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## Zen and Wall Street: profile of a philosopher-investor

### **Abstract**

Extract:

Having spent sixteen years teaching philosophy in Singapore, half a year in Hong Kong, and a few months near Shanghai, the three major financial centres in Cultural China, I have been unwittingly exposed to the brutality and intricacies of the business and financial world. I am particularly interested in the psychology of stock trading which could benefit greatly from Zen and Taoistic cultural resources.

### **Keywords**

business, finance, Zen, Taoist philosophy

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### *Viewpoints:*

## **Zen and Wall Street: Profile of a Philosopher-Investor**

*by Martin Lu*

I knew Wesley since we studied philosophy together in the late 1960s and early 1970s in the United States. He was at one time studying for the Christian priesthood and subsequently switched to philosophy. A few years ago, after having retired as a philosophy professor and a college vice president, he became a Wall Street investor. During the period of 1999-2002, when the portfolios of most investors and mutual funds had been devastated, he paid taxes on hundreds of thousands of dollars. I was curious about his performance and asked him whether his cultural and religious background had anything to do with his outstanding stock-trading performance.

"The major pitfalls in investment are buried deep in the emotional recesses of the individual," he replied. "In other words, the enemy is not the fluctuating circumstances in the world; it is the individual himself." As a Chinese and a philosopher, he was aware of Taoist and Zen cultural characteristics, such as "tranquillity as the foundation of wisdom" (*Platform Sutra*), "the illusiveness of all phenomenal forms (manifestations)" (*Diamond Sutra*), "reversal as the movement of the Tao" (*Tao Te Ching*), and "fasting of the mind" (*Chuang Tzu*).

Having spent sixteen years teaching philosophy in Singapore, half a year in Hong Kong, and a few months near Shanghai, the three major financial centres in Cultural China, I have been unwittingly exposed to the brutality and intricacies of the business and financial world. I am particularly interested in the psychology of stock trading which could benefit greatly from Zen and Taoistic cultural resources.

I reestablished contact with Wesley in September 2002, after an absence of communication for about 25 years. So we started email and instant-message exchange of ideas on various topics. After a while our topics were narrowed down to philosophy and stocks. I soon realized that I had much to learn from him about Wall Street, and there is room for cooperation between us in the area of cultural resources and stock-trading.

### ***Matching the Three Phases of Taoist Philosophy to Wall Street***

According to Fung Yu-lan, one of the most eminent Chinese philosophers of the 20<sup>th</sup> century, the original concern of philosophical Taoism (flourishing between 6<sup>th</sup> and 3<sup>rd</sup> century b.c.) is "how to preserve life and avoid harm and danger in the human world."<sup>(1)</sup> We could compare this Taoist concern with the investor's primary aim of "how to preserve capital in the tumultuous world of finance." Professor Fung classifies Taoism into three different phases, which seem to parallel the three progressive and ambivalent attitudes of the investors toward Wall Street.

During the first phase, the early Taoists were mostly recluses or hermits who "thought that the world was so bad that nothing could be done for it."<sup>(2)</sup> Similarly, for the many small investors who have lost money in the stock market, it is the symbol of greed, risk, and irresponsibility (if not outright fraud) meant for reckless gamblers and speculators, and not for conservative decent people. Even today, in much of the world including Japan, most people still harbour this attitude towards the stock market. This helps explain why the savings rate for Japan is so high and its current interest rate has reached an historic low. Stock-owning culture is not as prevalent in many countries as in the U.S. Hence a great many investors still hold this aloof attitude towards the market and the recent account

scandals only confirm their long-held suspicions.

During the second phase of Taoist development, the recluse realizes that "though things (in this world) are ever changeable and changing, the laws that govern this change of things are not themselves changeable".(3) The most fundamental of these principles is: "Reversing is the movement of the Tao".(4) This law finds expression in the following: "When a thing reaches one extreme, it reverts from it." "It is upon calamity that blessing leans, upon blessing that calamity rests."(5) "A hurricane never lasts the whole morning, nor a rainstorm the whole day."(6) Adherents believed that if they followed these principles in life they could turn things to their advantage.

The above could well be applied to movements in the stock market. Thus parallel to this Taoist second phase, investors who have learned from their losses and failures in the stock market may be emboldened by some successes in a bull market and take a second look at the way the market functions. Perhaps there are also invariable trading principles on Wall Street which, if followed, could lead to financial rewards and even fortunes. The effectiveness of trading principles is the philosophy behind most financial advice offered by investment gurus and their books, and behind the majority of traders and active investors.

