

John Maynard Keynes as an Investor: Timeless Lessons and Principles

By John F. Wasik

Article Highlights

- Keynes genuinely enjoyed being a speculator and investor, and was able to adapt to some of the worst financial calamities.
- After concluding unpredictable “animal spirits” were the force behind market activity, Keynes altered his strategy to focus on the intrinsic value of stocks.
- His success in the 1930s came from pursuing low valuations, dividends, positive cash flow and future earnings and from following a buy-and-hold approach.

As an active investor, I am always searching for guideposts that would help me avoid the perennial mistakes most investors make.

How do I avoid buying at the top of a market or jumping out when my entire portfolio gets whacked? How do I keep the faith when there’s turmoil aplenty, as was the case in 2008? How important are dividends in a downturn?

In the portfolios of the great economist John Maynard Keynes, I found some answers and reinforcement. Like Keynes, I did nearly everything wrong for years until I discovered a durable path to investment success. I speculated in commodities, dove into individual stocks on a whim and held onto losers far too long.

I found solace, though, when I examined Keynes’ investments, which span two world wars. Even though I and millions of others have weathered brutal markets in this century, they had nothing on Keynes, who was investing money for King’s College (Cambridge University), two insurance companies and private accounts for himself and his famous Bloomsbury friends.

Although he’s better known for his sweeping—and controversial—economic theories, Keynes was a fervent practitioner of capitalism. His rousing success as an investor shows how he embraced markets nearly all of his life.

Viewing his record as an investor, it’s ludicrous to call Keynes a socialist, which he wasn’t. Keynes genuinely enjoyed being a speculator and investor. He called his favorite stocks



his “pets.” In addition to thinking through the ideas that would rescue Western economies (as well as Japan and eventually China) after two devastating cataclysms, he managed money for his own portfolio, his friends and several institutions.

Keynes was able to adapt to some of the worst financial and historical calamities. Although he was a harsh critic of capitalism and markets, he kept investing—and was rewarded. His experience provides solid grounding

for stock investors everywhere.

Keynes the Stellar Investor

Keynes learned from his mistakes and near financial ruin. He was able to move on, reach new conclusions about how to regard market movements and earn a place in the pantheon of great investors that includes Benjamin Graham, Warren Buffett and George Soros. It’s no small stretch to say that Keynes was also the godfather of behavioral economics and value investing at a time when such things had little or no currency.

Among other things, Keynes genuinely enjoyed being a speculator and investor. Keynes was most likely one of the first hedge fund managers and established some time-honored principles that the best investors follow today.

It was only after I went through thousands of brokerage account statements, ledgers, shareholder letters and portfolio summaries that Keynes’ investment personality emerged. Thanks to gracious access granted to me by the

Dollar Cost Averaging

An analysis of Keynes' early personal portfolio shows how he was buying and selling one of his favorite stocks at the time: U.S. Steel. Keynes consistently purchased shares at lower prices, thus reducing his average cost. The shares he sold were within 10% of the highest purchase price.

This is dollar cost averaging, a method that has worked for decades because it avoids buying at the absolute highest price and selling at the lowest. This is a good method for long-term, buy-and-hold investors who want to own companies that offer dividend-reinvestment plans, where new shares can be purchased—preferably on a regular basis—at no commission. If Keynes liked a stock, he kept buying it and was encouraged when the price came down, so he bought more and got better bargains.

Table 1. Dollar Cost Averaging Transactions of U.S. Steel

Year	Action	Shares	Price (\$)
1911	Buy	10	71¾
1912	Buy	10	60¾
1912	Buy	10	66¾
1912	Buy	20	66¾
1912	Sell	10	68¾
1912	Buy	10	65
1913	Buy	10	66⅓
1913	Buy	20	65¾
1913	Buy	30	65¾
1913	Buy	30	61½
1913	Buy	30	62
1913	Sell	10	67
1913	Buy	20	59½
1913	Buy	20	60⅔

King's College archives at Cambridge University, I was able to piece together a side of Keynes that most economists have never seen. The narrative starts with a brilliant Cambridge lecturer who is starting to make his way in academia after an unsatisfactory post in the India Office prior to World War I.

Early Investments

It's at the end of the 20th century's first decade that we see Keynes' growing interest in markets, investing and speculation. In his lecture notes, we see a curious Keynes who has, up until that point, little direct engagement in investing, but a yearning to explore. His lecture on the stock market in 1910 calls it "essentially a practical subject, which cannot properly be taught by book or lecture."

