Leithner Letter No. 205-208:
26 November 2016-26 February 2017

He [Keynes] remained an active speculator, an exhausting and dangerous pastime in that turbulent decade. … Buying and selling on margin, he was able to leverage his positions substantially and his portfolio could be very volatile. [After losing everything in 1919-1920 and requiring a bailout] he began 1923 with about $125,000 … During the next five years, he doubled his money, making most of it trading commodities and currencies, rather than stocks. … But as 1928 progressed, his portfolio began to unravel. He sustained substantial losses in April when rubber prices collapsed by 50% as the world cartel broke down, forcing him to liquidate large holdings to meet margin requirements. …

The price for being a speculator was that all these miscalculations wrought havoc on his net worth. By the middle of 1929, he had lost almost three-quarters of his money. The only saving grace was that in order to meet his margin payments, he was forced to liquidate much of his stock portfolio and entered the turmoil of 1929 only modestly invested in the market. …

During the 1930s, Keynes's speculative activities made him a rich man. After losing 80% of his money when commodity prices collapsed after 1928, he … ended 1929 with a portfolio of under $40,000. He shifted his strategy from short term speculation to long-term investment and at the lows of the Depression put together a concentrated portfolio of a select number of British and American equities. Convinced that Roosevelt would succeed in reviving the U.S. economy, Keynes used margin to leverage his portfolio … By 1936, his net worth was close to $2.5 million—the equivalent today of $30 million. Though the bear market of 1937 more than halved this, by 1943 it had recovered to $2 million.

Liaquat Ahamed
Lords of Finance: The Bankers Who Broke the World (2009)

John Maynard Keynes as Investor-Speculator: A More Balanced Assessment

John Maynard Keynes (1st Baron Keynes of Tilton, 1883-1946) is usually remembered as the author of *The General Theory of Employment, Interest and Money* (1936) and the father of "Keynesian economics." He was probably the most famous and influential – and certainly the most destructive[1] – economist of the 20th century. Only infrequently, in contrast, has he been recalled as a speculator who lost heavily, learnt hard lessons and became an investor. One of today's most prominent Keynesians, Paul Krugman, apparently didn't know until John Wasik (the author of *Keynes's Way to Wealth*, McGraw-Hill, 2014) informed him that Keynes managed several investment vehicles – one of which he ran into the ground.

"Regardless of how you feel about his theories on the need for governmental intervention in the economy," writes Jason Zweig in Keynes One Mean Money Manager (*The Wall Street Journal*, 2 April 2012), Keynes has, among those who're aware of this aspect of his life, "long … had a reputation as an outstanding investor." Warren Buffett hasn't just lauded Keynes's investment acumen: he's cited Keynes as a forerunner of his investment philosophy.[2] In his 1988 Letter to Berkshire Hathaway's shareholders, Buffett stated that "Keynes … began as a market-timer (leaning on business and credit-cycle theory) and converted, after much thought, to value investing." In his 1991 Letter, Buffett enthused that

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[1] The literature that destroys Keynesian from first principles is vast. For a recent and very readable overview for a general audience, see Hunter Lewis, *Where Keynes Went Wrong: And Why World Governments Keep Creating Inflation, Bubbles, and Busts* (Axios Press, 2011). For an academic demolition, see Hans-Hermann Hoppe, The Misesian Case Against Keynes, in Mark Skousen, ed., *Dissent on Keynes: A Critical Appraisal of Economics* (Praeger, 1992). pp. 199-223 and Henry Hazlitt, The Failure of the "New Economics" – An Analysis of the Keynesian Fallacies (1959, Mises Institute 2007).

[2] See Roger Lowenstein in *Buffett: The Making of an American Capitalist* (Weidenfeld & Nicolson, 1995), p. 103 and Donald Moggridge, ed., *The Collected Writings of John Maynard Keynes*, vol. 12 (Macmillan, 1983), Chap. 1, "Keynes as an Investor."

Keynes's "brilliance as a practicing investor matched his brilliance in thought." Zweig extolled Keynes even more highly:

> the famous economist also was one of the greatest investors of the past century … David Chambers and Elroy Dimson, finance scholars at the University of Cambridge and the London Business School, respectively, … have found Keynes's returns were extraordinary.[3]

Similarly, John Wasik claims that Keynes was a "stunningly successful investor;" and the blurb in the jacket accompanying Justyn Walsh's book[4] lauds his

> ability to make vast sums of money on the stock market. … The college endowment fund he managed … massively outperformed the broader market over a two-decade period.

As evidence of their claims, Zweig, Walsh and Wasik cite the research of academics such as Chambers and Dimson. Alas, the non-academics overstate and perhaps even misrepresent the results of the academics' research. Chambers and Dimson, who claim that they "provide the first detailed analysis of [Keynes's] investment ability in terms of his management of portfolios," actually find, in their own words, that "previous studies … claimed that Keynes's performance for [King's College of the University of Cambridge] was stellar. Our results, however, qualify this view." Specifically, "his investment performance for King's

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3 See in particular David Chambers and Elroy Dimson, John Maynard Keynes, Investment Innovator, *Journal of Economic Perspectives*, vol. 27, no. 3 (Summer 2013), pp. 213-228. See also David Chambers and Ali Kabiri, Keynes and Wall Street, *Business History Review*, vol. 90 (Summer 2016), pp. 301–328; David Chambers, Elroy Dimson and Justin Foo, Keynes, King's, and Endowment Asset Management, in Jeffrey Brown and Caroline Hoxby, eds., *How the Financial Crisis and Great Recession Affected Higher Education* (University of Chicago Press, 2014), pp. 127- 150; and David Chambers, Elroy Dimson and Justin Foo, Keynes the Stock Market Investor: A Quantitative Analysis, *Journal of Financial and Quantitative Analysis*, vol. 50., no. 4, 2015, pp. 431–449. See also Jess Chua and Richard Woodward, "J.M. Keynes' Investment Performance: A Note," *Journal of Finance*, vol. 38, no. 1 (1983), pp. 232-235. Their data appear at www.maynardkedynes.org.

4 *Keynes and the Market: How the World's Greatest Economist Overturned Conventional Wisdom and Made a Fortune on the Stock Market* (John Wiley & Sons, 2008).

College, whilst impressive, was not the uninterrupted success that has previously been believed."[5]

Seven Aspects of a More Balanced Assessment

I reanalyse data compiled by (1) Chambers and Dimson and (2) Moggridge. Unlike the academics, I analyse Keynes's personal portfolio as well as the main external one (i.e., the "Discretionary Portfolio" of King's College) over which he possessed virtually unfettered discretion. When I

1. state these results properly – that is, as geometric rather than arithmetic means, and
2. adjust for the considerable risk that Keynes took during most of his investment career (in particular, his heavy use of borrowed money),

I find that his overall results were indeed excellent (albeit extremely volatile); but they weren't as good as Chambers and Dimson state – and not phenomenal as Walsh, Wasik and Zweig imply. Moreover,

3. I present evidence that suggests that the Great Depression and Second World War were boons rather than (as Zweig implies) burdens to Keynes's investments.

Finally, I add four set of points that put Keynes, his *modus operandi* and results into perspective:

4. In key respects Keynes was blatantly hypocritical: privately, he eagerly speculated in markets; publicly, he self-righteously demanded that the government regulate them. The public-spirited reformer purported to see the damage that volatile prices wreaked upon consumers and producers; yet the self-interested speculator sought unabashedly to profit thereby.

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[5] See also Hunter Lewis, Was Keynes a Brilliant Investor? (Mises Wire, 28 August 2013).

5. Jason Zweig also adopts a double standard: he lauds the concentration of Keynes's portfolio – including his heavy emphasis upon gold mining stocks – yet for exactly the same reason excoriates Ron Paul's.
6. The academic establishment, too, has greatly changed its tune. A few decades ago its standard of evidence was exceedingly strict: leading professors emphatically denied that "outperformance" was possible – and even if it was, without up to 75 years of quarterly data they couldn't ascertain whether it resulted from brains or mere luck. Today, however, they accept Keynes's subjective "estimates" (rather than hard evidence from contract notes and the like) of the Discretionary Portfolio's 20-year track record, and ignore the more volatile and leveraged results of his personal investments. On this basis, they laud Keynes's "outperformance."
7. We can't ignore the incontrovertible truth that Keynes was insufferably arrogant, and that such people usually get their comeuppance – as Keynes the speculator did. Yet we must also acknowledge that Keynes the investor did progress (as opposed to originate) genuine innovations; and as Zweig notes in John Maynard Keynes: Courage Is the Key to Investing (*The Wall Street Journal*, 14 October 2016), during market crashes he displayed courage and patience.

Chambers and Dimson, as well as Walsh and Wasik, rightly conclude that Keynes learnt from adverse experience. Fortunately, he saw the light at just the right time. But was he, as Zweig gushes, "one of the greatest investors of the past century"? That's an exaggeration. He was a courageous innovator who achieved excellent long-term results; but he was also extremely well-connected – and his contacts allowed him to borrow heavily and repeatedly saved him from oblivion. In that sense, too, he was lucky. Keynes the investor (unlike Keynes the economist) deserves study and in some respects emulation – but not veneration.

