Freeman-Shor, Lee – The Art of Execution

Harriman House, 2015, [Equity Investing] Grade ★★★★★

I'm a terrible snob when it comes to investment literature. Books written for private investors rarely interest me. This is different. This might be the most important book on investments that a private investor can read – if he can gather the discipline to follow the advice. It might actually save quite a few professional portfolio managers' bacon as well.

Lee Freeman-Shor is the PM of Old Mutual's Best Ideas Fund. The fund's strategy is to select the 45 best investors they can find and let them invest in 10 stocks each. The aggregate of the underlying positions makes up the fund. The interesting thing from the perspective of the reader of this book is that this has given the author an unprecedented real time access to analyze and learn from the best during a long stretch of years. It turns out that less than half of the PMs' positions were profitable. Some PMs lost money on as much as 2/3rds of their positions. And still, on average these elite investors generated good or even great overall investment results. How this could be is the content of this book. The short answer is so called money management.

The author first analyzed how the PMs acted when it came to their loosing positions, dividing them into three groups according to their behaviour. The Rabbits that didn't handle loosing positions well and the Assassins and the Hunters who had two different profitable methods to turn losses around. Then Freeman-Lee looked to the opposite – how the PMs handle winning positions. They are now sorted into the unsuccessful Raiders and the top performing Connoisseurs. For each investor type the author analyzes their behavioural biases and discusses what could be learnt from what they are doing wrong and what they are doing right. A bit like *The Little Book of Behavioural Investing* by James Montier, but for the private investor and with a money management touch.

The thing with losses is that they become disproportionally harder to come back from the larger they get. If a stock goes down 25 percent it has to go up 33 percent to get even. If it goes down 50 percent it has to go up 100 percent and if it goes down 75 percent it has to go up 300 percent. The one thing you cannot do when experiencing losses is nothing. This is what the Rabbits did and they ended up in rabbit holes that were so deep that they couldn't come back from the losses. Two things work – either you sell or you buy. The Assassins used stop-losses that gave them a fair amount of small losses but never the big ones that were impossible to turn around to profits. This is the typical trend following investor. The Hunters instead waited a little longer and then they doubled down by adding to the position. By doing this they lowered their average purchase price to something that was possible to make a profit from when the stock turned up again. This is the typical value investor.

The loosing habit in handling profits was taking profits too early. High returns are built "*through preservation of capital and home runs*" as Stanley Druckenmiller put it. A successful portfolio's return is disproportionally created by a few very successful holdings. By selling as soon as a nice profit was at hand the Raiders effectively closed down their chance of home runs. Don't.

This is a book written for private investors so it is very simple. Take away the case studies and use normal size font and it could be 70 pages. For its stated audience it is great. There is a fine balance in writing about a specialist area to the broader public. The good author writes for an intelligent person who doesn't know much about the subject. The bad treats his readers like children. Freeman-Shor is in the good camp. I also like that he, in contrast to trading literature, gives a fuller range of money management options suited to both trend following investors and value investors.

The professional investor will not be surprised by anything in this book. Yet his performance could be vastly improved if he followed the advice. Simple but not easy.

Mats Larsson, October 30, 2015