According to economist and professor Victoria Chick, whom I interviewed in London in March 2013, Keynes "loved gambling and was always one to get involved in a card game." But it was a penchant for market speculation and his friendship with stockbroker Oswald Falk that propelled Keynes to explore the markets just before World War I. When

I asked his biographer, Lord Skidelsky, when he first saw evidence of Keynes' serious interest in investing, he surmised it was before 1910, when "like Soros, I think he used the financial markets to test his theory of probability." Keynes had begun work on a book on probability—later published in 1921 as "A Treatise on Probability"—prior to the war.

Before World War I, Keynes was mostly unchastened in the stock market. (The box above shows an example of his trading activity in one stock.) Since he didn't have inherited wealth—and lecturing at Cambridge didn't pay much at the time—he didn't really start investing in earnest until 1914, according to the editor of his papers, Donald Moggridge.

Using his knowledge of international finance, Keynes took to the currency markets with abandon. Floating currencies, which had been fixed before 1914, were notoriously volatile at the time, but Keynes thought he had the advantage of "superior knowledge." Believing that post-war inflation would hurt the values of the French franc, German reichsmark and Italian lira, Keynes shorted those currencies. This transaction made money if the currencies dropped in value relative

to other, stronger currencies such as the British pound or U.S. dollar. He went long on the Indian rupee, Norwegian and Danish kroner and U.S. dollar.

"He wanted to make money in a hurry in the 1920s," Skidelsky told me, "and thought gambling on currencies (when currencies were floating in the early 1920s) was the way to do it."

Along with Falk, his brother Geoffrey and Bloomsbury friends, Keynes set up an investing syndicate in 1920, which many financial historians claim was one of the first hedge funds. Rather than manage money for preservation of capital or yield, Keynes was speculating pure and simple. At first, his strategy paid off, netting \$30,000 for his investors in the first few months. By April 1920, notes Liaquat Ahamed in "The Lords of Finance: The Bankers Who Broke the World" (Penguin, 2009), Keynes made an additional \$80,000, which was astounding considering that most of Europe was essentially broke from the war. Then something unexpected happened, according to Ahamed: "Suddenly, in the space of four weeks, a spasm of optimism about Germany briefly drove the declining European currencies back

Portfolio Snapshot: A.D. Investment Trust Ltd.

As another virtual hedge fund, A.D. Investment Trust Ltd. was founded by Keynes and his associates at the British Treasury in July 1921. Keynes was a director until November 1927, when he sold all of his shares. From 1923 through 1927, dividends were 10% annually. After Keynes left, the firm didn't survive the 1929–32 sell-offs.

This was largely a commodity price-oriented portfolio that focused on the rise of commodity prices in the wake of World War I. Even the portfolio's stocks reflected growing demand for staples like rope, metals, oil and food. Currency speculation was also part of the mix. As the decade wore on, though, the portfolio direction headed more into stocks and less in commodities and foreign exchange.

As you can see in Table 2, this is a classic example of what Keynes called “opposed risks,” where gains in one asset class could offset losses in another. While he was losing money in commodities, for example, he was making money in stocks. If it weren't for the fact that this was

Table 2. Breakdown of Profits by Asset Class

Years	Currencies (£)	Commodities (£)	Stocks (£)
1921–22	5,000	5,400	3,600
1922–23	14,400	(6,400)	3,600
1923–24	(300)	28,300	0
1924–35	2,000	(15,000)	14,500
1925–26	1,500	(700)	2,600
Totals	22,600	11,600	23,400

Source: Collected Works of Keynes, Vol. XII, p. 32, King's College Archives.

a highly speculative and risky portfolio, this would be a good example of diversification that shows how holding relatively uncorrelated assets can amount to overall gains. Ultimately, though, at the end of this sampled holding period, stocks would be the winning asset class.

up, wiping out their entire capital.”

Embarrassed, though willing to get back on the speculation horse to make up the losses he suffered for his friends and family, Keynes re-invested in currencies following his 1920 shellacking. It also helped that he was staked by his father and wealthy investors, who had unwavering confidence in Keynes.

The Roaring 1920s

As a trader who believed that he could profit from the impact of supply and demand curves, Keynes became enraptured with the idea of commodities trading in the 1920s. Europe clearly needed every kind of commodity to rebuild after the Great War. Prices generally followed the demand. There were opportunities for astute speculators and Keynes started researching and writing about commodities in the early 1920s for the London and Cambridge Economic Service and Manchester Guardian. A glimpse of how he invested during this time period can be seen in the A.D. Investment Trust Ltd. portfolio snapshot, shown in the box above.