Keynes's Results

King's Discretionary Portfolio

According to Chalmers and Dimson, in 1921 Keynes persuaded his colleagues at King's to exclude part of the College's endowment from the restrictions of the Trustee Act. Accordingly, henceforth the endowment comprised two funds: its

"Restricted Portfolio" remained subject to the Act and its "Discretionary Portfolio" didn't. Further, although he managed both, from 1924 Keynes "had full and apparently unchallenged discretion over [the Discretionary Portfolio's] investment policy until his death in 1946." Because "it offers the purest expression of his views," Chambers and Dimson focus their analysis upon the Discretionary Portfolio.[6]

Their description of these data makes an astonishing admission. They took

> information from [Keynes's] annual investment review of the College endowment, the *Report to the Inspectors of Accounts,* which he prepared from 1922 until his death (although the report for 1926 is missing) for [the College's] investment committee, known as the Estates Committee. In the *Reports*, Keynes … provided … year-end holdings at market values as well as annual capital appreciation and income figures. [Hence the returns data] are based on the estimates made by Keynes of the appreciation or depreciation for each year as a percentage of the start-year market value. To this capital gain or loss is added the income return for the year [all of which was disbursed rather than reinvested].

Analyses of Keynes's results, in other words, don't derive from verifiable records. More specifically, they don't stem from objective information such as contract notes; instead, they depend upon Keynes's subjective "estimates." Can we trust them? I don't query Chambers' and Dimson's collation of these data; but given his highly questionable character, it's sensible to take Keynes's "estimates" with a pinch of salt.[7]

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[6] For a discussion of the limitations of previous studies' data, see Chambers, Dimson and Foo. Chambers and Dimson add that "the Discretionary Portfolio initially comprised a fund known as the "Chest" and then from September 1933 also included Fund B., a pooled vehicle for a myriad of small endowed funds which had been previously been managed on a segregated basis. The two accounts were managed in a similar style. Although attention has tended to concentrate on the Chest, we look at Keynes's trading record for both these discretionary accounts."

[7] In an infamous letter to Lytton Strachey, written as an undergraduate in 1905, Keynes boasted: "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." On another occasion Maynard wrote to Strachey: "Is it monomania – this colossal moral superiority that we feel? I get the feeling that most

Chambers and Dimson found that "over the whole period, from end August 1922 to end August 1946, the annual performance of the Discretionary Portfolio averaged +16.0 percent, as compared to +10.4 percent for the [British stock] market index." Chambers, Dimson and Foo appended the Discretionary Portfolio's annualised results from 1925 to 1946. Figure 1 summarises these data. Over this slightly more restricted period, the portfolio returned an average (arithmetic) mean of 15.2% per year. Chambers and Dimson should – but don't – mention that in most investment contexts the arithmetic mean (which they compute) is inappropriate and the geometric mean (which they don't) is appropriate.[8] The geometric mean is 13.0% per year, and for good measure the median annual return is 11.2%. Throughout Keynes's tenure as manager, the Discretionary Portfolio comprised mostly equities. Yet during his tenure he radically switched his investment approach to a bottom-up, buy-and-hold stock-

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of the rest [of the world] never see anything at all – [they're either] too stupid or too wicked." Murray Rothbard's biography of Keynes concluded that its subject was an "arrogant, sadistic, power-besotted bully, a deliberate and systemic liar, intellectually irresponsible, an opponent of principle, in favour of short term hedonism and nihilistic opponent of Bourgeois morality in all of its areas, a hater of thrift and savings, somebody who wanted to exterminate the creditor class, an imperialist, an anti-Semite, and a Fascist. Outside of that I guess he was a great guy" (see Keynes, The Man (Ludwig von Mises Institute, 2010).

Ahamed (p. 342) adds another salient point: "people rarely tell the complete truth either about their amorous exploits or their stock portfolios, the latter being especially true for professional investors whose reputations hinge on appearing to be prescient about the market."

8 Chris Gallant (What Is the Difference between Arithmetic and Geometric Averages?) writes: "Suppose you have invested your savings in the stock market for five years. If your returns each year were 90%, 10%, 20%, 30% and -90%, what would your average return be during this period? Well, taking the simple arithmetic average, you would get an answer of 12%. Not too shabby, you might think. However, when it comes to annual investment returns, the numbers are not independent of each other. If you lose a ton of money one year, you have that much less capital to generate returns during the following years, and vice versa. Because of this reality, we need to calculate the geometric average of your investment returns in order to get an accurate measurement of what your actual average annual return over the five-year period is." In this example, the geometric average annual return is -20.08%. "That's a heck of a lot worse than the 12% arithmetic average we calculated earlier, and unfortunately it's also the number that represents reality in this case. It may seem confusing as to why geometric average returns are more accurate than arithmetic average returns, but look at it this way: if you lose 100% of your capital in one year, you don't have any hope of making a return on it during the next year. In other words, investment returns are not independent of each other, so they require a geometric average to represent their mean."

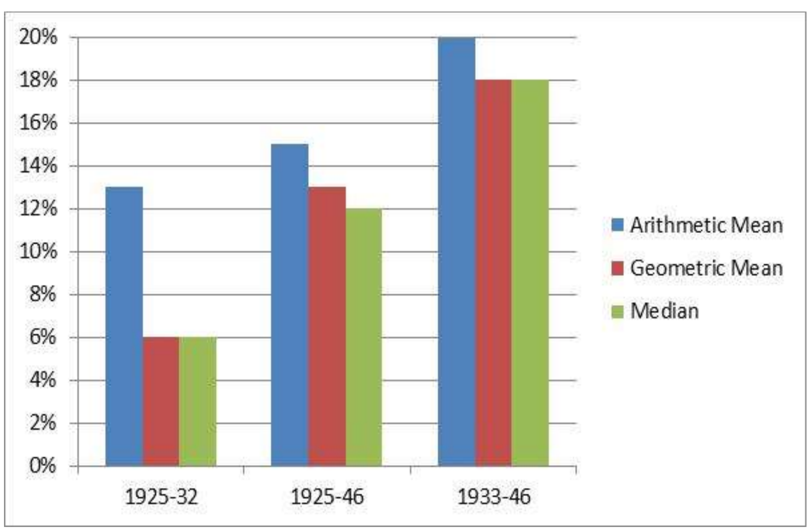
picking approach. Detailed analysis of his investment correspondence as well as the statistical analysis of his performance … suggests the early 1930s as the most likely inflection point in the evolution of his investment approach.

Following Moggridge, who first noticed that Keynes's approach changed fundamentally during the early 1930s, Figure 1 divides Keynes' tenure into two periods: 1925-1932 and 1933-1946. According to Chambers and Dimson, Keynes

> began managing the Discretionary Portfolio employing a top-down investment approach using monetary and economic indicators to market-time his switching between equities, fixed income and cash. … [During the early 1930s,] Keynes radically switched his investment approach to a bottom-up, buy-and-hold stock-picking approach.

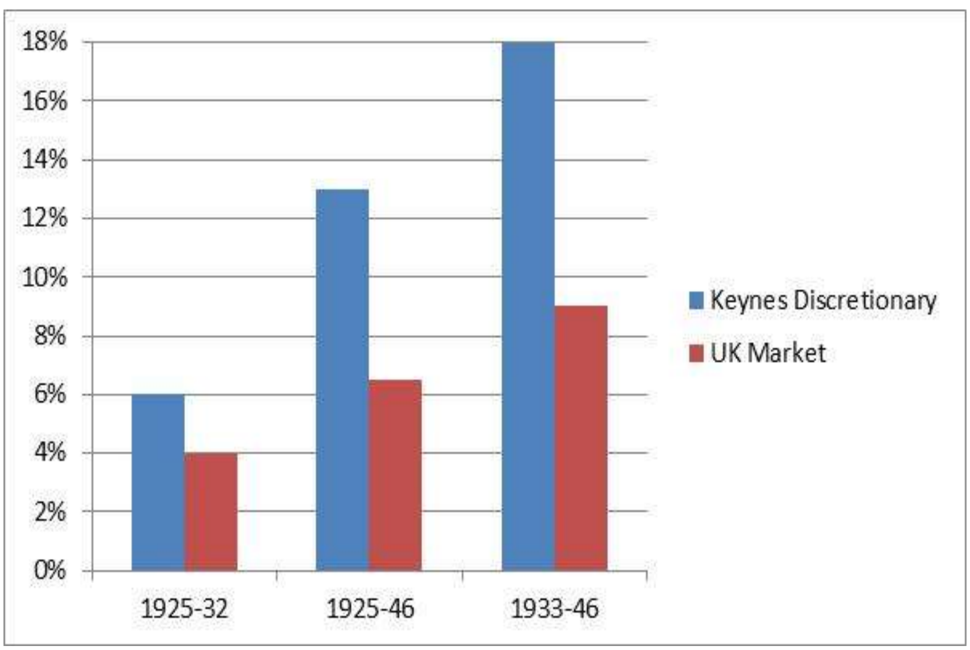
Figure 1 indicates that during the earlier period his results were relatively pedestrian: the geometric mean is 5.8% per year (versus an arithmetic mean of 12.8%) and the median return is 6.4%. During the later period, the geometric mean is 17.9% (the arithmetic mean is 20.0%) per year and the median is 18.3%.

