

## Investing the Toyota Way

This spring, the previously unthinkable happened – Toyota passed General Motors as the world’s biggest automobile manufacturer. When we read this, we could not remember any Toyota advertisement, in sharp contrast to several memorable ads for GM cars. Who among us has not lusted after The Northstar System® after seeing a Cadillac ad? Who among us has the foggiest notion of what it is? For GMC trucks, the metal stamp proclaims “We Are Professional Grade®.” But what profession are they talking about? Lawyers? Dentists? The Pontiac division asserts “We Build Excitement!” We commend Pontiac for its refreshing candor, admitting that they focus on the sizzle rather than the steak.

One reason for building “excitement” is that it is easy to convey in an advertisement. Start with pulsating rock music. Add an attractive member of the opposite sex sitting in the passenger seat with an adoring gaze. Top it off with the car zipping through an amazingly beautiful and challenging terrain, accompanied by a hedge clause telling you that this is actually a professional driver on a closed course, not something you are supposed to emulate. But, of course, the purpose of the ad is to create in you an immediate desire to emulate. The unstated message is that if you buy this car, energetic rock music will accompany your every move, attractive members of the opposite sex will find you worthy of adoring gazes, and your life will be more exciting and fulfilling.

As it is in autos, so it is in the investment world. Advertisements sell financial products by conveying excitement, not safety, reliability or a rational process. Major investment firms advertise short-term world-beating returns, while others show supposed retirees snowboarding or kayaking down rapids. The ads do not sell you on having enough money to live on when you turn 90, but taking the one bold stroke that allows you to remain young and live like the people in the ad.

If you are not selling excitement, the creative process for ads gets a little dodgy. Volvo is up to the challenge, conveying its message of safety showing cars filled with mannequins slamming into a wall in spectacular crash tests or, with a softer touch, showing parents protectively watching their toddler in a car seat through the rearview mirror. Toyota's strong point, though, is reliability, not the most visual of virtues. Just as a matter of logic, it is hard to demonstrate the absence of a negative. Are they supposed to show a car door slamming 5,000 times with no rattle developing?

*The degree of one's emotion varies  
inversely with one's knowledge of the facts  
- the less you know the hotter you get.*

*~ Bertrand Russell*

Toyota's reliability is the result of their manufacturing process, of a thousand small correct decisions, not a single, bold decision. Process, though, usually is not inherently interesting. An old joke tells of two auto executives, Japanese and American, whose plane crashes in enemy territory. Their captors grant them one last wish before they are executed. The Japanese executive asks to give his lecture on manufacturing processes one last time; the American asks to die first, so he does not have to listen to the lecture again. This is not about nationality (many of those Toyotas are made in the U.S. with U.S. workers, after all), but about focus. Focus on process risks boredom, and generally does not arouse positive emotions, the intention of most good ads. Advertisers can generate the emotion of excitement relatively quickly, so excitement is perfect in a world of short attention spans and 30-second TV spots.

We believe that, similar to auto manufacturing, wise investing is the result of many small decisions. We try to identify areas within our client portfolios where probabilities favor one course of action over another and act accordingly, taking no action unless we believe we can identify an edge. Each small advantage, in itself, is not particularly interesting, nor is it ever a sure thing, just a probability. If you have a coin that comes up heads 60 percent of the time, it makes sense to bet on heads, but you would be foolish to bet the farm on the next flip of the coin. The winning strategy is continually to bet relatively small amounts on heads ~ remunerative, but not particularly exciting, even if you added a pulsating sound track. Making bold strokes in the investment business may be exciting, but it tends to be dangerous. Deciding you like biotechnology stocks and putting half the portfolio in them is exciting and easy to communicate, but ultimately probably destructive. Managers at the top of the performance heap in any given quarter or year are very often taking these chances that other managers believe are unwise. Their risk taking, while exciting, can devastate the portfolio.

So we are resigned to conduct our profession in a way we believe is consistent with our fiduciary duties, but which will never generate a great TV ad. We take solace, however, that in the auto industry, reality did matter – unexciting, process-oriented Toyota is the winner. If you would like a rational investment process applied to your portfolio, call us at (503) 419-3938 or go to our web site [www.sigmainvestment.com](http://www.sigmainvestment.com) before we start proclaiming ourselves as the only investment managers using The Northstar System®.