How did Keynes do overall during the 1920s? While it's difficult to tell because he traded so many contracts in the 1920s, Skidelsky found that in 1927 his net assets totaled some \$3.4 million (in today's dollars). But everything in world markets began to change in 1928, when prices began to drop and Keynes was still long in rubber, wheat, cotton and tin. After the stock market crash of 1929, he would eventually lose some 80% of his net worth, forcing him to put some of his paintings on the market (though he ended up not selling them).

By the end of the decade, Keynes' foray into commodities ended much the same way the 1920s began (with currency losses), only worse. He was on the wrong side of most of his trades when demand collapsed. By 1930, after Wall Street crashed and the world plunged into the Great Depression, wholesale prices had plummeted 20%. Many commodities took a 50% hit.

The Great Depression and World War II

Having lost the bulk of two fortunes,

Keynes re-oriented his thinking about trying to predict market movements. If one couldn't rely upon a mountain of data analysis and speculative insights on supply and demand, then what was left? In his 1936 book “The General Theory of Employment, Interest and Money,” he concluded that “animal spirits” were the force behind market activity. They were hard to reckon with and impossible to predict, so he needed to adjust to this unpredictable current of irrationality.

As he began to step outside the bounds of classical economics, he was doubtless influenced by his investment failures. Instead of trying to anticipate the market, Keynes now focused on the enterprise, or intrinsic, value of what stocks were worth. He drastically reduced his commodity positions. Then he latched onto high-dividend stocks in the 1930s, when most traders were out of the market. It was this contrarian view that launched Keynes as not only one of the first value investors, but as a long-term investor who turned his back on short-term valuations and market trends. Even more remarkable was that

Keynes' 10 Keys to Wealth

1. Over time, stocks beat bonds. Although this is not always true—it depends upon the time period studied—it's generally true. From 1926–2011, large-company stocks returned an average 9.8% and small-company stocks returned 11.9%, according to Ibbotson Associates. This compares to 6.1% for long-term corporate bonds and 3.5% for U.S. Treasury bills. If you want capital appreciation combined with income, then stocks are still a potent long-term choice for most investors.

2. Speculation is a dangerous game. Keynes thought he could play the fluctuations in currency and commodity markets with his “superior knowledge.” It may be easy enough to digest a ream of statistics and figures about past and present market conditions, but your research may have no predictive value for the future.

3. Probability is not the same thing as uncertainty. You may have some excellent analysts' estimates on earnings predictions and bond yields or the latest technical charts on various cycles. But, as Keynes discovered, it doesn't absolve you of the market's uncertainty about a stock or the economy.

4. Opposed risks will help balance your portfolio. You need to invest in a mix of assets that are truly uncorrelated during market downturns to give you real diversification.

5. Take advantage of the value quotient. In the 1930s, when markets were tumbling, Keynes decided to focus on a company's “intrinsic” value. How much was it worth when it was broken up? What was its franchise/enterprise value, or competitive advantage? What would generate profits into the future? Was it raising its dividends?

6. Dividends don't lie. Dividends are paid out every quarter and represent a share of a company's earnings. When Keynes loaded up on utility companies in the 1930s, he did so to buffer his portfolio and to grab an income stream.

7. Don't move with the crowd. Being a contrarian pays off. Find healthy, unloved companies and stick with them. You'll do much better finding underdogs and holding them than buying today's popular stocks and hoping they'll gain value.

8. Invest for the long term. Even if the current environment looks dismal, if you have a long-range investment policy—and it still works for you given your appetite for risk—stick with it. Rebalance once a year to ensure that you're on course and not loading up in any one asset class.

9. Invest passively. Given that you can't divine the state of long- or short-term expectations because animal spirits are doing their mischief, put most of your money in cheap index funds. The cost difference that index funds offer is always in your favor and allows you to build more wealth.

10. Drink more champagne! This is said to have been Keynes' one regret—that he had not enjoyed life more and drank more bubbly. The object of investing is to ensure prosperity, not become obsessed with making money. So put your investing on autopilot with a sound plan that meets your goals and monitor it once a year. Then go out and live.

Excerpted (edited) from “Keynes's Way to Wealth,” by John F. Wasik.