Figure 1:
King's College Discretionary Portfolio,
Three Measures of Central Tendency over Three Time Intervals



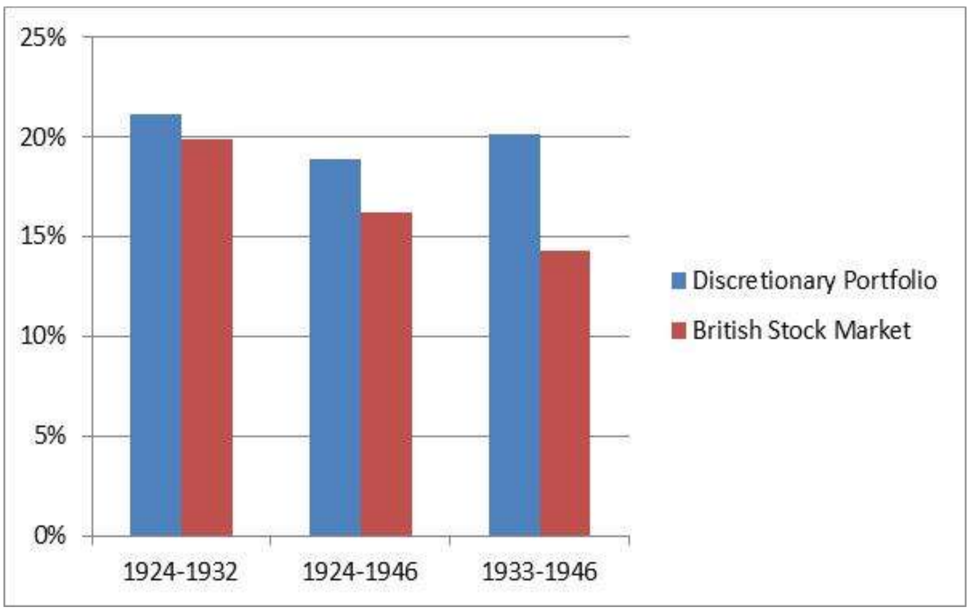
How did Keynes perform vis-à-vis a benchmark? Figure 2 compares the Discretionary Portfolio's results to the British market's. Over time, both improved; the former's, however, improved relative to the latter's. During the entire (1925-1946) period, the Discretionary Portfolio returned a geometric mean of 13.0% per year; the British market, on the other hand, returned only half as much (6.5%). Hence Keynes "outperformed" the market by 6.5 percentage points per year. During the earlier sub-period (1925-1932), the British market returned a geometric average of 4.0% per year versus the Discretionary Portfolio's 5.5%; Keynes thus outperformed by a much smaller margin (1.5 percentage points per year). During the latter sub-period (1933-1946), on the other hand, the British market returned 9.1% per year versus the Discretionary Portfolio's 17.9%; Keynes thus outperformed by a much more considerable margin of 8.8 percentage points per year. At first glance, that's outstanding.

Figure 2:
Discretionary Portfolio versus the British Market,
Geometric Means over Three Intervals



Although Chambers and Dimson don't, there's considerably more to say. First, and as Figure 3 shows, Keynes's results were much more variable than the British market's. Moreover, the variability of the market's returns decreased over time whereas the Discretionary Portfolio's didn't. Which is better: improving returns and decreasing volatility, like the overall British market offered? Or superior (vis-à-vis the overall market) results over time and a roughly constant level of volatility? I'd prefer higher-but-more-variable results; clearly, however, some and perhaps many people might prefer a smoother but less profitable ride.

Figure 3:
One Measure of Dispersion (Standard Deviation),
Two Portfolios and Three Intervals

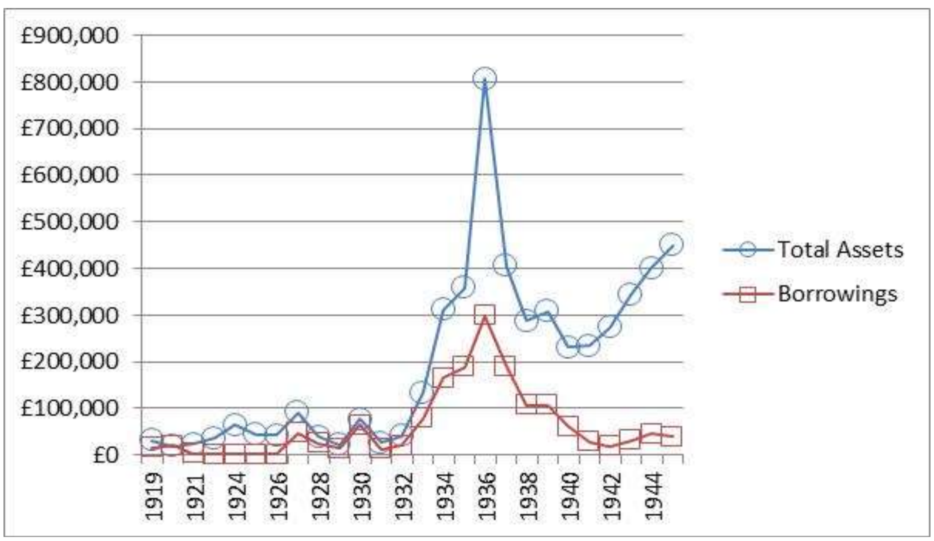


Second, Chambers and Dimson don't incorporate into their analysis the actual risks that Keynes took. Their adjustments for "risk" include the concentration (versus the diversification) of his investments, the extent to which his portfolio differed from the overall market, whether he bought large-capitalisation companies or small caps, etc. Alas, they utter not a word about the debt that Keynes incurred. As a personal investor, he didn't skirt bankruptcy on more than one occasion because he bought mining shares rather than bank stocks: he repeatedly played with fire by borrowing heavily. Second, Chambers and Dimson don't analyse – indeed, and inexplicably (given the availability of data in the public domain), they don't even mention – Keynes's personal portfolio.[9] An analysis of Keynes's personal holdings, adjusted for leverage, doesn't overturn but does temper Chambers' and Dimson's assessment of his investment acumen.

Keynes's Personal Portfolio

For most of his career, Keynes leveraged his personal holdings up to his eyeballs; that is, in order to invest and speculate he borrowed huge sums. Figure 4 shows that before the early 1930s he borrowed less than £100,000; from 1932 to 1936 his debt trebled to £300,000; and for the rest of his life he pruned his borrowings. Fuelled by debt, his gross assets skyrocketed from less than £100,000 in 1932 to ca. £800,000 in 1936 – and then collapsed to ca. £250,000 in 1939 before virtually doubling – but not recovering their highpoint – by 1945. (As a comparison, £800,000 of gross assets in 1936 is the equivalent of approximately $US13,600,000 and £48,000,000 today; and £300,000 of debt in 1936 is equivalent to ca. $US5,100,000 and £18,000,000 today.)

Figure 4:
Total Assets and Borrowings, Keynes's Personal Portfolio, 1919-1945



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9 These data appear in Moggridge (p. 11). Are they invalid or unreliable? If they are, why? Neither Moggridge nor Chambers and Dimson nor John Maynard Keynes as Investor, Part II (Horizon Research Group, Global Contrarian Research Report Compendium, October 2010) mention any particular shortcomings. Accordingly, I too assume that they're accurate.

Figure 4 plots the leverage of Keynes's holdings: that is, it expresses his borrowing for investment as a percentage of his portfolio's (a) gross assets and (b) net assets (i.e., equity). The ratio of debt to gross assets averaged 36% and the ratio of net to equity averaged 80%. Leverage reached its maximum in 1929 – that is, on the eve of the Great Depression – and thereafter fell steadily and cumulatively dramatically. By the 1940s, the personal portfolio was lightly leveraged: both ratios were little more than (and often less than) 10%.

