GREENLINE FINANCE · A DIGITAL BOOK

THE THREE HABITS THAT KILL MOST PORTFOLIOS

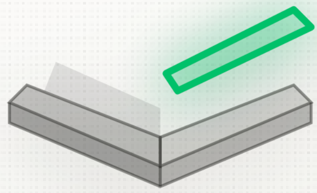
Three investors who found out.
One who did not.

GREENLINE FINANCE

Financial literacy over get-rich-quick schemes.

PART ZERO

WHY THIS EXISTS



There is a kind of page you have seen before. It posts a ticker every morning, a chart every afternoon, and a screenshot of somebody's account every Friday.

That is not what this is, and it is not what Greenline is.

We are here for one thing, which is that you understand how money works well enough to make your own decisions. Not our decisions. **Yours.**

So let us get the important part out of the way first.

Nothing in this book is investment advice. Not a single sentence. You will not find a ticker, a sector, an allocation or a recommendation anywhere in these pages, and that absence is deliberate.

The whole point of investing is that you put your money into what **you** believe in, having understood what you are doing and what it can cost you. Nobody who has never met you can tell you what belongs in your portfolio, and anybody who tries is either selling something or has confused an audience with a client.

That is why we have very little patience for the accounts and channels that publish a new conviction every day. Not because they are always wrong, but because the format itself is dishonest. A market that changes its mind every morning cannot be understood through a post that changes its mind every morning.

What we can do is something different, and in the long run more useful. We can show you how people who were genuinely good at this lost everything anyway, and what they had in common.

This book has three parts, and each one is built around a habit.

Every part opens with a story. You will meet a person, learn what they did for a living, how they thought, how they made their money and how they lost it. Each story sits inside a real market event: **the bond collapse of 1994, the technology crash of 2000, and the financial crisis of 2008.**

Three of these people are destroyed. A fourth appears in all three parts, and he is the least impressive person in the book. He earns less than the others in every good year. He is still here at the end.

One thing about the format. We name the habit only at the end of each part, never at the beginning.

That is on purpose. If we give you the label first, you will read the story looking for the thing we already told you to find, and you will finish with a term you can repeat and a concept you have not absorbed. Understanding what happened matters far more than knowing what it is called. The name is a handle. The story is the thing.

The people in this book are invented. The markets are not.

Gerald Vance, Marcus Deng, Renée Talbot and Walter Kerr never existed. They are composites, built to show how ordinary and reasonable each of these habits feels from the inside.

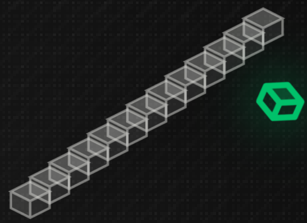
Everything around them is real and sourced. The Federal Reserve really did raise rates seven times in 1994. The Nasdaq really did fall 78 percent. The S&P 500 really did lose 57 percent between October 2007 and March 2009. Every figure in these pages comes from the record, and the sources are listed at the back.

We built it this way for a reason. Real investors leave behind their trades but not their reasoning, and the reasoning is the part you need. A composite lets us show you the inside of a decision that looked completely sensible at the time.

Because that is the uncomfortable thing about all three of these habits. **None of them feel like mistakes while you are making them.** They feel like experience.

PART ONE

HARTFORD, 1993



Gerald Vance had been managing bond money for twenty six years, and for the last twelve of them he had been right.

He was fifty two years old, he ran a mid-sized fixed income fund out of an office in Hartford, and he had a rule he liked to repeat to younger colleagues.

Bonds do not surprise you. Stocks surprise you.

To understand why Gerry believed that, you have to understand what he had lived through.

He started in 1968 and spent his first thirteen years being punished. Inflation ran into double digits. Bond prices fell and kept falling. By 1981 the ten year Treasury yielded almost sixteen percent and everybody he had started with had left the business.

Then, in 1981, the direction reversed. Rates began to fall, and they fell for the next twelve years. Every year Gerry bought longer bonds, every year rates dropped again, and every year he looked slightly smarter than the year before.

By the middle of 1992 the federal funds rate sat around three percent, **the lowest level since the early 1960s.** By the end of 1993 the thirty year Treasury yielded 6.2 percent. Gerry's fund was long duration, which is the technical way of saying it was arranged to make the most money if rates kept falling and to lose the most if they rose.

He was not reckless about it. He had read the arguments for a rate rise and dismissed them, and his reasoning was the sort that sounds like wisdom.