The logic is quite simple: If there are no rules to follow on Wall Street, there is no rationale and basis for professional fee-charging advice, and active day traders will have no rational reasons to trade either. But the devastating bear market of the last two years has shown that normally effective principles do not protect the funds and portfolios managed by seasoned financial advisers. Many of these funds have depreciated by more than 50% and some of the high-flying hedge funds have even gone into involuntary liquidation bordering on bankruptcy.

And if we look at the major banks listed on Wall Street, their investment decisions of lending millions of dollars to companies such as Enron and WorldCom indicate that their financial savvy leaves much to be desired, not to mention the apparent conflict of interest between their investment banking and research analysis sections. Under these circumstances, ordinary investors are justified to ask: "Why do we give money for them to manage? They do not even know how to manage their own money." In fact, a trend has emerged for affluent investors in the U.S. to abandon their full service financial advisers and instead manage their own money. With the readily available access to financial information on the internet, investors are likely to become increasingly self-reliant in their investment approach - a factor which would have a far-reaching impact on the financial service industry.

According to Fung Yu-lan, at the third phase of Taoist development, the original Taoist problem of "how to preserve life and avoid harm and danger" could be resolved by taking a higher point of view through identifying ourselves with the nature of things and with the universe. To illustrate this higher point of view, Professor Fung quotes this saying of Chuang-tzu (a Chinese Taoist living between 399 and 295 b.c.):

The universe is the unity of all things. If we attain this unity and identify ourselves with it, then the members of our body are but so much dust and dirt, while life and death, end and beginning, are but as the succession of day and night, which cannot disturb our inner peace. How much less shall we be troubled by worldly gain and loss, good-luck and bad-luck! (Ch. 20.)

So the original Taoist problem of "avoiding harm and danger" is finally resolved by abolishing it. In other words, if the rotation of life and death is as natural as day and night, there is no question of physical harm and danger. The inspiration of the aforementioned Taoist wisdom for Wall Street is this: initially we are concerned about losing money (first phase), then we are very self-conscious about gain and loss (second phase), and finally we identify our overall investment objective with the whole economy and are not easily disturbed by the daily fluctuations on Wall Street (third phase).

To be sure, it is not easy for most investors to attain this Taoist and Zen imperturbability, but we could at least try to adopt a detached attitude towards the market without being unduly disturbed by

its daily fluctuations. For example, small investors like us cannot help being influenced by market highs and lows if our investments are exposed to the market. But Bill Gates, probably the wealthiest person in the world, will not be as affected. Our investment psychology is such that we could actually perform better if we manage to keep a distance from it, not to mention the peace of mind generated as a result.

Having drawn the parallels between Taoism and investment psychology, I shall now focus on the second and third stock-trading attitudes, the principle-oriented and Zen Tao (the Way of Zen) approaches. Without going too much into the philosophical details, the reason I refer to Zen Tao rather than simply Zen or Tao is that Zen Buddhism is the philosophical offspring of Buddhism which introduced from India and the indigenous Taoism of China. As a result, Zen Buddhism and Taoism are to some degree mixed with each other. Some scholars even wonder whether Zen Buddhism is actually more Taoistic than Buddhist. Thus I would use Zen or Zen Tao to refer to a philosophical attitude sharing some common features of Zen Buddhism and Taoism without delving into the nuances of their philosophical differences.

I shall next discuss the difference between the prevailing principle-oriented stock-trading approach and the Zen approach highlighted in this essay. Wesley's stock-investment style as illustrated below is neither fundamental nor technical. He pays attention to the fundamentals of the companies in which he invests, but he also heeds the overall technical tone of the market. I would not say that his style fully imbibes the salient qualities of the Taoist sage adumbrated above, but there is an undeniable Zen feature to it. If we want to characterize it in Taoist terms, his style tends to fit in between the second and the third phase Taoist mentality.

A similarity may be found in a world-class golfer or a chess-master who has transformed his principle-conscious skill (the second phase) into an art-form (the third phase of a higher point of view) going beyond the rules and principles. Confucius once said that when he was at the age of 70 he could follow his heart's desire spontaneously without trespassing the conventional rules of conduct. In other words, he had so assimilated the rules that they had become part of his own wisdom. Likewise, a Zen-style stock investor would have so digested the prevailing principles of trading that they have also been absorbed into his spontaneous and intuitive trading self.