Figure 4:
Leverage of Keynes's Personal Portfolio, 1919-1945

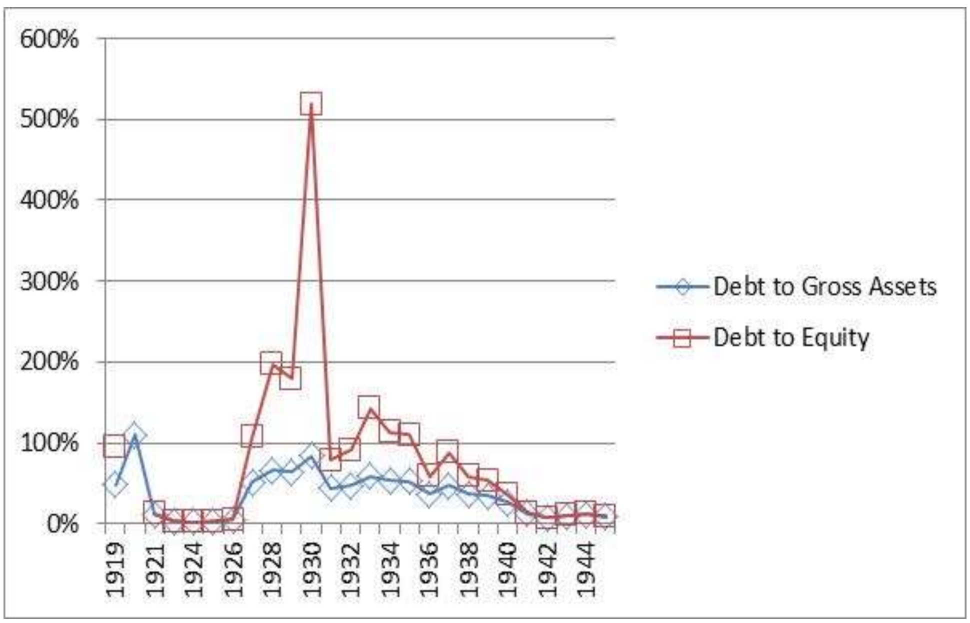
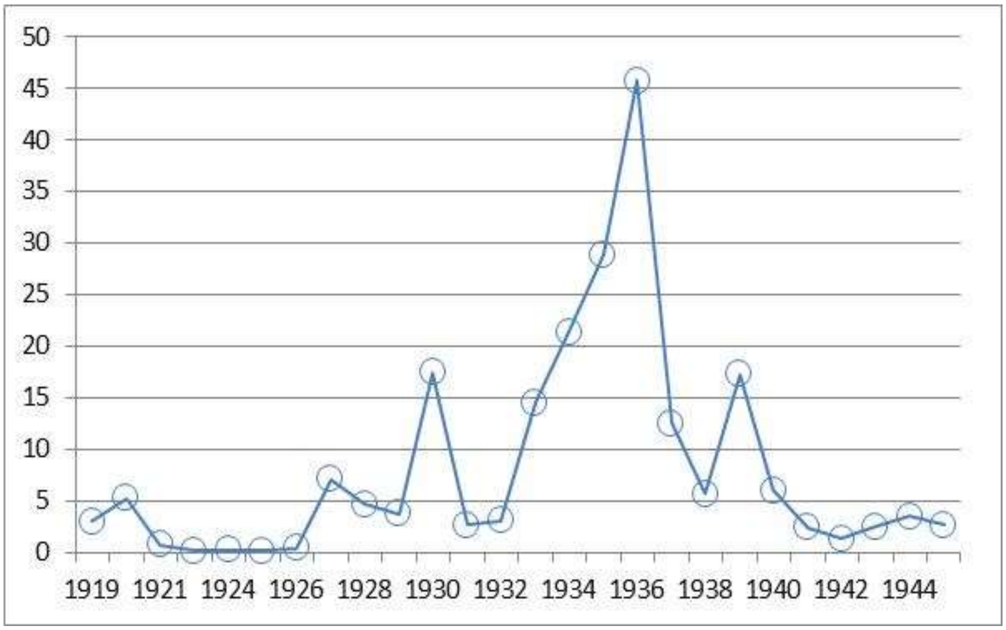


Figure 5 expresses Keynes's personal debt as a multiple of his total personal income from all sources (that is, salaries, book and other royalties, and his portfolio's dividends, interest and capital gains). Apart from the mid-1920s, when it was effectively zero, the multiple was simply breathtaking: it averaged 8.1 times and at its height exceeded 45 times. *How on earth was Keynes able to borrow so much? I don't know, but can make a rather obvious guess:* as a well-connected insider – indeed, as a peer, a director of the Bank of England and the chairman of a major insurer – he was "one of us" and thus eminently bankable. Moreover, as he reached the pinnacle of the establishment I assume that (even if they'd wanted to do so, which they likely didn't) his lenders dared neither to call nor even to refuse to extend his loans.

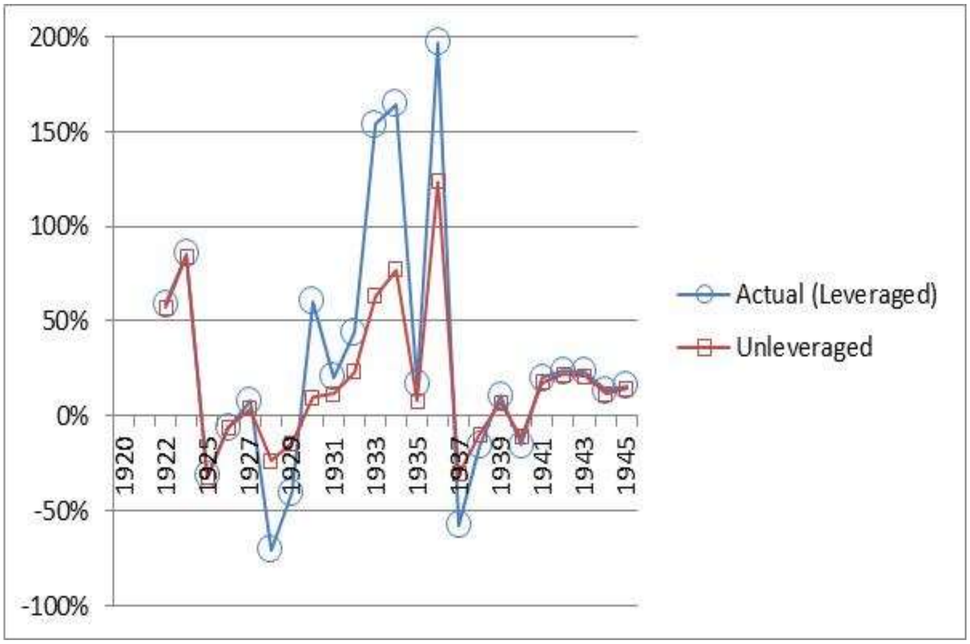
Figure 5:
Keynes's Debt as a Multiple of Total Income from All Sources, 1919-1945



Not surprisingly, and as the "Actual (Leveraged)" results in Figure 6 show, high leverage begets volatile returns. In 1920 he lost his entire portfolio and more – 111%. He also lost 32% in 1925, 70% in 1927, a further 40% in 1928 (making a loss of 88% over the two years) and 58% in 1937. On the other hand, he gained 59% in 1922 and 86% in 1923, 60% in 1930, 154% in 1933 and 164% in 1934 (making a total gain of 352% over the two years) and 197% in 1936.

From 1933, Keynes's personal portfolio "outperformed" the Discretionary Portfolio. Over the entire period (1922-1945), the personal portfolio generated a geometric mean return of 14.3% per year and the Discretionary Portfolio 13.6%. During the years to 1932, it returned an average of 0.7% per year and the Discretionary Portfolio averaged 5.8%. From 1933 the personal portfolio increased, on average, 25.4% per year; the Discretionary Portfolio averaged 17.9%. This overall "outperformance" came at the cost of considerably greater volatility: for the entire period, the standard deviation of the personal portfolio is 71.9 and that of the Discretionary Portfolio is 18.9.

Figure 6:
Keynes's Portfolio, Actual (Leveraged) and
Hypothetical (Unleveraged) Returns, 1920-1945



What if Keynes's personal portfolio had used no debt? Figure 6 also plots his results under this assumption. Given that leverage magnifies results both upwards and downwards, on an unleveraged basis Keynes does neither so well nor as badly. His best result occurred in 1936 (124% versus the "leveraged" 238%); and his worst was in 1937 (-31% versus the "leveraged -58%). For the entire period, the "unleveraged" geometric mean is 13.3% (versus the "leveraged" 14.3%); for 1922-1932, the "unleveraged" mean is 6.5% (versus the "leveraged" 0.7%); and for 1933-1945, the "unleveraged" mean is 18.6% (versus the "leveraged" 25.4%).

These results have an important implication. Although Chambers and Dimson don't mention it, it's reasonable to assume that the Discretionary Portfolio was leveraged. I doubt that Keynes leveraged it nearly as much as his personal portfolio; at the same time, I'd be surprised – given his complete discretion and clear predilection for debt – if it were completely unleveraged.[10] Accordingly, we should compare apples with apples: in other words, we should probably reduce somewhat (I don't know by how much) the results in Figure 2. I don't doubt that in 1933-1946 Keynes's results exceeded the British market's; yet I wonder whether, properly adjusted for the risk he took (namely with borrowed money), he did so to the extent that Chambers and Dimson find. Hence the key question becomes: to what extent was Keynes lucky as well as (eventually) astute?

