

**Bares, Brian T. – The Small-Cap Advantage**

*John Wiley & Sons, 2011, [Equity Investing] Grade* ★★☆☆

This is a book with the dual purpose of on the one hand teaching aspiring small-cap portfolio managers how to set up shop and on the other hand giving institutional investors a better feel of what to look for when performing due diligence of small-cap managers. In respect to this aim the grade is unfairly low. However, this is not the book that Brian Bares should have written and it quite annoys me.

On the sleeve, one of the reviewers claims that Bares “is the Warren Buffett of small and micro-cap stocks” and in scattered sections the writing is very insightful. However, ask yourself, would you rather watch the paintings of Vincent Van Gogh or hear him discussing various ways to organize a studio; would you rather watch Michael Jordan play basketball or read his writing on potential methods to run an NBA-franchise? I certainly would have wanted this book to give me the full account on how the Texas based Bares Capital Management so successfully have managed their small-cap portfolios.

The book gives the top down view on the pros and cons of investing in small-cap equity and on the options of indexing vs. active strategies such as either quantitative or fundamental ones. The choices for fee structures, organizational and legal setup are discussed, as is the fundraising process where a number of types of investors into small-cap funds are presented including the endowments. I have almost no objections to what is said and must commend the author’s integrity in debating the many areas where there arise agency issues, i.e. where the interest of the PM and the end-investor aren’t fully aligned.

But it’s still fairly dull as a text – the legal entity could be this or that, the traits of a compliance officer should include the following, the pros and cons of outsourcing back office are these etc. The spark arises in the short passages when topics like,

how to get an investment edge (quoting Bill Miller’s trio of informational edge, analytical edge and behavioral edge), fundamental investment research, position sizing, the roles of analysts vs. PMs and similar front-office activities are touched upon.

Barnes Capital Management invests in businesses with good potential for long term compounding of business value. They focus on moats, exceptional managers and growth driven by the ample opportunities to reinvest capital at high return on capital. Their portfolios are very concentrated with 8 to 12 positions, “weighted heavily” in the highest-conviction ideas. There are certainly things to discuss, say the art form of deciding who are the exceptional managers and if this differs in small-cap investing with more owner-managers than in the large-cap area etc. Which mistakes have they made in assessing management and what did they learn? Or why not describe how to add other measures of safety to compensate for the lack of diversification? Topics like these are quickly glanced over.

For financial planners, endowment officers etc. the text delivers a basic checklist in prose on how to evaluate this investment area. For anyone new to professional money management who is in the process of setting up a small-cap portfolio, most practical aspects are ticked off to get him off the ground. The person who instead wanted to get a fuller text on the art of small-cap investing with real-life examples from a firm that has had success in the area will have to wait for the next book.

It is probably unfair to judge a book for what it could have been instead of for what the author’s stated intentions for writing the text actually was. However, I can’t help feeling cheated of a chance to learn something much more valuable than differentiating between a hedge fund and a managed account.

Mats Larsson, February 9, 2016