Asset allocation

Filings shed light on the secrets of 'super investors'

Highly successful investors who regularly trounce S&P 500 eschew macro forecasting

Smart Money

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5 HOURS AGO by: **Miles Johnson**

In recent years the idea that no person or fund can consistently outperform the wider stock market by skill alone has been fashionable. Emboldened by traditional investment houses haemorrhaging market share (http://next.ft.com/content/856a0372-e897-11e6-893c-082c54a7f539) to automated passive funds the once-maligned advocates of the efficient market hypothesis have revised their mantra: you can't beat the market, so buy an exchange traded fund (http://next.ft.com/content/00a1c748-be1b-11e6-8b45-b8b81dd5d

080) instead.

Outsiders listening in to this debate may conclude that research-based investment in the stock market (http://next.ft.com/content/fddca86c-7ab7-11e6-ae24-f193b105145e) is a fool's errand, and that anyone who has done well for any period is no more skilful than a gambler at a roulette table. This is simply wrong. An examination of the evidence shows that there are a small number of highly successful investors that have consistently trounced the S&P 500. The question that needs to be asked is what is this small group doing that has proven so painfully elusive (http://next.ft.com/content/12dcd476-bc4e-11e6-8b45-b8b81dd5d080) to the rest of their industry?

Using analysis of US regulatory filings by WhaleWisdom (https://whalewisdom.com/), a data provider, we are able to look back at the record of almost every large investor from the start of 2001. According to WhaleWisdom's analysis of quarterly 13f filings the long US stock picks of David Tepper's Appaloosa have made 1,324 per cent since 2001, compared to a 142 per cent for the S&P 500 index over the same period. Mason Hawkins' Southeastern Asset Management has made 435 per cent over the same timeframe, while Seth Klarman's Baupost has made 368 per cent. Steven Mandel's Lone Pine has made 361 per cent, and Berkshire Hathaway is up 287 per cent on this basis.

Of course this methodology is not perfect. US 13f forms lag by a quarter, meaning the information used to compile the performance is always incomplete. These filings also do not show how these investors' other positions, such as their short book or bond holdings have done. But because these investors tend to be highly concentrated and hold their stock positions for a long time the analysis is meaningful, unlike say a similar exercise for a large mutual fund with thousands of holdings or a high-frequency trading outfit.

So what are these "super investors" in the stock market doing that allows them to so roundly demolish the performance of their rivals? All are different, but they share some similar traits and none of them are particularly new or innovative. Firstly, from their public statements these investors tend to ignore or place little emphasis on macro forecasting. Almost all of these investors have recognised that trying to accurately assess how fast the economy will grow this year, or when the Federal Reserve will raise rates is a waste of time and provides them with no investment edge.

Instead they invest in businesses and industries, not stocks. Market watchers are prone to being so utterly focused on prices moving up and down that they forget that stocks represent fractional ownership of real businesses. Looking back over the holdings of these investors one of the things that stands out is their depth of analysis helping them spot large mispricings and long-term structural changes in industries years ahead of Wall Street.

David Tepper's investment in US airlines is a good example. Appaloosa began building up a position in Delta Air Lines (http://markets.ft.com/data/equities/tearsheet/summary?s=us:DAL) and United Continental (http://markets.ft.com/data/equities/tearsheet/summary?s=us:UAL) as early as 2009 at a time when the US airline sector was loathed by investors, being regarded as permanently unprofitable because of overcapacity and waste. At the time Mr Tepper became involved, US airlines had begun a series of mergers that resulted in a transformation of the industry. Delta's operating margins rose from about 0.5 per cent in 2008 to 13 per cent by 2014. Since the middle of 2009, Continental shares are up more than 1,000 per cent, while Delta shares are up by more than 600 per cent.

These investors also tend to concentrate their investments in a small number of their best ideas rather than hundreds of mediocre ones and hold these positions for long periods of time. Mr Klarman's Baupost currently holds 70 per cent of his US stock investments in 10 ideas, and holds on average its top 20 ideas for eight quarters, while Southeastern holds for 9.5 quarters. These are time horizons that in the world of modern fund management are more akin to decades.

All these things may seem simple but the reality remains that the vast majority of the investment industry remain hopelessly unable to practise them. That is the real crisis in active management, not the practice of active investment itself.

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