Figure 7:
Mark-to-Market Valuation (Net of Debt) of Keynes's Investments, 1919-1945

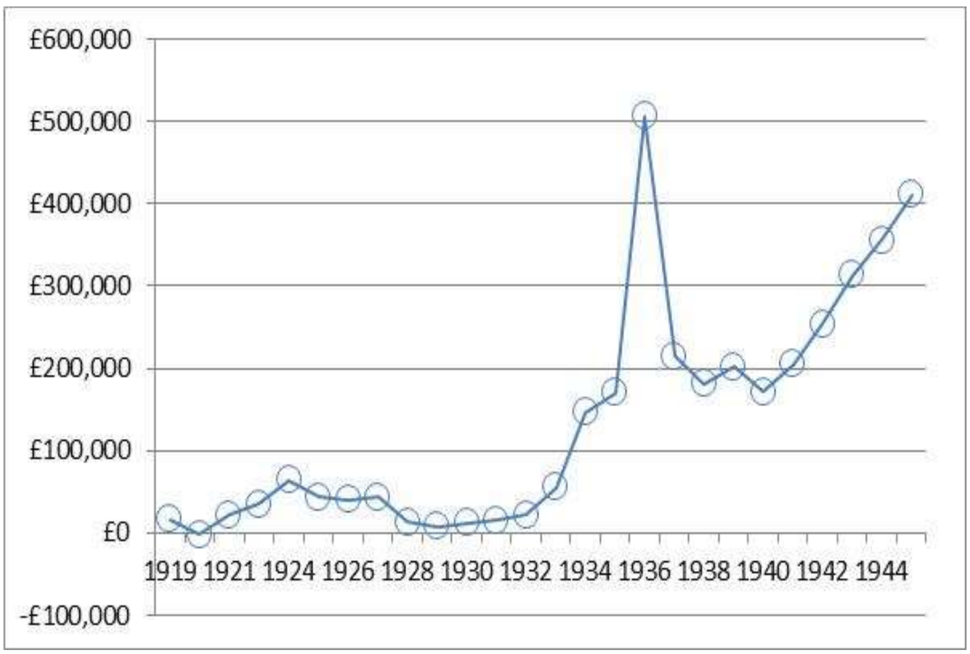


Figure 7 plots the market value of Keynes's personal investments net of debt.[11] Perhaps because he spent heavily, but certainly (at least in part) because he was

10 I infer from Walsh and Wasik that Keynes borrowed most heavily in order to finance his personal holdings (over which he had total discretion); he borrowed less heavily in order to manage King's portfolio, over which he exercised considerable discretion; and he borrowed comparatively very cautiously in order to boost the returns of two insurance companies' holdings – over whose investments he exercised significant influence but little control.

11 John Maynard Keynes as Investor, Part II rightly states "One should be very cautious when looking at [these] data …, especially the figures on net assets." I disagree with the next several sentences: "They can't be used to generate investment performance, because Keynes also used his money, not merely to live, but also for his various activities. We don't have good numbers on his cash flow for charitable activities, intellectual pursuits, book-buying or any of his other hobbies. Chances are,

very heavily leveraged and his investments plummeted, between the mid-1920s and 1929 Keynes's net investment assets sagged from more than £60,000 in 1924 to less than £8,000 in 1929 (re-read the extended quote on p. 1 to remind yourself why). That's a decrease of almost 90%. By 1936, however – this time fuelled by extremely heavy borrowing – his equity skyrocketed to £500,000. By 1940, however, it crashed to £180,000 (a decrease of almost two-thirds) before doubling to ca. £400,000 in 1945. Accepting the possibility that he spent heavy on bequests, etc., during the late 1930s, 1936 was his personal portfolio's high-water mark.

What about the Great Depression and Second World War?

In "Keynes One Mean Money Manager" Jason Zweig wrote:

> How he achieved [his investment results] was even more remarkable. From 1924 to 1946 … Keynes outperformed the British share market by an average of eight [sic] percentage points annually, adjusted for risk. Such great investors as Benjamin Graham, Peter Lynch, John Templeton and Warren Buffett beat the market by an average of three to 13 percentage points over their careers. Most of them, however, didn't have to cope with the Great Depression or World War II.

Is it true, as Zweig implies, that depression and war weakened Keynes's results? If they hadn't occurred, would his results have been better than they actually were? I don't think so. If anything, the timing of the Depression was, from the point of view of Keynes the investor, a Godsend: its onset (and the consequent collapse of stocks' prices), together with his abandonment of damaging old ways and adoption of remunerative new ways, enabled him to purchase quality assets at extremely cheap prices – and thus, it seems to me, greatly boosted his results in 1933-1946. *Close to the bottom, in other words, Keynes had the good sense – and good fortune – to abandon his poor old approach and adopt a much better new one.*
At the nadir of the Great Depression, at least as far as the Standard & Poor's 500 Index was concerned (i.e., in June 1932), the Cyclically-Adjusted PE Ratio (CAPE) fell to 5.6. That's among the lowest CAPEs in U.S. history. Table 1 reprints the

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since he lived well, the actual returns would have resulted in a higher level of net assets than he had when he died in 1946." Bearing this caveat in mind, I see no reason (assuming that the figures are accurate) that we cannot use these data for this purpose.

table on p. 14 of Leithner Letter No. 200-204 (26 July-26 October 2016). It demonstrates that investment returns are heavily mean regressing: the lower that CAPE falls at a given point in time, the higher is the subsequent return to investors who were brave and lucky enough to buy at the low point. In mid-1932, CAPE fell towards the lower bound of the Table's lowest decile. On average since 1926, whenever CAPE has fallen within this decile the subsequent ten-year return averages 10.3% per year and has risen as high as 17.5% per year. *Specifically, he who – without a penny of leverage – "bought" the S&P 500 in June 1932 and held his investment until the end of 1945 earned an average (geometric mean) rate of return, including dividends, of 12.6% per year.*

Table 1: CPI-Adjusted Ten-Year Returns (Compounded per Annum), S&P 500, Ranked Shiller PEs, 1926-2015

Decile	**Starting CAPE**		**Avg Subseq 10-Yr Return**	**Worst Subseq 10-Yr Return**	**Best Subseq 10-Yr Return**	**Std Dev**
	Low	High				
1	**5.2**	**9.6**	**10.3%**	**4.8%**	**17.5%**	**2.5%**
2	9.6	10.8	10.4%	3.8%	17.0%	3.5%
3	10.8	11.9	10.4%	2.8%	15.1%	3.3%
4	11.9	13.8	9.1%	1.2%	14.3%	3.8%
5	13.8	15.7	8.0%	-0.9%	15.1%	4.5%
6	15.7	17.3	5.6%	-2.3%	15.0%	5.1%
7	17.3	18.9	5.3%	-3.9%	13.8%	5.1%
8	18.9	21.1	3.9%	-3.3%	9.9%	3.9%
9	21.1	25.1	0.9%	-4.4%	8.2%	3.8%
10	25.1	46.1	0.5%	-6.1%	6.3%	3.6%

These data, which Robert Shiller has compiled, have no British counterpart. My guess is that, if and when somebody does compile them, a British version of Table 1 would impart a similar message. Keynes did indeed generate excellent returns, particularly from 1933 until his death; and the effect of the Great Depression, which slashed the prices of stocks and thereby enabled him to buy at very cheap prices, likely flattered rather than hindered his results.

Figure 8 plots the course over time of a hypothetical investment of £1 in the Discretionary Portfolio and overall British stock market under the assumption that dividends, capital gains, etc., had been reinvested (rather than, as was actually the case, disbursed to the College); Figure 9 plots such an investment in Keynes's personal portfolio under the same assumption. The Discretionary Portfolio compounds to £16.76 in 1946; an equivalent investment in the British market grows to £4.24. The investment in the Keynes's personal portfolio in 1922 grows to £11.03 in 1945; an equivalent investment in the British market grows to £3.67. Before the early-1930s, Keynes's portfolios either tracks or lags the market; during the mid-1930s each overtakes the British benchmark – and then stumbles in the late 1930s. Finally, from 1940 each of Keynes's portfolios exceeds the British market. What explains his seemingly-phenomenal results from 1940? Part of the answer, as Chambers and Kabiri detail, is that he invested in U.S. equities. Zweig describes this shift ("John Maynard Kenyes: Courage Is the Key to Investing"):

> By 1939, he had put half [of the Discretionary Portfolio] in U.S. companies, favouring high-dividend-paying preferred stocks, investment trusts (diversified stock portfolios similar to today's mutual funds) and, later on, public utilities. He focussed on a small number of stocks trading at low multiples of their value as businesses, often hanging on [for years] until their stock prices finally rose to reflect these values.

Another part of the answer is that, as Figure 10 details, stocks in Britain and the U.S. rose strongly from 1940. From 1940 to 1946, an investment in the Discretionary Portfolio roughly trebled. Keynes's personal portfolio grew by 2.2 times to 1945. Investments in the American (S&P 500) and British markets increased 2.0-2.3 times. The Discretionary Portfolio's return outpaced the two countries' market indices, but the personal portfolio's didn't exceed the S&P 500's. Diverse, index-based portfolios clearly rose very strongly during these years; hence markets during the Second World War helped rather than hindered Keynes.