Keynes stuck to his new investment theory during one of the most turbulent decades for stocks in history.

More importantly, the results from this tumultuous period show Keynes' resilience and willingness to adapt to changing markets. Keep in mind that during the Great Depression, there were a series of recessions followed by stock market comebacks. Although Keynes wasn't able to avoid some of the largest sell-offs in 1930–31, 1938 and 1940, the King's College Chest Fund had a winning streak from 1932 to 1937, a period in which U.S. stock

market losses ranged from 25% to 43% annually. Over those six years, U.S. big companies lost money in three annual periods. Considering the time in which he was investing, Keynes showed either amazing skill or sizzling luck.

Looking at two of the worst-recorded years for large U.S. stocks—1931 and 1937—Keynes did reasonably well. He only lost about 25% in 1931 when the U.S. stock market lost 43.3%. In 1937, he gained 8.5%, while the U.S. market lost 35%. He beat the U.K. market in 12 out of 18 years.

Much of Keynes' innovative style

was fueled by his growing preference for stocks, although he contributed a plethora of insights and advances to institutional money management as well. David Chambers of the Cambridge Judge Business School and Elroy Dimson of the London Business School published a study in the *Journal of Economic Perspectives* last year that showed that “Keynes' experience in managing the [King's College] endowment remains of great relevance today.”

What's even more remarkable is that Keynes was not only managing money for King's College during his heyday,

but also managing institutional funds for National Mutual Life Assurance Society, the Provincial Insurance Company and personal funds for himself, friends and colleagues.

As Table 3 shows, Keynes pivoted from his losing macro strategy in the 1920s, in which he underperformed indexes from 1926 through 1928, to a more bottom-up style thereafter. His outstanding performance reflects his modified style: He only fell behind market indexes once in the 1930s (1938 was his worst year, but it was also dismal in the U.S.) and once in the 1940s. His Sharpe ratio (risk-adjusted performance) and average performance were excellent as well.

Keynes the Investment Innovator

Keynes' performance under fire during the 1930s and World War II (his street in London was literally bombed) inspired several generations of investors who followed. His dogged pursuit of value stocks, dividends, cash flow and future earnings established him as a durable "buy and hold" investor who was confident he would be rewarded in the long run.

After his death in 1946, the vindication of Keynes' portfolios proved that he deserved to be emulated. Although

his estate was worth at least \$22 million (in 2013 dollars) when he died, his contribution to the arts, modern economics and a more stable global economic climate is incalculable.

As an investor, he championed the merit of examining the "earning power" of stocks, looking deep into the ability of a business to survive in a variety of economic conditions, and the abandonment of market timing and speculation.

The larger message from Keynes' investment style is that if he saw value in a company, he ignored the short-term "noise" of the market and held onto a company he saw as a worthwhile enterprise. He was always looking ahead and didn't particularly like selling a stock. And if a stock paid dividends, that was icing on the cake.

Even more significant is his recognition of "animal spirits" and the role that mass psychology plays in investing and markets. In doing so, he tackled one of the most elusive—and powerful—elements of markets, behavior that modern economists have yet to fully understand, much less predict. ▲

Table 3. Keynes at King's: Performance From 1925 Through 1946

Year	Discretionary Portfolio (%)	U.K. Equity Index (%)	Difference (%)
1925	30.26	17.33	12.93
1926	6.40	11.83	(5.43)
1927	2.00	19.90	(17.90)
1928	3.04	16.99	(13.95)
1929	7.29	5.40	1.89
1930	(12.48)	(17.58)	5.10
1931	(5.70)	(30.17)	24.47
1932	29.19	27.33	1.86
1933	54.39	27.04	27.35
1934	26.13	13.15	12.98
1935	34.75	7.95	26.81
1936	40.00	19.08	20.92
1937	11.20	0.63	10.57
1938	(22.75)	(8.64)	(14.11)
1939	10.64	(5.17)	15.81
1940	(7.07)	(21.08)	14.01
1941	30.55	27.24	3.31
1942	8.35	9.38	(1.02)
1943	39.29	26.97	12.32
1944	14.20	10.86	3.34
1945	12.52	3.65	8.87
1946	22.41	15.62	6.79
Average	15.21	8.08	7.13

Source: Annual Reports to Inspectors of Accounts for King's College for financial years ended in August, estimated by Chambers and Dimson in the Journal of Economic Perspectives. Table is condensed to exclude restricted fund returns, although average returns are reflected in the "total" fund performance.

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