

The Investment Mind Game

And How to Play It

12 rules for keeping your head, and your capital,
when the market turns against you

Tim du Toit

Founder, Quant Investing

quant-investing.com

Why I Wrote This

Dear Fellow Investor,

Most investing advice is about what to buy. This is not.

After more than 39 years of investing my own money, I have learned that the hardest part is not finding good companies. Good companies are not that hard to find. The hard part is holding on to them when the market falls, the news turns dark, and every screen you look at is red.

That is the real game.

I call it the Mind Game, because it is played inside your own head, and it is where most investors lose. Not on the analysis. On the emotion.

I have lost money by selling good companies at the bottom because I could not take the pain any longer. I have watched friends do the same. Over the years I built rules to stop myself doing it again. These 12 are those rules.

They will not make you rich this year. They are here to keep you in the game long enough for a sensible strategy to do its work, which is measured in years, not weeks.

Read them once now. Then keep this guide and read it again the next time the market frightens you. That second reading is the most important one.

This guide is general information and research, not personalised investment advice. It does not take account of your personal circumstances. Prices go up and down, and you can lose money, including part of the capital you invest. Past performance is not a guarantee of future results. Any decision about your money is yours alone.

The 12 Rules at A Glance

The whole guide on one page. Come back to this list when you do not have time for the rest.

1. Set your plan, then stop watching the noise.
2. Match the strategy to your own temperament, not someone else's.
3. Make yourself unbreakable: stop losses, a cash reserve, and never being forced to sell.
4. Decide what “enough” is, so the goalposts stop moving.
5. Plan for when the plan fails. Keep a margin of safety.
6. The real prize money buys is control over your own time.
7. Keep three separate portfolios: safety, income, and growth.
8. Treat volatility as the fee you pay for long-term returns, not as a loss.
9. There is no single best idea. Follow the strategy, never the story.
10. There is no perfect strategy. The best one is the one you can stick with.
11. More information will not save you. Simple rules will.
12. Getting wealthy and staying wealthy need different skills.

Rule 1 Set your plan, then stop watching the noise

The moment you put money into an investment, your mind changes gear.

It feels as if your future, and the future of the people who depend on you, is on the line. That feeling is normal. It is also useless for making decisions.

Here is what happens. Talking heads on the business channels start warning about exactly the kind of company you just bought. Charts appear in your newsfeed. Your mind starts reading every small daily price move as a sign that you were right, or that you were a fool.

You cannot switch this off. Telling yourself to relax does not work.

What works is a rule: once you have done your analysis, built your plan and set your alerts, you deliberately look away and let the plan run.

Remember what you are looking at. The people on the business channels are paid to fill airtime, often with a scripted opinion. Charts in the media are drawn to trigger a reaction. None of it is about your plan.

Trust the plan you made when you were calm, not the fear you feel when you are not. The urge to act on the noise fades faster every time you refuse to feed it.

This only works if you have a written, tested investment strategy in the first place. If you do not have one yet, start with the strategies we have tested and published: [the best investment strategies at Quant Investing](#).

Rule 2 Match the strategy to your temperament, not someone else's

You do your analysis, buy a good company and feel calm about it.

Then a friend tells you about someone who downloaded some software, got told what to buy and sell, and made enough to buy a house last year (you never hear about the trader that got wiped out). Your good mood is gone, and a small voice starts saying your friend may be on to something.

Do not fall for it.

This is not about better or worse. It is about what is right for you.

The person your friend described sounds like a trader. Traders love the excitement of price movement and place orders often. The market needs them, and there is nothing wrong with it, but it is a different game with a different temperament behind it.

I chose to be an active investor who buys quality undervalued companies and holds them. It fits how I am wired. There are also wealth-retention investors who already have enough and simply want a steady income and protection from inflation. They accept lower returns for more stability. That is a perfectly good choice too.

So be honest with yourself. Do you enjoy the win-big, lose-big life of a trader? Or do you want a sensible process that lets you get on with your life? Once you know which one you are, you can hear about someone else's win and feel nothing but pleased for them, because you are running your own race.

Rule 3 Make yourself unbreakable

Warren Buffett once said something that has stayed with me: to make money in the market, you first must survive. For me, surviving means getting through a big fall without selling at the bottom.

To do that I need two things: not to give in to the emotional pain of a large loss, and to have enough money set aside that I am never forced to sell. Both sound simple. Both took me years to put in place.

See small losses as a fee

I treat small losses not as failures but as a fee I pay for long-term returns. That single change in how I see them made them much easier to accept. Even a strategy with a high probability of success will have losers. That is a fact of investing.

