THE BAM ALLIANCE
A Community of Independent Advisors

Moneyball: Objectivity Over Intuition

Making evidence-based decisions in baseball and investing

For more than a century, major league baseball teams have used scouts to scour the high school and college ranks for the next generation of great players. Scouts look for skills: speed, power and other specific tools considered essential to play in the big leagues. They trust their instincts to gauge players' potential to improve. They *perceive* the best of the bunch. Every major league team took this approach until Billy Beane came along.

Played by Brad Pitt in the 2011 movie *Moneyball*, Beane is the general manager of the Oakland Athletics. Beane was a keynote speaker at the 2012 BAM National Conference in St. Louis. His presentation gave a fascinating look at the unconventional approach his team took to selecting players.

More than that, his story has important parallels to modern investing.

A new way of thinking
Beane's approach is a classic example of conventional wisdom being turned on its head. Instead of trusting the perceptions and predictions of scouts, Beane and his assistant Paul DePodesta relied on the numbers. They looked at performance stats, not at how a player ran, threw or swung the bat. They emphatically focused on the stats that most strongly correlated to producing runs and wins. These turned out to be not batting average and RBIs (which scouts traditionally tracked), but on-base percentage and slugging percentage.

Beane and DePodesta used evidence, not emotion, and science, not sentiment. Their statistical models produced a list of prospects that most teams ignored completely — no-names with what seemed like limited raw talent. But what Beane's picks did have was the special ability to get on base. Beane knew the math from there: Getting on base leads to runs. And runs lead to wins that lead to playoff appearances and bigger crowds.

Their draft picks were slammed by fans and lampooned by talk radio hosts until the A's started winning. They won a lot. The A's reached the playoffs in 2000, 2001, 2002, 2003, 2006 and 2012, despite consistently having among the lowest team salaries, typically about 25 percent of the New York Yankees.

Beane's success was a big win for discipline over impulse. He relied on objective, measurable performance, no matter how much it conflicted with the accepted rules of player selection, conventions that had changed little since Hank Aaron put on his first pair of spikes.

The rest of baseball was slow to follow, but now most teams (including some in other sports) supplement their scouting efforts with the same kind of statistical analysis that Beane and DePodesta brought to the big leagues. The conventional wisdom is evolving.

Scouting for investments

The investment industry has relied on its own scouting system too — expressed through the speculative strategies of active fund managers, the predictive buy and sell picks of analysts and the emotional riffs of market commentators. Indeed, the industry's superstars are often described like scouts when they are described as having a great eye for value, an uncanny ability to see where the markets are going or a rare instinct for the bond market.

This subjective, expert-based method for choosing investments has been the standard mode of operation for generations. And just like in baseball, challenges to the conventional wisdom have been slow to take hold.

But the challenges persist and strengthen. Speculative investors and advisors are now facing a tidal wave of data that demonstrate stock picking and market timing are, on average, unlikely to keep up with market returns over the long term. Yes, it is possible for an actively managed mutual fund to beat market-level returns in any given year, but over extended periods, it is not likely.

Many decades of empirical evidence and peer-reviewed academic research tell us that investors who can resist the temptation to chase hot stocks or try to time a market top or bottom will likely be better off. This data is in direct conflict with a core business model of Wall Street firms, which makes money on prediction (even when the predictions are wrong). For now, only a quiet minority of investors and advisors embrace the objective evidence.

Trust math, not instincts

You don't have to be a diehard baseball fan to enjoy *Moneyball*. The book by Michael Lewis and the movie upon which it was based provide fascinating looks at the difficulty of overcoming impulse and emotion in decision making. As Beane describes, it is an ongoing struggle. For instance, he tries his best to not watch any of his team's games because watching the live action makes him too subjective. When he sees a player make a bad decision, he has the ability to yank him off the field immediately, even if the numbers say that the offending player provides the best chance to win.

The same school of thought applies to investing. There is not much to be gained by staring at a 401(k) all day long. The impulse to make changes would be overwhelming. But as Beane has found, math and empirical evidence have a way of moving us forward no matter what our emotions might be.