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## Quarterly Commentary

March 2024  
First Quarter

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“True knowledge exists in knowing that you know nothing.”

- Socrates

Apelles of Kos, a prominent painter during the 4<sup>th</sup> century BC, was respected for his artwork depicting ancient Greece. According to Pliny the Elder, the Roman author responsible for *Naturalis Historia* (Natural History), Apelles far surpassed contemporaries in his craft. Why? According to Pliny, Apelles liked to display his art publicly and listen to the compliments and critiques of his work from afar. He would then go back and touch up his painting to remedy any observations he found valuable, as he strived for perfection. When asked why he approached it this way, he responded, “Nulla dies sine linea.” *Not a day without a line drawn.* For Apelles, a painting was a never-ending endeavor where perfection could be pursued, but never obtained.

One day a cobbler commented on a piece that Apelles had completed which contained a shoe. The cobbler noticed a sandal was missing a loop, and when the cobbler left, Apelles revised the painting. The next day the cobbler returned and was satisfied that the shoe was correctly depicted, however, he now observed an irregularity with the subject’s leg. Apelles, piqued by the comment, emerged from the shadows, and asserted, “Ne sutor ultra crepidam.” *Let the shoemaker venture no further than the shoe.*

The Apelles story is the origin for the word, “ultracrepidarian”, and according to Webster’s Dictionary is defined as:

**A person who criticizes, judges, or gives advice outside their area of expertise.**

As history shows, there have always been people who fit this definition. However, the invention of the smartphone, the copious amount of available information, and the ability to reach the masses on social media created the perfect environment for ultracrepidarian behavior.

How many people nonchalantly became epidemiologists in 2020, never having attended a single day of medical school? Or how many times have we witnessed a Hollywood actor become a political expert in foreign affairs? Or seen the newly married makeup blogger now dispense relationship advice to thousands? *Let the shoemaker venture no further than the shoe.*

The ultracrepidarian holds a special place within the investment community. We have television shows and speaking events dedicated to individuals who provide countless economic forecasts, warnings, and predictions as if attending a prestigious business school makes one an expert soothsayer.

As generalists, we are overly self-aware about falling into this category. We constantly get asked, “How can you do the research necessary to make an informed decision when there are specialists and industry experts you are competing with?” Our answer: We seek to identify value in the reality of simplicity versus the perception of complexity. We understand our strengths and weaknesses and ask “Why?” and state, “I don’t know” often. We learned this through the studying of one man’s influential work on behavioral finance that serves as the antidote to ultracrepidarian behavior.



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### The Influence of Kahneman

Daniel Kahneman, awarded the 2002 Nobel Memorial Prize in Economic Sciences, was an expert in behavioral economics. He wrote the New York Times bestseller, “Thinking, Fast and Slow.” The book is a must-read and details the psychological study of the two states of thinking, which Kahneman calls System 1 and System 2.

From “Thinking, Fast and Slow”:

- » **System 1** operates automatically and quickly, with little or no effort and no sense of voluntary control.
- » **System 2** allocates attention to the effortful mental activities that demand it, including complex computations. The operations of System 2 are often associated with the subjective experience of agency, choice, and concentration.

System 1 is your fast thinking. If an adult driver were asked, “What do you do at a red light?”, their instant response would be “stop.” This is the essence of System 1 – it is something you know immediately or via intuition. If this same person were asked, “How far will you have travelled if you go 27 miles an hour for 13 minutes?”, they would most likely not have an immediate response. Most individuals would have to get out a pen and paper (or calculator) to solve the problem. This is the essence of System 2, or your slow thinking. System 2 requires concentrated thought and focus to answer a question or solve a problem. Both systems are important and mutually inclusive.

Kahneman spends over two-thirds of the book discussing the “heuristics of judgement” that occur when System 1 influences our decision-making, but when System 2 is also needed. We observe this when someone in one field believes they can transfer that knowledge horizontally to an entirely different one based off experience and intuition. It is human

instinct to construct understandable interpretations and explanations for complex subject matter in our world. To do this, we gravitate towards the path of least resistance, which is to use intuition to solve most problems. Relying exclusively on System 1 and using phrases like “[this time is different](#)” or “[it will never be the same](#)” can prove costly in the investment business.

### WYSIATI – What You See Is All There Is

One of Kahneman’s important principles we apply to our investment process is WYSIATI. When decisions are analyzed, our brains tend to deal with the known knowns or the observations that sit stored in our institutional memory. The perpetual investment paradox is that decisions are made with inconclusive information and a wide variety of outcomes that cannot be accurately predicted. To deal with this, System 1 kicks in and attempts to “make sense of partial information in a complex world.”

**WYSIATI “facilitates the achievement of coherence and of the cognitive ease that causes us to accept a statement as true. It explains why we can think fast, and how we are able to make sense of partial information in a complex world. Much of the time, the coherent story we put together is close enough to reality to support reasonable action.”**

Kahneman highlights biases that occur with this method of thinking because:

**Indeed, you will often find that knowing little makes it easier to fit everything you know into a coherent pattern.**

Human beings base our judgements and decisions on things which we can see. We continually fail to recognize there could be critical evidence that is missing, and must never stop asking, “Why?” or saying, “I don’t know.”



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### The Nixon Tenets for Addressing WYSIATI

In addressing the biases that result from decisions based on that which is observable, we've established some straightforward principles:

- » **Be Curious:** Take the generalist approach that every new investment opportunity requires a blank slate. Use specialists to speed up the due diligence process but remain fiercely independent. Trust, but verify.
- » **Be Qualitatively Different:** Extreme sentiment and volatility should be viewed opportunistically. Make no assumptions or have predispositions about any opportunity.
- » **Be Flexible:** Markets are constantly changing, so we too must evolve. Be pragmatic in our view and approach.

We place a high premium on independent thought and diverse opinions, being open to new ideas and opportunities. As generalists, we acknowledge we put ourselves at risk for the [illusion of understanding](#) or [attribute substitution](#) bias. To address this, we aim for investment discussions to have what Kahneman calls "adversarial collaboration", or the ability to disagree so that we might arrive at the truth (versus winning the argument). We begin our work with a blank canvas to help mitigate any overconfidence or framing bias, as our goal is to reduce risk or error by adhering to a consistent due diligence process.

### Opportunistic Investing: A Repeatable Process

Over the last five years, we've made investments in housing, energy, and other real estate related companies, to name a few. While completely different industries, the process by which we analyzed the opportunities remained the same:

- » **Identify What Is Changing:** Is it temporary or permanent? Has the market recognized this change?

- » **Seek Outsider CEOs:** Do they manage for long-term shareholder value and are excellent at capital allocation? Are they realistic about their business and do they balance humility and confidence?
- » **Gravitate Toward High-Quality:** Do the businesses have sustainable business models and attractive valuations? Do the balance sheets provide flexibility? Are they the leaders in their industry?

It would be fair for an outside observer to label us ultracrepidarians. However, we would argue the hours of study and research while applying the same disciplined approach remains consistent regardless of sector. Investment opportunities are not arbitrary; we have learned to compound mental pattern recognition models across three generations of investors and recognize process determines results.

Just as Apelles strived for perfection and viewed his painting as never truly complete, we view our role similarly. You entrusted us with your capital and have given us a blank canvas to place our brushstrokes on. Our goal is to create a work of art that is worth a whole lot more than it was in the beginning. We fully acknowledge the painting is never finished and are constantly seeking opportunities to improve its worth. "Nulla dies sine linea." *Not a day without a line drawn.*

### The Nixon Capital Team

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