For the large losses I keep a plan, and a big part of that plan is a strict trailing stop loss. Knowing in advance that I can get out lets me invest calmly in the first place.

Be honest about how large a fall can be. Two of the strategies we have tested and published returned well over 1,000% over 13 years, and both still fell more than 50% at their worst point along the way (a maximum drawdown of 50.8% and 53.2%). Strong long-term returns and deep temporary falls are not opposites. They are part of the same journey. If you are not ready for the fall, you will not be there for the return.

Talk to another investor

I have two friends, both investors, that I speak with about once a month. We do not just talk about companies. We talk about how we feel about our gains and losses. It reminds me I am not alone, and it gives me an outside view of my own state of mind. I recommend you find the same.

Keep a cash reserve

I keep enough cash for two to three years of living expenses. It removes the feeling that I depend on my investment returns to get by, and it means a crash never forces me to sell at the worst time. That reserve is what makes the rest of the plan possible.

The trailing stop loss is not a spreadsheet exercise. In the Quant Investing screener you can set it and get an alert when a company hits it, so the decision is made in advance and not in the heat of a falling market. See how the [screener works](#).

Rule 4 Decide what “enough” is

How much money is enough for you? “More than I have now” is not an answer. It is a trap.

Morgan Housel, in *The Psychology of Money*, put it so well. The only way to know how much food you can eat is to eat until you are sick. Almost nobody does this, because being sick is worse than any meal is good. Yet in money and investing, plenty of people only stop reaching for more when they break.

The goalposts must stop moving. If they do not, you will only stop when something forces you to, and by then the damage is done.

When you are young, with a long working life ahead, taking large risks for a large payoff can make sense. But once you have enough, risking what you have and need for what you do not have and do not need is a bad idea.

When you reach that point, your job changes: diversify, follow a good-enough strategy, and make yourself hard to break.

Rule 5 Plan for when the plan fails

Finding a sound investment strategy that fits you is one of the most important plans you will make. But there is a second plan that matters just as much: the plan for when your plan does not work.

Call it Plan B.

You build it by leaving room for error, what Warren Buffett calls a margin of safety. It takes many forms: spending less than you earn, holding cash, and planning for lower returns and more ups and downs than you expect.

Investing is not a hard science

However much some professionals want you to believe otherwise, investing is not physics. It is millions of people making imperfect decisions with incomplete information about things that will shape their financial lives. Room for error, held as cash or enforced by a stop loss, is what lets you ride out the falls and stay with your plan.

Could you survive a 30% fall?

On paper you might say yes, if you can pay your bills. But what about in your head?

Do not underestimate what a 30% drop does to your confidence, often at the exact moment the best buying opportunities appear. You must prepare for this in advance, because if you sell at the bottom, you have no way to make the loss back.

My own preparation is simple. I assume future returns will be lower than the past, so I save more than I otherwise would. And I keep those three years of expenses in cash, so a crash never puts me under pressure to sell. The aim of a margin of safety is to make forecasts unnecessary.

Rule 6 The best thing money buys is control over your time

What is the most valuable thing money can buy? It is not anything physical.

Researchers who study wellbeing keep finding the same answer: the strongest predictor of positive feelings is a powerful sense of being in control of your own life. The first time I read that I was not convinced. The more I thought about it and implemented it in my life, the more certain I became.

Think about being able to do what you want, when you want, with the people you want, for as long as you want. As you save more and your portfolio grows, you buy more of exactly that, one step at a time. Independence, not a bigger number, is the highest dividend your money can give you.

Rule 7 Keep three separate portfolios

To earn good long-term returns, you must stay invested through losing years. That is far harder than it looks. The best way I have found to make it possible is to divide your money into three separate portfolios, and to report on each one separately.

Safety portfolio

This covers the unexpected: a lost job, an emergency. Its whole purpose is to let you stay invested everywhere else. It has a five-year horizon and holds cash, money-market funds or short-term bonds.

Income portfolio

This holds conservative, lower-volatility investments that keep up with inflation and add a little income. Its horizon runs from about year six up to your retirement. Typical holdings are medium-term bonds, real estate investment trusts and other defensive assets.

Growth portfolio

This holds your long-term, higher-risk assets, the ones meant to grow your wealth for retirement. Ideally you do not touch it until you retire, so its horizon is long. Equities and ETFs are typical assets for this portfolio.