The Fed had not tightened in three years. Inflation was quiet. Wages were flat. Companies could not raise prices. And in twelve years, every single time somebody had told him rates were about to turn, they had been wrong.

Twelve years is a long time to be right.

On 4 February 1994, the Federal Reserve raised the federal funds rate from three percent to 3.25 percent.

A quarter of one percent. It ended a three year easing cycle, and the market had priced in no tightening at all for the first half of the year.

Gerry read the announcement and was not particularly alarmed. Twenty five basis points is nothing. It was the smallest move the Fed makes.

Then they did it again in March. Again in April. Fifty in May. Fifty in August. Seventy five in November. **Seven increases in nine months, taking the target from three percent to 5.5 percent.**

The thirty year Treasury yield went from 6.2 percent to above eight. The two year went from 4.25 to over 7.7. Mortgage rates rose by more than thirty percent.

Across the world, roughly **1.5 trillion dollars** came off the value of bond portfolios. It became known as the Great Bond Massacre, and it remains the worst year in the history of the bond market.

Gerry's fund was down 19 percent by September. He had never had a down year of more than four.

The part that finished him was not the loss. It was what he did next.

In April, after the second hike, he added. Rates had overshot, the economy could not carry borrowing costs at that level, and the position was cheaper than it had been in January. Everything he knew said this was the moment to be brave.

He had been right about exactly this, in exactly this way, eleven times since 1981.

By December he was down 31 percent, investors were leaving, and he was managing less than a third of the money he had run a year earlier. He was let go in March 1995 and never managed outside money again. He spent the next decade selling municipal bonds to retail clients in the same city, and by every account he was very good at it, and very careful.

He was not the worst casualty of that year. In Orange County, California, the treasurer had built a **20.6 billion dollar** book on 7.6 billion of deposits, borrowing the difference. Every twenty five basis point move cost the pool roughly **350 million dollars.** On 6 December 1994 the county filed for bankruptcy, the largest municipal failure in American history to that point.

Both men had the same information. Neither of them had done anything unusual. They had simply lived through twelve years of one thing and concluded that the one thing was the rule.

Two hundred miles west, a chemistry teacher named Walter Kerr also lost money in 1994. He was forty six, he taught at a public high school in Dayton, Ohio, and his retirement account fell about six percent that year.

He did nothing about it. He had bonds, and he had stocks, and he had some cash, and the arrangement was not there because he had a view about interest rates. It was there because he did not have a view about interest rates.

Walter used to tell his students that in chemistry **one result is not a result.** You run the experiment again, and again, and if it comes out the same way forty times you have something, and even then you write down the conditions, because the conditions are half the answer.

He had applied the same standard to his own money and reached an unglamorous conclusion. Twelve years of falling rates was a long streak. It was not a law of nature.

That is the first habit, and here is its name.

MISTAKING A STREAK FOR A LAW

It is not stupidity. Gerry Vance was not stupid and neither was the treasurer of Orange County. It is the entirely reasonable act of taking a long run of consistent evidence and treating it as a rule about how the world works, when all it ever was is a description of what has happened so far.

The longer the streak, the more it feels like law, and the more of your money you put behind it.

PART TWO

SAN JOSE, 1999

Marcus Deng resigned as a network engineer on 12 March 1999, at the age of twenty nine.

He had turned 46,000 dollars into 611,000 in eighteen months. His manager asked him to reconsider. He remembers being polite about it.

Marcus was not a gambler and he would have been offended by the suggestion.

He worked. He read every filing, he ran spreadsheets at night, he understood the technology in a way most of the market did not, and he had a thesis he could defend for an hour. The internet was going to reorganise commerce, the companies building it were being valued on the wrong metrics, and the market was slowly waking up to what he already knew.

Every part of that thesis was correct. The internet did reorganise commerce. The companies building it did become the largest in the world.

His results said he was right. **Between January 1995 and March 2000, the Nasdaq went from 751 to 5,048.** In 1999 alone it rose 86 percent. By December of that year the Nasdaq accounted for eighty percent of total US equity market value, up from eleven percent of NYSE volume in 1990.

Marcus beat it. In 1999 his account returned 214 percent, against the index's 86.

There is only one honest way to read that number, and it took him nine years to find it.

Here is what the number actually meant.

Marcus held technology stocks in a year when technology stocks rose 86 percent. He held the more speculative ones, which rose more. He used a margin account, which multiplied whatever the portfolio did. Take those three facts together and 214 percent is not evidence of judgement. It is arithmetic.

But that is not how it feels from the inside, and it is not what he was told. He was told he had a gift.

