynes’ Investment Principles

- Focus on the estimated intrinsic value of a stock – rather than attempt to divine market trends
- Ensure that a sufficiently large margin of safety exists before purchase
- Apply independent judgment in valuing stocks – often a contrarian view
- Limit transactions costs and ignore market volatility by maintaining a steadfast holding of stocks
- Practice a policy of portfolio concentration by allocating to a few market stunners
- Maintain the appropriate temperament by balancing “equanimity and patience” with the ability to act decisively
End Part II: Keynes the Institutional Investor

Part III: The General Theory of Employment, Interest and Money – Chapter 12
Chapter 12:
The State of Long Term Expectations – Section III

- Our knowledge of the factors which will govern the yield of an investment some years hence is usually very slight and often negligible.

- If human nature felt no temptation to take a chance, no satisfaction in constructing a factory, a railway, a mine or a farm, there might not be much investment merely as a result of cold calculation.

- The daily revaluations of the Stock Exchange, though they are primarily made to facilitate transfers of old investments between one individual and another, inevitably exact a decisive influence on the rate of current investment.

- For there is no sense in building up a new enterprise at a cost greater than that which a similar existing enterprise can be purchased; whilst there is an inducement to spend on a project what may seem like an extravagant sum, if it can be floated off on the stock exchange at an immediate profit. (Tobin’s Q?)
Tobin’s Q (Market Value/Replacement Value)

- Buy Stocks
- Sell Stocks
Chapter 12: The State of Long Term Expectations – Section V

- Conventional valuation is established by the mass psychology of a large number of ignorant individuals...the market will be subject to waves of optimistic and pessimistic sentiment.

- The social object of skilled investment should be to defeat the dark forces of time and ignorance which envelope our future.

- The private object of the most skilled investor is to beat the gun...to outwit the crowd, and to pass the bad, or depreciating, half-crown to the other fellow.

- A game of Old Maid, of Musical Chairs – a pastime in which he is victor who passes the Old Maid to his neighbor before the game is over, who secures a chair for himself before the music stops.
professional investment may be liked to those newspaper competitions in which the competitors have to pick out the six prettiest faces from a hundred photographs, the prize being awarded to the competitor whose choice most nearly corresponds to the average preferences of the competitors as a whole.
But won’t “serious-minded” long term investors dominate the “game players”?

- Investments based on genuine long term expectations is so difficult as to be practical
- Human nature desires quick results
- Institutional investors will not tolerate “long term investing”

Because the essence of this behavior is that it should be:

*eccentric, unconventional and rash in the eyes of average opinion. If he is successful that will only confirm the general belief in his rashness; and if in the short run he is unsuccessful, which is very likely, he will not receive much mercy. *Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally.*
Chapter 12:  
The State of Long Term Expectations – Section VI

- Speculation ... forecasting the psychology of the market

- Enterprise ... forecasting the prospective return of assets over their whole life.

- Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done.
Chapter 12:
The State of Long Term Expectations – Section VI

- The spectacle of modern investment markets has sometimes moved me towards the conclusion that to make the purchase of an investment permanent and indissoluble, like marriage...might be a useful remedy of our contemporary evils. For this would force the investor to direct his mind to the long term prospects...

- The introduction of a substantial Government transfer tax on all transactions might prove the most serviceable reform available, with a view to mitigating the predominance of speculation in the United States. (Tobin tax?)
Apart from instability due to speculation, there is instability due to human nature.

Our decision to do something can only be taken as a result of animal spirits – the spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities.

This means that economic prosperity is excessively dependent on a political and social atmosphere which is congenial to the average business man.

If animal spirits are dimmed...leaving us to depend on nothing but mathematical expectation, enterprise will fade and die.
After giving full weight to the importance of changes in long term expectations... I am now somewhat skeptical of the success of a merely monetary policy directed towards influencing the rate of interest.

I expect to see the State, which is in a position to calculate the marginal efficiency of capital goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directly organizing investment.
Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years ago.
Appendix
Nor should the argument seem strange that taxation may be so high as to defeat its object, and that, given sufficient time to gather the fruits, a reduction of taxation will run a better chance than an increase of balancing the budget.

For to take the opposite view today is to resemble a manufacturer who, running at a loss, decides to raise his price, and when his declining sales increase the loss, wrapping himself in the rectitude of plain arithmetic, decides that prudence requires him to raise the price still more.

Keynes: *The Means to Prosperity* 1931
Keynes on Hayek

- The book, as it stands, seems to me to be one of the most frightful muddles I have ever read...

Keynes review of *Prices and Production* 1931

- In my opinion it is a grand book...Morally and philosophically I find myself in agreement with virtually the whole of it: and not only in agreement with it, but in deeply moved agreement.

Keynes on *The Road to Serfdom* 1944
Keynes on FDR

- President Roosevelt is magnificently right...to explore new paths” and “to achieve something better than the miserable confusion and unutterable waste of opportunity in which an obstinate adherence to ancient rules of thumb has engulfed us.

  Keynes in the Daily Mail 1933
  as FDR went off the gold standard

- ...what is the object of chasing the utilities around the lot every other week?

  Keynes personal letter to FDR 1938

- “I saw your friend Keynes. He left a whole rigmarole of figures. He must be a mathematician rather than a political economist.”

  FDR to his Labor Secretary 1934
Keynes on Marxism

- Marxism, he said, was ...complicated hocus pocus. He said he had read Marx...as if it were a detective story trying to find some clue to an idea in it and never succeeding

  *Recollection* by Michael Straight

- Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.

  *Economic Consequences of the Peace* 1920

- I can be influenced by what seems to me to be justice and good sense; but the class war will find me on the side of the educated bourgeoisie.

  *A Short View of Russia* 1925
Internet Links

- One Minute Keynes
  http://www.youtube.com/watch?feature=player_embedded&v=U1S9F3agsUA

- Keynes vs. Hayek
  http://www.youtube.com/watch?v=d0nERTFo-Sk