

# Introduction

For the last twenty years I've been writing occasional memos to my clients—first at Trust Company of the West and then at Oaktree Capital Management, the company I cofounded in 1995. I use the memos to set forth my investment philosophy, explain the workings of finance and provide my take on recent events. Those memos form the core of this book, and you will find passages from many of them in the pages that follow, for I believe their lessons apply as well today as they did when they were written. For inclusion here I've made some minor changes, primarily to make their message clearer.

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**PAUL JOHNSON:** *I never had a single text to use in teaching my investment courses at the Columbia Graduate School of Business until I read Howard Marks's The Most Important Thing. I used his book in the fall of 2011 as the primary text in my course on value investing and security analysis. Marks's discussion was an excellent complement to my lectures.*

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What, exactly, is “the most important thing”? In July 2003, I wrote a memo with that title that pulled together the elements I felt were essential

for investment success. Here's how it began: "As I meet with clients and prospects, I repeatedly hear myself say, 'The most important thing is X.' And then ten minutes later it's, 'The most important thing is Y.' And then Z, and so on." All told, the memo ended up discussing eighteen "most important things."

Since that original memo, I've made a few adjustments in the things I consider "the most important," but the fundamental notion is unchanged: they're *all* important. Successful investing requires thoughtful attention to many separate aspects, all at the same time. Omit any one and the result is likely to be less than satisfactory. That is why I have built this book around the idea of the most important things—each is a brick in what I hope will be a solid wall, and none is dispensable.

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**PAUL JOHNSON:** *This comment is a theme that runs through The Most Important Thing and is critical to Marks's view of investing. I believe the most challenging investment concept to explain to graduate business students is that investing requires the concurrent balancing of many different fundamental issues. The Most Important Thing does an excellent job of making this point clear.*

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I didn't set out to write a manual for investing. Rather, this book is a statement of my investment philosophy. I consider it my creed, and in the course of my investing career it has served like a religion. These are the things I believe in, the guideposts that keep me on track. The messages I deliver are the ones I consider the most lasting. I'm confident their relevance will extend beyond today.

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**HOWARD MARKS:** *This book is primarily about what I call "the human side of investing." It does not offer much on financial analysis or investment theory—more how to think and how to deal with the psychological influences that interfere with investment thinking and a lot about the mistakes others make in their thinking. When I say "how to think," I don't mean to suggest that my process is the only way, just one example. You have to follow a disciplined thought process in order to be successful, but it doesn't have to be mine.*

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You won't find a how-to book here. There's no surefire recipe for investment success. No step-by-step instructions. No valuation formulas

containing mathematical constants or fixed ratios—in fact, very few numbers. Just a way to think that might help you make good decisions and, perhaps more important, avoid the pitfalls that ensnare so many.

It's not my goal to simplify the act of investing. In fact, the thing I most want to make clear is just how complex it is. Those who try to simplify investing do their audience a great disservice. I'm going to stick to general thoughts on return, risk and process; any time I discuss specific asset classes and tactics, I do so only to illustrate my points.

A word about the organization of the book. I mentioned above that successful investing involves thoughtful attention to many areas simultaneously. If it were somehow possible to do so, I would discuss all of them at once. But unfortunately the limitations of language force me to take one topic at a time. Thus I begin with a discussion of the market environment in which investing takes place, to establish the playing field. Then I go on to discuss investors themselves, the elements that affect their investment success or lack of it, and the things they should do to improve their chances. The final chapters are an attempt to pull together both groups of ideas into a summation. Because my philosophy is “of a piece,” however, some ideas are relevant to more than one chapter; please bear with me if you sense repetition.

I hope you'll find this book's contents novel, thought provoking and perhaps even controversial. If anyone tells me, “I so enjoyed your book; it bore out everything I've ever read,” I'll feel I failed. It's my goal to share ideas and ways of thinking about investment matters that you haven't come across before. Heaven for me would be seven little words: “I never thought of it that way.”

In particular, you'll find I spend more time discussing risk and how to limit it than how to achieve investment returns. To me, risk is the most interesting, challenging and essential aspect of investing.

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**PAUL JOHNSON:** *The Most Important Thing is the first comprehensive discussion of risk and its importance in the investment process that I have read. In fact, the strongest aspect of the book and its greatest contribution to the canon of investment wisdom is its extensive discussion of risk.*  
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When potential clients want to understand what makes Oaktree tick, their number one question is usually some variation on “What have been the keys to your success?” My answer is simple: an effective investment philosophy, developed and honed over more than four decades and implemented conscientiously by highly skilled individuals who share culture and values.

Where does an investment philosophy come from? The one thing I’m sure of is that no one arrives on the doorstep of an investment career with his or her philosophy fully formed. A philosophy has to be the sum of many ideas accumulated over a long period of time from a variety of sources. One cannot develop an effective philosophy without having been exposed to life’s lessons. In my life I’ve been quite fortunate in terms of both rich experiences and powerful lessons.