He had built a system by then, and every piece of it was reasonable on its own. Add to positions that were working. Cut positions that were not. Concentrate where his research was strongest. Use margin when conviction was highest.

Read those four rules again. **Every one of them increases his exposure precisely when the market has been rising**, and every one is dressed as discipline.

Meanwhile, the people who ran these companies were doing the opposite. Between September 1999 and July 2000, insiders at dot-com companies sold **43 billion dollars** of their own stock, twice the rate at which they had sold in 1997 and 1998. In the month before the peak, insiders were selling twenty three shares for every one they bought.

In that same year, individual investors put **260 billion dollars** into US equity funds.

The Nasdaq peaked on 10 March 2000 at 5,048.62.

Marcus was up 41 percent for the year in ten weeks. He had 2.3 million dollars and a plan to stop at five.

One month later the index had lost 34.2 percent. In mid-April it had its worst week in history, falling more than 25 percent, which was worse than the week of the 1987 crash. He added on the way down, because the thesis had not changed and the businesses were the same businesses. That was true, and it did not help.

He was sold out by his broker in September 2001 with 71,000 dollars remaining.

The index kept going. **By 4 October 2002 the Nasdaq had fallen 78 percent from its peak, to 1,114**, giving back every point it had gained since 1995. Roughly five trillion dollars of market value was gone. **It did not reach March 2000 levels again until 2015**, fifteen years later.

The businesses he had believed in mostly did exactly what he said they would. Amazon fell 77 percent in 2000 alone and went on to become one of the largest companies on earth. He was right about the world and it destroyed him anyway, because being right eventually is not the same thing as surviving until eventually arrives.

Walter Kerr was fifty two in 2000 and still teaching chemistry.

His retirement account returned nine percent in 1999, which was a fifth of what Marcus made, and he heard about it at every family gathering that year. His brother in law had opinions about people who leave money in bonds during a technology revolution.

Walter's account fell about twelve percent over the following two years, and by 2004 it had made the ground back. He was not clever. He simply never held enough of any one thing for any one thing to matter that much.

That is the second habit.

MISTAKING A RISING MARKET FOR SKILL

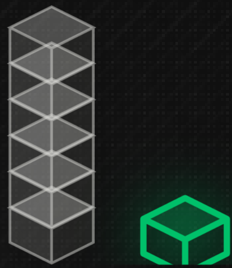
Every investor in a bull market is running the same experiment with no control group. You buy things, the things go up, and there is no way from inside the result to separate what you did from what the tide did.

The trap is not the belief itself. The trap is what the belief makes you do next. A person who thinks their returns come from skill takes more risk, because they believe they can manage it. A person who suspects their returns come from the market takes less, because they know they cannot.

Both of them feel confident. Only one of them is still investing in 2003.

PART THREE

PHOENIX, 2006



Renée Talbot had sold houses in Phoenix for nineteen years, and she thought the people buying them in 2006 were being foolish.

She was not one of them. She was doing something she considered far more sensible.

Renée was forty four, twice divorced, and better at reading a neighbourhood than anyone she knew.

She had watched Phoenix go up for a decade and she had a clear view about it. Some of it was real. People were genuinely moving there, the jobs were genuinely arriving, and the land was genuinely finite in the directions that mattered. Some of it was nonsense, and she could name the streets where the nonsense lived.

So she did not buy houses. Buying houses at those prices was what the fools were doing. Instead she built what she thought of as a serious portfolio, and it is worth listing what was in it, because on paper it looks careful.

She owned two rental properties in Tempe. She owned shares in a regional bank she had used for nineteen years. She owned a homebuilder. She owned a title insurance company. She owned a mortgage lender that paid an excellent dividend. She owned a fund holding mortgage backed securities, rated AAA, because she understood the collateral better than any fund manager in New York possibly could.

Seven positions, four sectors, three asset classes. **Her adviser told her she was well diversified.**

She had also borrowed against the rentals to buy some of the rest, because the properties were worth so much more than she paid that leaving that equity idle seemed almost negligent.

Look at that list again.

The rentals depended on Phoenix house prices. The regional bank's loan book was Phoenix house prices. The homebuilder built Phoenix houses. The title company insured Phoenix transactions. The mortgage lender wrote Phoenix mortgages. The AAA fund held Phoenix mortgages, among others.

She did not own seven things. She owned one thing seven times, and she had borrowed to own more of it.

None of this was visible in 2006, and that is the point worth sitting with. Every position had a different name, a different ticker, a different sector classification and a different price chart. On a spreadsheet it was a diversified portfolio. It was only ever one bet, and the bet was that houses in Phoenix would not fall.