### ***Zen Koan and the Taoist Wisdom of Non-Action***

Everyday around the trading world, thousands of stock traders, fund managers, and financial advisers are literally glued to the stock screen, watching the irrational and random fluctuations of the stock prices with the hope of making profitable trade for themselves or their clients. The intense concentration and accompanied anxiety could be comparable with studying the Zen *koan* with the goal of attaining enlightenment.

So to be consistently successful on Wall Street could not be a matter of luck: it hinges upon the Zen wisdom lying deep below the conscious and rational surface of our mind (in conventional language) or no-mind (to use Zen terminology). This secret of success has often been equated to principle-oriented trading skill, multi-levelled dynamic software, or competent chart-reading and prediction. To be sure, the usefulness of advisory services also help. But the accounting scandals, illegal and unscrupulous manipulations by chief executive officers and financial officers have played havoc with the company financial statements scrutinized closely by the fundamentals analyst. Nowadays, the financial statements - along with its much followed price-earning ratios - could only be taken with a grain of salt. In fact, during this bear market of the last three years when a stock suddenly dropped it would be safer just to take note of the technical signals and sell it.

Let us next discuss how Taoist non-action could be applied to Wall Street. Very often "what not to do" or simply "doing nothing and let nature take its own course" is more important than "what to do". The legendary story of Jesse Livermore, immortalized in *Reminiscences of a Stock Operator*,<sup>(7)</sup> has left an indelible imprint on generations of stock investors and speculators eighty years after its first

publication in 1923. Some of his remarks on stock-trading principles could be better appreciated from the perspective of the Taoist non-action (*wu-wei*) rather than the principle-oriented positive approach in Western culture.

The stock-trading lessons and reflections which Livermore stated during his time are still as true and relevant nowadays:

The desire for constant action irrespective of underlying conditions is responsible for many losses in Wall Street even among the professionals, who feel that they must take home some money every day, as though they were working for regular wages.(8)

He also stresses the value of non-action in the face of uncertainty:

There is nothing like losing all you have in the world for teaching you what not to do. And when you know what not to do in order not to lose money, you begin to learn what to do in order to win. Did you get that? You begin to learn!(9)

During his trading career, he had made and lost several fortunes. He had learned that "what not to do" is more important than "what to do". For the Chinese Taoist, the Tao (the Way) cannot be expressed in words. Thus the opening statement in the *Tao Te Ching* is: "The Way that can be expressed in words is not the invariable Way." Similarly in the Zen Buddhist sutras of the *Diamond Sutra* and the *Platform Sutra*, the ultimate truths of Tathagata (suchness), Nirvana, or Buddhahood, are always explained in terms of what it is not rather than what it is. The *Diamond Sutra* teaches:

Whosoever are "positive forms and material characteristics (xiang)" there is delusion; but whosoever perceives that all "positive forms and material characteristics" are in fact no "positive forms and material characteristics" perceives the Absolute Reality of suchness (Tathagata).(10)

### ***My Investment Style (Wesley)***

Martin,

My investment style could be explained as follows:

1. Advisory Services: I began writing a book on stock trading but never completed it. The first one line, of the first chapter: Never trust your brokers. All the conflict of interest you heard lately, I figured this out long, long ago. I have never used them for advice. Advisory services are also not good. I just want data and make my own decisions.
2. Capital Protection: How do I protect myself in a down market? I get out before it is too late; sometimes even months before the market collapses. Sometimes the cash sits in the money market for months waiting to be invested. So, you must be patient: a Zen and Taoist virtue. One fatal mistake most people make, brokers and advisers in particular, is that they overstay. When the market collapses, they have all the money tied up and have nothing with which to buy stocks at cheap prices. You must build up cash in order to be able to buy cheap stocks.
3. Risk Management: Yes, I cut losses, usually for 2 main reasons: a) I feel the overall market is moving up, so I move in. Then within days I notice that it was a false move; so I would move out b) I buy into a stock and then someone exposes a scandal within the company. I get out.
4. Bottom Fishing: My preferred technique is to buy when it hits bottom, not when it is on the way down. I have to make a judgment as to when it hits bottom.

### ***My Recent Performance Record (Wesley)***

Martin,

In good times anybody can make money, but that is not due to skill, because rising tides lift all boats, including sinking boats. Real skill comes into play when it is a down market. In 1999, 2000 and 2001, I made so much money when many others lost money. I paid capital gains taxes of more than \$200,000 in 3 years. (More than \$100,000 in 1999 alone!) The years 2000 and 1999 were very good years for me. On some days my portfolio went up \$90,000 in a single day and did this repeatedly, in lesser amounts, such as \$40,000 and \$30,000. In 1999, my paper profit was \$12,000 at the beginning of the year and by year's end, it went to \$280,000.