Figure 8:
The Growth of an Investment of £1,
Dividends, Etc., Reinvested, 1924-1946

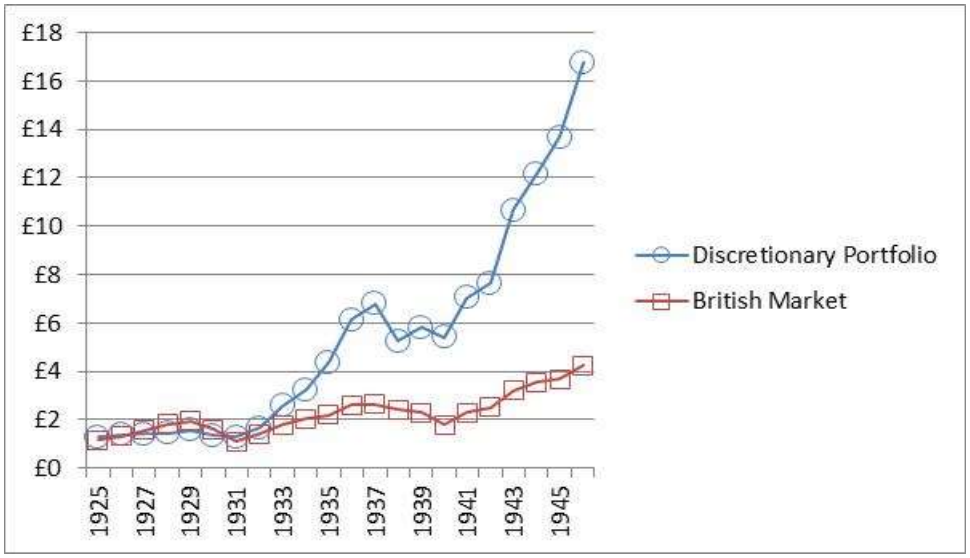


Figure 9:
The Growth of an Investment of £1,
Dividends, Etc., Reinvested, 1922-1945

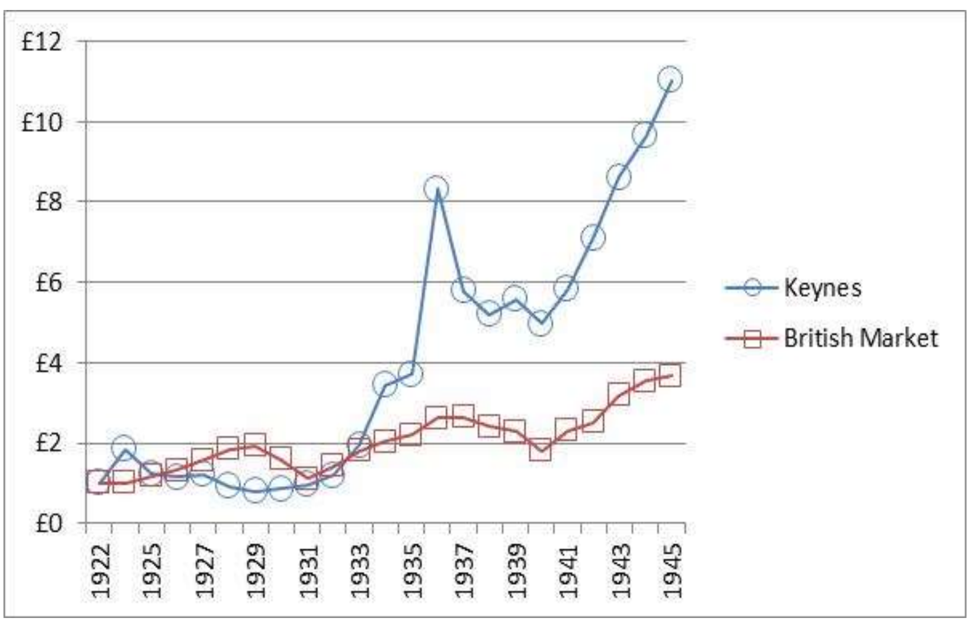
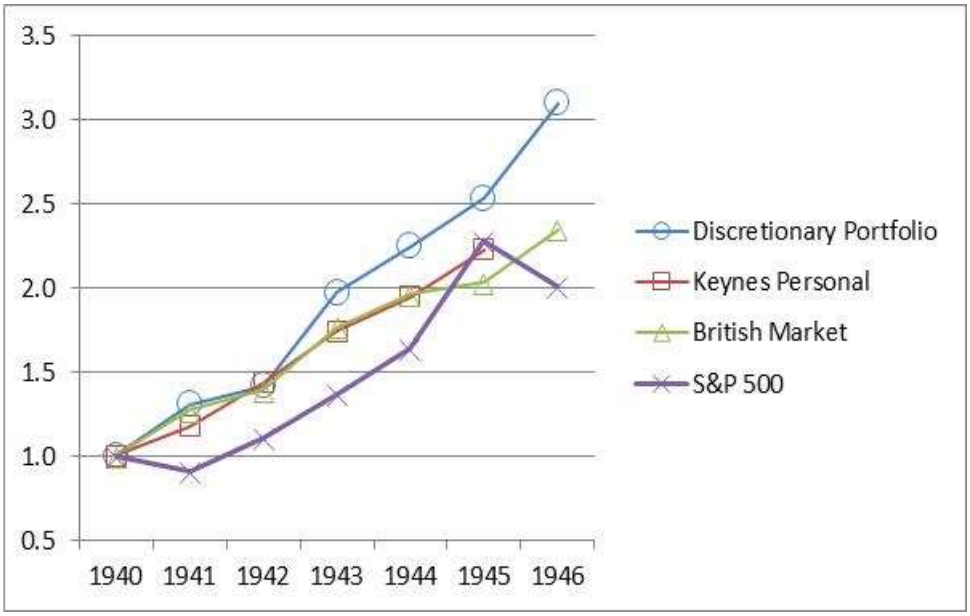


Figure 10:
The Growth of Four Portfolios, 1940-1946 (1940=1.0)



Concentrated Portfolios: Bouquets for Insiders, Brickbats for Outsiders

Chambers and Dimson show that, although their weighting varied over time, from 1922 and 1945 producers of commodities (that is, miners and producers of oil) comprised the lion's share of Keynes's portfolio. According to Zweig,

> Keynes … made titanic bets on industries he thought were cheap; by 1936, he had 66% of his portfolio in mining stocks and not a farthing in bank or energy shares. South African gold companies, he correctly foresaw, would benefit from falling currency values. Keynes wasn't only a pioneer in owning stocks when most big investors favoured bonds. He also relished risk, concentrating as much as half of his assets on his favourite five holdings or, as he called them, his "pets."

The mainstream media seems to practice double standards on this score (for full details, see Leithner Letter No. 148-150, 26 April-26 June 2012). On 20 August 2011, for example, in Candidate of Gloom and Doom, *Barron's* stated:

> Say this for him: Ron Paul puts his money where his mouth is. Over the past 16 years, the dollar gloom-and-doom prophet has invested heavily in gold-mining stocks. It's his hedge against what the Texas Republican congressman and perennial presidential candidate calls "The Great Inflation," which he has long preached is inevitable, given the profligacy of the federal government and the easy monetary policies of the Federal Reserve. In all, Ron Paul's portfolio amounts to a super bearish bet against the U.S. economy. … Paul's strategy is a financial planner's nightmare. Most pros say that gold-mining stocks should be a small part of a diverse portfolio because the shares tend to outperform in bull markets but underperform in bear markets. Mining stocks, for example, were among the most dismal performers in 2008.

On 21 December 2011, Zweig joined the fray. In The Ron Paul Portfolio, he wrote

> Republican presidential candidate Rep. Ron Paul marches to his own drummer in politics – and in his investment portfolio, too. … We've looked at hundreds of the annual financial-disclosure forms in which the members of Congress reveal their assets and trades – and we've never seen a more unorthodox portfolio than Ron Paul's. … Rep. Paul's portfolio is valued between $2.44 million and $5.46 million. (Congressional disclosures are given in ranges, not precise amounts.) … But Ron Paul's portfolio isn't merely different. It's shockingly different.

According to Zweig, Paul owned shares of ca. two dozen mining companies – many of them smaller Canadian "juniors." Such stocks, Zweig opines, are "highly risky … Ten of these stocks have total market valuations of less than $500 million, a common definition of a 'microcap' stock. Mr Paul has … roughly 5% of his assets … invested in these tiny, extremely volatile stocks." Zweig added:

> Paul appears to be a strict buy-and-hold investor who rarely trades; he has held many of his mining stocks [at least 10 years]. But, as gold and silver prices have fallen sharply since September, precious-metals

> equities have also taken a pounding, with many dropping 20% or more. That exposes the risk in making a big bet on one narrow sector.

At Zweig's request, William Bernstein, an investment manager at Efficient Portfolio Advisors in Eastford, CT, reviewed Paul's portfolio. Bernstein "has never seen such an extreme bet on economic catastrophe. This portfolio is a half-step away from a cellar-full of canned goods and nine-millimetre rounds." According to Bernstein, many "possible doomsday scenarios" menace the U.S. economy and financial markets. Yet, he asserts, Paul's portfolio protects against only one of them: the very high inflation that would accompany the collapse of the dollar. In Bernstein's opinion, if deflation (which he presumably defines in conventional terms, that is, as a general decrease in the prices of most goods and services) occurs instead, then "this portfolio is at great risk" because it contains no bonds and is so highly exposed to gold. Zweig concluded:

> Running an investment portfolio that protects against only one bad outcome is like living in California and buying homeowner's insurance that protects only against earthquakes, says Mr Bernstein. You also want protection against fire and wind and theft and the full range of risks that houses are prone to. Likewise, he adds, investors should hold a broad mix of assets that will hold up under a variety of good and bad scenarios. … But you can say this for Ron Paul: In investing, as in politics, he has the courage of his convictions.