Nobody's spreadsheet has a column for what happens if the thing underneath all of it stops being true.

Phoenix house prices peaked in 2006.

The S&P 500 peaked on 9 October 2007 at 1,565.15 and bottomed on 9 March 2009 at 676.53, a fall of 57 percent, the deepest American equity drawdown since the Great Depression. In 2008 alone the index lost about 37 percent, its worst year since 1931.

But an index number badly understates what happened to Renée, because the index is diversified and she was not. The regional bank was taken over by the FDIC. The mortgage lender went to zero. The homebuilder fell more than eighty percent. The title company followed the transactions that stopped happening. The AAA fund turned out to hold exactly what she thought it held, which was the problem.

And the rentals, which she had borrowed against, fell by more than half while the loans stayed exactly the same size.

In September and October of 2008 there were twenty days when the S&P fell one percent or more, fifteen days with losses over two percent, and five days when it dropped more than five. The VIX closed above eighty. There was no week in which she could have calmly reorganised anything.

She filed for personal bankruptcy in 2010. She was fifty eight when she started selling houses again.

Walter Kerr retired from teaching in June 2008, at sixty.

His timing could not have been worse and it barely mattered. His account fell about twenty two percent over the following nine months, which was less than half what the index did, because roughly forty percent of what he held was government bonds and cash, and bonds were close to the only thing that worked that year.

He did not sell. He did not add. He moved his withdrawal rate down for two years and he waited. **The S&P did not close above its 2007 peak until March 2013**, more than five years later, and by then he had been fine for a while.

That is the third habit.

BUILDING A PORTFOLIO THAT ONLY SURVIVES IF YOU ARE RIGHT

Renée's portfolio had no answer to one specific question, and it was the only question that ever mattered: what happens if the thing I am most confident about turns out to be wrong?

Not slightly wrong. Wrong.

Diversification is not owning many things. It is owning things that do not fail for the same reason. Seven positions that all depend on one assumption are one position wearing seven names, and adding borrowed money to that arrangement does not increase your return. It sets the point at which you are no longer allowed to wait.

What they had in common

Three people. Three decades. Three completely different markets.

Gerry Vance understood bonds better than almost anyone alive. Marcus Deng was right about the internet before the market was. Renée Talbot knew her city street by street.

Not one of them was destroyed by ignorance.

Each of them had built something that worked, tested it against reality, seen it confirmed for years, and then done the one thing that seems most rational of all. They increased their commitment in proportion to their confidence.

And each of their confidences had been earned. That is what makes this hard. If the habit only caught fools, it would not be worth a book.

The three, together

✳ MISTAKING A STREAK FOR A LAW

Twelve years of falling rates described what had happened. It did not describe what had to happen. A long record is evidence about the past and nothing else, and the longer it runs the more it feels like something more.

✳ MISTAKING A RISING MARKET FOR SKILL

In a bull market there is no control group. You cannot separate your judgement from the tide by looking at your returns, because the returns contain both. What you believe about the cause determines how much you risk next.

✳ BUILDING A PORTFOLIO THAT ONLY SURVIVES IF YOU ARE RIGHT

Owning many things is not the same as owning things that fail for different reasons. Ask what happens if the thing you are surest about is wrong, and if the answer is that you are finished, the position is too large regardless of how good the reasoning is.

✳ AND THE ONE UNDERNEATH ALL THREE

Each habit is a way of quietly deciding that the market is knowable. The streak told Gerry he knew the rule. The returns told Marcus he knew the market. The city told Renée she knew the outcome. None of them were reckless. All three had simply stopped leaving room to be wrong.

Walter

Walter Kerr is not in this book because he was smart.

He earned less than Gerry Vance every year from 1982 to 1993. He earned a fifth of what Marcus Deng earned in 1999 and heard about it at Christmas. He was worse than Renée Talbot at understanding Phoenix, and worse than all three of them at almost everything to do with markets.

What he had was a single idea, borrowed from a subject that has nothing to do with money.

One result is not a result.

He never knew which decade would be the bad one, so he arranged things on the assumption that any of them might be. That arrangement cost him money in every good year, which is exactly what it was supposed to do, and it is the whole reason he was still investing at sixty five.

You do not have to copy him. He is not a recommendation and there is no portfolio in this book, deliberately.

What is worth taking is the question he asked before every decision, which is the only thing the three of them never asked.

> ***What would this cost me if I turn out to be wrong?***

Save this one.