The time I spent at two great business schools provided a very effective and provocative combination: nuts-and-bolts and qualitative instruction in the pre-theory days of my undergraduate education at Wharton, and a theoretical, quantitative education at the Graduate School of Business of the University of Chicago. It’s not the specific facts or processes I learned that mattered most, but being exposed to the two main schools of investment thought and having to ponder how to reconcile and synthesize them into my own approach.

Importantly, a philosophy like mine comes from going through life with your eyes open. You must be aware of what’s taking place in the world and of what results those events lead to. Only in this way can you put the lessons to work when similar circumstances materialize again. Failing to do this—more than anything else—is what dooms most investors to being victimized repeatedly by cycles of boom and bust.

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**SETH KLARMAN:** *Keeping your eyes open also increases the probability that you will be prepared for something that has never before occurred. Warren Buffett stressed the importance of this during his search for a successor. Alertness can help to identify and possibly avoid growing risks before it is too late. Marks makes this point in chapter 5.*

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I like to say, “Experience is what you got when you didn’t get what you wanted.”

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**JOEL GREENBLATT:** *This is one of my favorite “Howardisms.” I have the opportunity to think of it often!*  
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Good times teach only bad lessons: that investing is easy, that you know its secrets, and that you needn't worry about risk. The most valuable lessons are learned in tough times. In that sense, I've been “fortunate” to have lived through some doozies: the Arab oil embargo, stagflation, Nifty Fifty stock collapse and “death of equities” of the 1970s; Black Monday in 1987, when the Dow Jones Industrial Index lost 22.6 percent of its value in one day; the 1994 spike in interest rates that put rate-sensitive debt instruments into freefall; the emerging market crisis, Russian default and meltdown of Long-Term Capital Management in 1998; the bursting of the tech-stock bubble in 2000–2001; the accounting scandals of 2001–2002; and the worldwide financial crisis of 2007–2008.

Living through the 1970s was particularly formative, since so many challenges arose. It was virtually impossible to get an investment job during the seventies, meaning that in order to have experienced that decade, you had to have gotten your job before it started. How many of the people who started by the sixties were still working in the late nineties when the tech bubble rolled around? Not many. Most professional investors had joined the industry in the eighties or nineties and didn't know a market decline could exceed 5 percent, the greatest drop seen between 1982 and 1999.

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**SETH KLARMAN:** *This fact may be one of the most shocking statements in this book. During this period, investors were lulled to sleep, anticipating double-digit annual returns while completely losing sight of the risks. Seventeen years ought to qualify as long term—it is roughly half of a career—yet a career built only during this period would hardly have withstood the test of time.*  
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If you read widely, you can learn from people whose ideas merit publishing. Some of the most important for me were Charley Ellis's great article “The Loser's Game” (*The Financial Analysts Journal*, July-August 1975), *A Short History of Financial Euphoria*, by John Kenneth Galbraith (New York:

Viking, 1990) and Nassim Nicholas Taleb's *Fooled by Randomness* (New York: Texere, 2001). Each did a great deal to shape my thinking.

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**PAUL JOHNSON:** *This is an excellent book list. Fortunately, students can now add The Most Important Thing to it!*  
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Finally, I've been extremely fortunate to learn directly from some outstanding thinkers: John Kenneth Galbraith on human foibles; Warren Buffett on patience and contrarianism; Charlie Munger on the importance of reasonable expectations; Bruce Newberg on "probability and outcome"; Michael Milken on conscious risk bearing; and Ric Kayne on setting "traps" (underrated investment opportunities where you can make a lot but can't lose a lot). I've also benefited from my association with Peter Bernstein, Seth Klarman, Jack Bogle, Jacob Rothschild, Jeremy Grantham, Joel Greenblatt, Tony Pace, Orin Kramer, Jim Grant and Doug Kass.

The happy truth is that I was exposed to all of these elements and aware enough to combine them into the investment philosophy that has worked for my organizations—and thus for my clients—for many years. It's not the only right one—there are lots of ways to skin the cat—but it's right for us.

I hasten to point out that my philosophy wouldn't have meant much without skilled implementation on the part of my incredible Oaktree cofounders—Bruce Karsh, Sheldon Stone, Larry Keele, Richard Masson and Steve Kaplan—with whom I was fortunate to team up between 1983 and 1993. I'm convinced that no idea can be any better than the action taken on it, and that's especially true in the world of investing. The philosophy I share here wouldn't have attracted attention were it not for the accomplishments of these partners and the rest of my Oaktree colleagues.

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**HOWARD MARKS:** *Through these annotations I want to recognize the wonderful people who contributed to the making of this book: Bridget Flannery-McCoy, Milenda Lee, Jennifer Jerome, Meredith Howard, and Noah Arlow of Columbia University Press, as well as my editorial consultant, Maggie Stuckey. Above all, I want to thank Myles Thompson for coming to me with the idea of doing a book with Columbia and guiding it to fruition. Finally, I want to add mention of my friend Peter Kaufman, who has contributed to my thinking by suggesting noninvestment parallels.*  
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THE MOST IMPORTANT THING  
*ILLUMINATED*