Report them separately

Reporting on them separately is the whole point of the exercise. When you see the three returns apart, you expect the safety portfolio to be dull and stable, the income portfolio to wobble a little, and the growth portfolio to have more ups and downs.

Because you know this in advance, a bad year in the growth portfolio does not frighten you into selling. Keeping them separate in your reporting keeps them separate in your mind, and that is what lets you stay the course.

Rule 8 Treat volatility as a fee, not a loss

I have learned to see volatility as the fee I pay for high returns over long periods, and I suggest you do the same.

By volatility I mean price falls that match the market or that no company news can explain.

How often have you seen a share drop 3% or more in a day with no reason you can find? If your experience is like mine, it happens all the time. It used to send me looking for explanations. Does someone know something I do not? Should I sell? Did I miss a report?

There was usually nothing to find. More sellers than buyers that day, and no more than that. I now see the move as a fee, and I move on.

Following a strict trailing stop loss makes this easier. If a price really does keep falling, the stop takes me out and limits the damage.

Most of the time it never triggers, and the price recovers. Either way I do not over think every small dip.

Rule 9 There is no single best idea

Two questions I hear often: which company will perform best, and do I have to buy them all or can I pick and choose?

They are good questions with an uncomfortable answer.

Neither you nor I can know which idea will do best.

Forecasting the market, up or down, is hopeless. The media always finds someone who is sure what comes next, often with a good-sounding argument, but study after study shows that humans, experts included, cannot forecast reliably.

A few real examples

Here are companies we recommended in the newsletter. I list them not to boast but to show how unlikely each large gain looked at the time.

- Eckert & Ziegler, a quiet German maker of medical isotope technology, up 75.0% in six months.
- CropEnergies, a German bio-ethanol producer, up 75.9% in 15 months.
- Reply SpA, an Italian IT company, up 269% over three years, despite account receivables of more than 400 days when we recommended it, which is why I doubted it at the time.
- Arctic Paper, a Polish paper manufacturer, up 146.9% in 12 months.

Each of these was in an unglamorous industry with real problems and an uncertain future. If I had tried to pick the winners in advance, I would have skipped several of them. I know, because I have made that mistake many times before.

I listed a few winners, but a lot of other ideas went nowhere, and some lost money. That is exactly the point: because I cannot tell in advance which will be which, I hold many small positions and let the strategy, not my judgement of any single company, do the work.

What do you do

You follow the strategy rather than the story. For the newsletters that means: do not buy into falling markets (the 200-day moving average rule), hold a diversified portfolio of undervalued quality companies, keep each position small at 2% to 4%, limit losses with a trailing stop, and sell after a year if a company no longer meets the strategy.

This is exactly why the newsletter exists alongside the screener. The screener lets you find these companies yourself. The newsletter shows you which companies a tested strategy is buying each month, so you can see what disciplined investing looks like in practice and check it against your own ideas. Here is [how we select the ideas](#).

Rule 10 There is no perfect strategy, only one you can stick with

As the Prussian strategist Carl von Clausewitz put it, the greatest enemy of a good plan is the dream of a perfect plan.

The best investment strategy you will ever find is not the one with the highest return, the best Sharpe ratio, the smallest drawdown, or the one beating the market right now. It is:

- a sensible strategy,
- good enough to reach your financial goals,
- that you can stick with in good markets and bad,
- and that lets you sleep at night.

In other words, the one that fits your nature and that you are comfortable holding.

It must still be a good, tested strategy

Comfort is not enough on its own. It must be a strategy that has been shown to work, in different markets worldwide, over long periods, in up and down markets. The good news is there are more than enough of these to choose from.

Once you have it, do not keep changing it

Be very careful about switching your strategy to whatever is beating the market now. You will almost always do it at the worst possible moment.

Think of the value investors who sold cheap companies to buy internet stocks at insane valuations, right before the bubble burst. They lost far more than their shirts.

Every good strategy underperforms the market some of the time, sometimes for a few years. Only if you are genuinely comfortable with yours will you hold it through those times, and holding through them is the whole point.

You do not have to guess which strategies are tested. We have backtested and published the strongest ones, with their returns and their worst falls shown side by side, so you can judge them honestly: [see the tested strategies](#).

Rule 11 More information will not save you

If there is one lesson I have learned repeatedly, it is that the world is too complex to fully understand, however hard I try.

The more I try to explain events and trends, to tell myself a story that makes sense, the more attached I become to that story. And the more attached I am, the more blind I become to what is happening.

What I have learned is the idea that I understand what is going on in the markets gives me a false confidence that costs me money.