On 5 January 2012, in a follow-up article entitled How Weird Is Ron Paul's Portfolio?, Zweig noted that "Paul's supporters protested, in their comments [about the article on 21 December], that his portfolio has already been vindicated by its performance." He conceded a vital fact that his first article had somehow forgotten even to mention:

> There isn't much doubt that … Paul's portfolio has outperformed the U.S. stock market as a whole. Ten years ago, the NYSE Arca Gold BUGS Index, a basket of stocks in mining companies, was at $65; this week, it's at $522. That's roughly a 23% average annual return; over the past decade, by contrast, the Standard & Poor's 500-stock index,

> counting dividends, has returned some 2.9% annually [compare this result to Keynes's in 1933-1946].

But Zweig acknowledged this point very grudgingly: "… we would argue that performance alone can't tell you whether an investment approach is sensible or not." *But that's exactly why he lauded Keynes's portfolio*: "Keynes's returns," he gushes, "were extraordinary." Moreover, they were remarkable because

> Keynes was no mere contrarian. He was the epitome of his own definition of a long-term investor: "eccentric, unconventional and rash in the eyes of average opinion." To emulate Keynes, "you have to be idiosyncratic," Mr Chambers says. "That's easy to say but much harder to execute." One of Keynes's biggest advantages … was that the board of King's College gave him uncontested authority to invest as he wished. Today, such latitude can be found only in smaller investment boutiques … Even more than in Keynes's day, it is worth hiring an active money manager only if you have the confidence that he or she is a free spirit who will have a completely free hand.

See the double standard? Keynes was "no mere contrarian" – he was "one of the greatest investors of the past century." Yet Zweig mocks Paul's portfolio precisely because it's unconventional – yet omits to mention the strong similarities between Keynes's and Paul's. *Moreover, Zweig also omits to mention that Paul's long-term results are better than Keynes's. By Zweig's logic, therefore, Paul should rank with Keynes as one of the century's great investors.* But no: Paul's portfolio is "weird" and "risky." Zweig excoriates Paul because his focussed and unleveraged portfolio *might* crash; yet he ignores the fact that Keynes's very concentrated and heavily leveraged personal portfolio *did* crash – more than once. Zweig's assessment is blatantly and pathetically biased in favour of Keynes and against Paul – and is thus risible.

Academics Have Changed Their Tune – and Given Keynes a Massive Benefit of the Doubt

For decades after the 1960s, when they became the guardians of unchallengeable orthodoxy, proponents of the Efficient-Markets Hypothesis (EMH) were adamant: it is impossible to "beat the market" consistently on a risk-adjusted basis. This is because market prices react only to genuinely new information – which, by definition, one cannot (unless one engages in "insider trading") know beforehand. Brandishing their arcane theory, the high priests within the universities "airily dismissed Buffett's outperformance as a red herring. Buffett's record signified nothing; absent *seventy-five years* of quarterly data … one couldn't 'establish whether he had done it with brains or luck'" (Lowenstein, p. 314).[12] More-over, the sensible investor – that is, the one who followed the academics' advice – possessed a diversified portfolio that mimicked major market indices.

Today, however, Chambers and Dimson credulously accept Keynes's subjective "estimates" (rather than hard evidence from contract notes and the like) of the Discretionary Portfolio's 20-year track record; they praise his construction of portfolios that bore little resemblance to the overall market; and they ignore the more volatile and leveraged results of his personal investments. Above all, they affirm Keynes's "outperformance."

If Keynes Was So Smart, Why Didn't He Quickly Become and Remain Rich?

From an early age, many people praised young Maynard's intellect. Soon after he entered King's in 1902, he was elected to an elite intellectual society, nicknamed "the Apostles," whose members included Bertrand Russell. Other people's brainpower rarely impressed Russell; yet he wrote in his *Autobiography* that Keynes's was "the sharpest and clearest that I have ever known." *And that was the problem: mere intelligence isn't a sufficient condition of success as an investor.* "Smart money" is often arrogant money, and arrogant money usually becomes dumb money. *Only when Keynes dropped his sense of superiority and acquired a justifiable framework could he begin to generate good results*. To do that doesn't require intelligence so much as disposition (Leithner Letter No. 192-195). Ben Graham

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[12] In the 1st edition of his best-selling book, A Random Walk Down Wall Street: The Time-Tested Strategy for Successful Investing (1973, 11th ed., W.W. Norton, 2011) Burton Malkiel, an economist at Princeton University, popularised this notion: "…But while I believe in the possibility of superior professional investment performance, I must emphasise that the evidence we have thus far does not support the view that such competence exists …" (p. 185).

noted that "the investor's chief problem – and even his worst enemy – is likely to be himself." Hence more than anything success as an investor requires "firmness of character." In the Preface to Graham's *The Intelligent Investor*, Warren Buffett has contended that high intelligence isn't even a necessary condition of success:

> to invest successfully over a lifetime does not require a stratospheric IQ, unusual business insights or inside information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework.

In *Fortune* magazine's *Investor's Guide* (1990), he added: "Investing is not a game where the guy with the 160 IQ beats the guy with 130 IQ." Charles Munger, in Wesco Financial Corp.'s *Annual Report* (1989), reflected "it is remarkable how much long-term advantage people like us [have obtained] by trying to be consistently not stupid, instead of trying to be very intelligent."

An amusing but profound article published by Dow Jones Newswire (15 May 2001) confirms Buffett's, Graham's and Munger's insight. Eleanor Laise ("If We're So Smart, Why Aren't We Rich? The Inside Story of How a Select Group of the Best and the Brightest Managed to Bungle the Easiest Stock") profiled an investment club whose "recent record has been nothing short of a fiasco, thanks to an overweighting in trendy tech stocks and pitifully bad timing … All told, the club saw the value of its assets fall by more than 40% over the past 12 months". One member said "we can screw up faster than anyone else;" another, a member since the mid-1960s, describes its investing strategy as "buy low, sell lower." From 1986-2001, the club's investments returned an average of 2.5% a year (versus the S&P 500's 15.3%). It

> sounds as if this group could really use an intelligent investing strategy. And that's ironic, given who its members are. This is the Mensa Investment Club. That's right, Mensa, the organisation founded in England in 1946 with the aim of assembling the brightest Britons to advise the government in times of crisis. The cost of admission: an IQ in the 98th percentile (or better). … The organisation, which *Vanity Fair* once dubbed "a dating service for dorks," has … 100,000 members worldwide and one of the sorriest investment clubs you will ever see.

The club's chairman of stock selection and editor of its investment newsletter told Laise: "it was my hope that a special-interest group within Mensa would have the intellect that would give us some kind of advantage." What, then, explains the chasm between members' formidable intelligence and their laughable results? Laise provides a strong hint: its chairman-editor

> transformed the club, which has $70,000 in assets, from a small-cap, value-oriented group to a momentum-buying Nasdaq nightmare. The centrepiece of his strategy is the TC 2000, a technical charting program that seems like a prop from the set of Star Trek. "This program is the coolest thing … You can show various types of graphs and add indicators, stochastics … and really confuse yourself."

The club traded at a dizzying rate. In 2000 it made "88 trades, or roughly one every three trading days." The high-IQ president-editor's described his method of "analysis:" "I'll go out and see what these idiots [on Internet chat sites] have to say about [the chart of a stock's price] because sometimes they'll observe something about the chart that I didn't see. The philosopher Karl Popper had the idea that we learn mainly by making mistakes … That's been part of [my] approach."
Similarly, we can learn much from Mensa geniuses during the Internet Bubble and Keynes in the 1920s: namely that allegedly smart people, reputedly among the world's most intelligent, will, if they proceed without a coherent and justifiable framework, arrogantly and repeatedly do stupid things.

Keynes Wasn't Great, but Did Become Very Good

Walsh (p. 162) aptly summarises Keynes's investment career. His

> experiences on the stock market read like some sort of morality play – an ambitious young man, labouring under the ancient sin of hubris, loses almost everything in his furious pursuit of wealth; suitably humbled, our protagonist, now wiser for the experience, applies his considerable intellect to the situation and discovers what he believes to be the one true path to stock market success. Somewhat ironically for a

> man who remarked that "in the long run we are all dead," Keynes – in his new guise as value investor – became particularly scornful of the stock market's insistence on taking the short view. In his later incarnation, Keynes looked beyond short-term price trends and events, instead focussing on the long-term earnings potential of a stock and adopting a steadfast ["buy-and-hold" approach to] his "pets."[13]

It's an exaggeration to claim, as Wasik does, that Keynes was a "stunningly successful investor." That's because, as Wasik concedes – and the quotation on p. 1 details – Keynes was "someone who had gained two fortunes through his trading prowess and lost them through his hubris." Keynes repeatedly lost heavily by borrowing deeply and speculating aggressively in commodities and currencies. In this respect he was blatantly hypocritical: privately, he speculated in these markets; publicly, he demanded that the government regulate them. Keynes the public-spirited reformer purported to see the damage that volatile prices wreaked upon consumers and producers; yet Keynes the self-interested speculator sought unabashedly to profit thereby. In Hunter Lewis' words,

> Keynes was a speculator, at the same time that he criticized speculators and the "casino" atmosphere of the market. He also failed entirely to understand that the casino was fuelled by the easy money policies which he espoused.