I was a Vice President of a college then, and one of my deans came into the office every day after the market closed and his first question was: "How much today?" I have refined my method to a point where I am very confident of its success. I do not play with Spiders (SPY, an exchange traded closed-end fund tracking the S and P 500 index), but I study them and understand them. There is room for investing in Spiders or index funds, etc., but I prefer to stick to individual stocks.

In a bull market environment, valuation tends to be rich; in a bear market environment, value is cut substantially. Thus conventional valuation is useless, not reliable. It is better to pay attention to the overall market. In an up-market, do not sell too quickly; it takes a stock 3 to 9 months, sometimes even longer, depending on the kind of stock and other factors, to reach a peak. This is not a hunch; it is a studied decision. When I decide to buy a stock at a certain price, I ask first: how far can it go up. Say, the price is \$5; target is \$10. I would reject it. Why? Because there is another stock which is selling at \$10, the target is \$35.

### ***Pitfalls of False Rallies***

Zen Saying: Patience (forget yourself and the market) is a Zen wisdom derived from long-term market meditation.

Market comments: There are always bear-market rallies, which may last a day or two, sometimes longer. But if there is no follow-through for a few sessions, invariably the rallies will fizzle out. So the moral is: Do not take any rallies as buying and turnaround signals. In the end, earnings are what support a sustainable good market.

It is always better to hold five or six positions which you have researched thoroughly and watch their movements. Never buy a diversity of stocks including mutual funds. In 2001 and 2002, there are thousands of mutual funds that lost more than one-third to half of their value.

Do not buy stocks which "hold the ground" but those which are beaten down, near the bottom, and have good products.

### ***Zen and Defensive Stocks***

Zen Saying: Walk when you walk; stop when you stop. But by no means should you wobble.

Trading Wisdom: Either you are in the market or out of the market. But never pretend to do both by buying "defensive stocks", which are often waiting for hits because of their usually high valuations.

### ***Concluding Remarks on "Zen and Stock Trading"***

*Martin:* Our dialogues on "Zen and Wall Street" are now coming to an end, Wesley. Could you summarize again: How is Zen related to stock trading?

*Wesley:* The justification is here: the major pitfalls in investment are buried deep in the emotional

recesses of the individuals. In other words, the enemy is not the fluctuating circumstances in the outside financial world; it is the individual himself. Zen has much to say about self-control, or mental cultivation and discipline in our conventional language.

*Martin:* To use the Zen language, our goal is to bring about the state of spontaneity or no-mind so that we are not too self-conscious about the results of our trading actions. To watch the screen day in and day out is almost like meditating on a Zen *koan*.

There is No Self and No Mind in Zen Buddhism. In the *Diamond Sutra*, the Absolute Reality cannot be expressed conceptually and verbally. It uses the negative rather than positive approach to indirectly "point to" Absolute Reality, stating "what it is not" rather than "what it is".

*Wesley:* I agree with this characterization of investors from the Zen perspective. There are many ways that stock trading may go wrong; so avoiding them is important. And I would add that the best investment approach is NOT necessarily the well-travelled way; the best way is frequently not taken by the crowd and less travelled.

I would give a list of good stocks for an individual to buy and the person could still lose money. He or she might buy too early, or might buy at the right time but pay too high, or might buy at the right price and time, but then sell prematurely, and so on.

*Martin:* We should concentrate on "not to lose" rather than "how to gain". We should also spend most of the time watching but doing nothing (Taoist non-action) rather than getting involved. Remember the story I told you about the hermit investor who lived somewhere in the mountains and came down to town to check stock prices once a week. He was so detached from the market and unemotional that he actually performed better than most day traders or fund managers glued to the screen all the time.

*Wesley:* You are right. What I am trying to do now is to select a handful of stocks that are well positioned to take off when the market turns up. If the market does not turn up, then I could have stocks that do not go down substantially. In other words, we have to protect the asset when we are wrong.

We could sit back in the Taoist fashion and enjoy ourselves only if we are actually well-positioned. If we are not well-positioned, the market will move up without us on board.

*Martin:* As a philosopher you are able to broaden your professional training and specialization from the ivory tower of the university into Wall Street, the heart of American capitalism. As a result, we understand better both the stock market and another practical aspect of Zen. This could be conducive not only to more profitable investment but also to more promising Zen enlightenment in our mundane lives.

Many thanks, Wesley, for your time in our email communications and instant message conversations in the last few weeks.

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