You hear it constantly from well-known investors: some trend “doesn't make sense”. What they mean is that it does not fit the model in their head.

But the world always makes sense. It is the map in our heads that is wrong and needs updating. And because every financial trend runs on human behaviour, if I refuse to update my map, I will never understand the trend, let alone invest and profit from it.

The market is smarter than you, smarter than me, smarter than all of us together. I respect it, gather just enough information without spinning a story, and keep things simple but no simpler than they should be.

Turn it into automatic rules

The way to do this reliably is to build rules that act for you, the same rules we use in the newsletter and that I use in my own portfolio:

- Do not invest into falling markets. Use the 200-day simple moving average rule.
- Sell losers fast and let winners run. Use a strict trailing stop loss.
- The trend is your friend. Build momentum into your process.

Rule 12 Getting wealthy and staying wealthy are different skills

Building wealth and keeping it need two completely different mindsets and confusing them is a common and expensive mistake.

Getting wealthy takes risk, optimism and a constant hunt for new ideas. You think about growth all the time.

Staying wealthy takes the opposite view: caution, respect for risk, diversification and the ability to survive events you did not see coming.

Your focus shifts from growing what you have to keeping it. What earned your wealth will not necessarily protect it. To stay wealthy, you must also become a little paranoid.

How to make yourself hard to break

- Keep debt low or avoid it completely.
- Never make a bet that can wipe you out.

Just as important, spread your risk across more than one dimension:

- Strategy risk: no single strategy works all the time.

- Country risk: watch out for home bias.
- Currency risk: decide whether and how to hedge it.
- Company risk: never let one holding grow too large.
- Broker risk: know what happens if your broker fails.

The best real-life lesson in staying wealthy is the life of Warren Buffett. His strategy kept evolving, he used almost no leverage, he never panicked through any of the bear markets he lived through, and he protected his reputation above all.

Those are staying-wealthy skills, and they are the ones most investors ignore.

Where this leaves you

You now have the 12 rules. Reading them is the easy part. Rules only work when you build them into a process you follow, especially on the day the market is falling, and every instinct tells you to sell everything.

That is what we do at Quant Investing, and it is what I do with my own money every single day. Two tools make it practical, and they are designed to work together.

Find the ideas yourself, then check them against a tested strategy

- The screener lets you find undervalued quality companies yourself, using the same tested strategies described in this guide, and set the trailing stop alerts that Rule 3 and Rule 8 are built on.
- The Quant Value newsletter shows you the companies a tested strategy is buying each month, with the full reasoning. It is a second, independent check: see what a disciplined process is doing, then compare it with your own screening before you act.

Most readers use both together, and there is a simple reason. On its own, the screener is 435.70 euro a year. Adding the Quant Value newsletter brings it to 639.70 euro a year. That is about 17 euro a month more, or roughly 56 cents a day, for a second opinion on every idea you find.

See the plans and what is in each one: quant-investing.com/pricing. Every paid subscription is covered by a 30-day money-back guarantee. No questions asked.

Not ready to subscribe? Test it in five minutes, for free

Start with the free demo. It runs on data from a year ago, which turns it into a test you can check yourself.

Run a screen, pick any five of the top ten companies, and look up their share price today. You will see a real one-year forward test of the strategy, not a marketing claim.

You can [start the free demo here](#).

Whatever you decide, use the 12 rules. They are the difference between a strategy that looks good on paper and one you can live with when it matters.

Take a breath. Remember why you started.

Your value analyst,

Tim du Toit

Founder, **Quant Investing**

Important information

This guide is general information and research published to a broad audience. It is not personalised investment advice and does not consider your individual circumstances, financial situation or goals. Nothing here is a recommendation to buy or sell any particular investment. Any decision about your money is yours alone, and you should consider your own situation and, where appropriate, seek independent advice.

All investing carries risk. Prices go up and down, and you can lose money, including part or all the capital you invest. The example companies shown are past results selected to illustrate a point and are not representative of every idea; strong strategies also have losing positions and can fall more than 50% at their worst point, as noted in Rule 3. Past performance is not a guarantee of future results. Any investment idea we publish is intended as general research with a 12-month time horizon and the method shown.

Serendipity Ventures UG is notified to BaFin as an independent producer of investment recommendations under section 86 WpHG. This does not mean BaFin approves or endorses this content.

Quant Investing is a publisher of research and commentary. We run these strategies in our own portfolio. We do not manage your money or provide advisory services. Full disclaimer: quant-investing.com.