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[13] It's important to add that, with respect to investment fundamentals and much else, Keynes was maddeningly inconsistent. Consider this passage from *The General Theory* – which, presumably, he wrote after renunciation of speculation and embrace of value investing:

"The state of long-term expectation, upon which our decisions are based, does not solely depend, therefore, on the most probable forecast we can make. It also depends on the confidence with which we make this forecast—on how highly we rate the likelihood of our best forecast turning out quite wrong. If we expect large changes but are very uncertain as to what precise form these changes will take, then our confidence will be weak. The outstanding fact is the extreme precariousness of the basis of knowledge on which our estimates of prospective yield have to be made. Our knowledge of the factors that will govern the yield of an investment some years hence is usually very slight and often negligible. If we speak frankly, we have to admit that our basis of knowledge for estimating the yield ten years hence of a railway, a copper mine, a textile factory, the goodwill of a patent medicine, an Atlantic liner, a building in the City of London amounts to little and sometimes to nothing …"

Keynes's father, the economist John Neville Keynes (1852-1949), rescued his son from the consequences of his first loss of fortune; Maynard's cronies and other "insiders" did likewise the second time 'round. As we've seen, the high-water mark of his net worth occurred in 1936. At his death a decade later, Keynes left an estate valued at almost £500,000. (That's the equivalent of ca. $US14m today – and doesn't count a collection of art and manuscripts, including the original copy of Sir Isaac Newton's *Philosophiæ Naturalis Principia Mathematica*, as well as various and considerable charitable donations made during his lifetime). Keynes was undoubtedly wealthy; but he wasn't remarkably so.

Although Keynes wasn't a "stunningly successful" investor, his ability to learn from his massive speculative errors ultimately made him an excellent one – albeit to a significant extent a lucky one. His arrogance was immense, yet losing two fortunes humbled him (at least with respect to his investment operations, if not his economic policy recommendations). His thinking and practice changed fundamentally during the Great Crash of 1929-1932. Keynes evolved from a "top-down," frantic, haughty and aggressive speculator in commodities and currencies into a "bottom-up," unhurried, humbled, cautious and long-term investor in the stocks of listed companies. Yet his conversion wasn't total: before, during and for several years afterwards he continued to borrow heavily.[14] Hence Keynes was a fortunate investor: had his leveraged purchases of well-financed companies gone awry, he might easily have lost a third fortune. But he didn't; accordingly, he has bequeathed three important lessons. First, he

> emphasised that individual investment profits are largely determined by how investors behave at market tops and bottoms – which is where price volatility concentrates, sudden spikes occur and the big investment mistakes [buying high, selling low] are made ("The Money Paradox," *Barron's*, 31 December 2011).

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14 In this sense, which the mainstream has also overlooked, Keynes seemed to presage Buffett: Andrea Frazzini, David Kabiller and Lasse Heje Pedersen ("Buffet's Alpha," NBER Working Paper No. w19681, 21 November 2013) assert that "Buffett's returns appear to be neither luck nor magic, but, rather, reward for the use of leverage combined with a focus on cheap, safe, quality stocks."

A passage of a letter that Keynes penned in the northern summer of 1938 to a fellow-director of the Provincial Insurance Company, which he chaired from 1923 until his death, encapsulates the second lesson:

> As time goes on, I get more and more convinced that the right method in investment is to put large sums into enterprises which one thinks one knows something about and in the management of which one thoroughly believes. It is a mistake to think that one limits one's risk by spreading too much between enterprises about which one knows little and has no reason for special confidence.[15]

Thirdly, Keynes didn't lack courage (which, admittedly, can be difficult to distinguish from overweening self-confidence). He refused to sell his stocks in 1929-1932 and 1937-1938. By holding his nerve at these nadirs, which were apparent only in retrospect, during the subsequent upswing he turned large mark-to-market (MTM) losses into gains. According to Wasik, during the 1930s he "continued to firm up his investment philosophy and was able to focus on maintaining his portfolios despite predictions that the [coming] war would ruin the economies of Britain and the U.S." Keynes's actions after the outbreak of war in 1939 reprised his behaviour a decade earlier. As Barton Briggs wrote in *Hedgehogging* (John Wiley & Sons, 2006, p. 301):

> Even at the darkest moments in 1940 and 1941, Keynes was convinced that England and the Unites States would win and that the post-war world, if properly organised, would be prosperous. If this didn't happen, it wouldn't make any difference whether an insurance company owned stocks or not. When the chairman of National Mutual [which he chaired from 1919 to 1938] and its directors found this reasoning odd, he resigned in disgust.

Just as Keynes retained and augmented his core holdings of equities in 1929-1932 and in 1937-1938, in 1940-1942 he held ground – that is, his stocks – as France collapsed, the Luftwaffe blitzed British cities, the Japanese captured Singapore

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15 Oliver Westall, *The Provincial Insurance Company 1903-1938: Family, Markets and Competitive Growth* (Manchester University Press, 1992), p. 369.

and U-boats threatened Britain's lifeline across the Atlantic. On each occasion he refused to abandon his investments and approach to investment because, looking beyond the bleak present, he was able to discern a brighter future.

Keynes's Letter to National Mutual

The sharp economic downturn and financial crisis of 1937-1938 cost Keynes much of his net worth. Yet he stood his ground. In 1938, National Mutual, whose investments he had helped to manage since 1921, incurred a large MTM loss. In a letter dated 18 March 1938 to its acting chairman, F.N. Curzon, who had demanded that Keynes explain the loss and his refusal to liquidate the portfolio's stocks, Keynes stuck to his guns. "I do not believe," he informed Curzon,

> That selling at very low prices is a remedy for having [bought] at higher ones … At soon as prices had fallen below a reasonable estimate of intrinsic value and long-period probabilities, there was nothing more to be done … The right course was to stand pretty well where one was.

Moreover,

> I feel no shame at being found owning a share when the bottom of the market comes. I do not think it is the business, far less the duty, of an institutional or any other serious investor to be constantly considering whether he should cut and run on a falling market, or to feel himself open to blame if shares depreciate in his hands … An investor is aiming, or should be aiming, primarily at long-period results, and should be judged solely by these … The idea that we should all be selling out to the other fellow and should all be finding ourselves with nothing but cash at the bottom of the market is not merely fantastic, but destructive of the whole system.[16]

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[16] Donald Moggridge, ed., *The Collected Writings of John Maynard Keynes*, vol. 12 (Macmillan, 1971), p. 77-79.

Keynes's Memo to King's

Two months after he wrote his letter to National Mutual, Keynes wrote to the Estates Committee of King's College. Its portfolio had incurred an even larger MTM loss than NM's; for this reason, and particularly in the wake of the bickering that had triggered his resignation from NM, Keynes sought to ensure that the Committee understood his original purpose and current thinking:

> The idea of wholesale shifts [selling stocks] is for various reasons impracticable 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, which, if it is widespread, has besides the grave social disadvantage of aggravating the scale of the fluctuations. I believe now that successful investment depends upon three principles:
>
> 1. A careful selection of a few investments … having regard to their cheapness in relation to their probable actual … value over a period of years ahead …;
> 2. A steadfast holding of these in fairly large units through thick and thin, perhaps for several years, until 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 …

"Ultimately," his memo concluded,

> the ideal investment portfolio is divided between the purchase of really secure future income … and equities which one believes to be capable of a large improvement to offset the fairly numerous cases which, with the best skill in the world, will go wrong (Moggridge, pp. 79-80).

During the Second World War, and despite his heavy workload as a consultant to the Treasury, Keynes continued to manage King's and Provincial's portfolios. Some of his last writings on investment, such as a letter to a fellow-director of Provincial in 1942, recapitulated the gist of his approach:

> I lay myself open to criticism because I am generally trying to look a long way ahead and am prepared to ignore immediate fluctuations … My purpose is to buy securities where I am satisfied as to assets and ultimate earning power and where the market price seems cheap in relation to these (Westfall, p. 369).

Conclusion

Keynes doesn't merit veneration but in one key respect he deserves study and emulation. Compared to most other market participants, he remained calm in 1929-1932, 1937-1938 and 1940-1942. Why buy shares whose prices have been falling? Why hold them as they continue to sag, and after many others have sold? Why sit on paper losses when it might be easier – emotionally, at least – to cut and run? At critical junctures, market participants' transitory behaviour doesn't reflect these investments' enduring values. Without making precise short-term predictions like the ones that had previously lost huge amounts of money, Keynes foresaw the day when bankers would once again be willing to lend, businesses would seek to hire and consumers wish to spend. He knew that even under the dourest assumptions prevailing at the bleakest times, his holdings were worth *something*. He also observed that at extreme junctures market participants didn't analyse – they emoted – and as a result they greatly mispriced many equities. Above all, Keynes understood that sooner or later the crowd would come to its senses and chase the very stocks they'd previously shunned – the ones which investors worthy of the name had bought on the downward leg and held through the bottom and into the recovery.

Chris Leithner