

Chancellor, Edward (ed) – Capital Account

TEXERE, 2004, [Equity Investing] Grade ★★★★★

There lies a danger in rereading books after a long time – it's not always they age gracefully. The subtitle of *Capital Account* is *A Money Manager's Reports on a Turbulent Decade, 1993-2002*. The time period corresponds roughly to the first half of my time in the equity market so far and I read the book when it came out in 2004. I liked it then and I like it even more now. In fact, I'm sure that I had benefitted greatly had I thought deeper about the topics presented at the time.

The disposition is that Edward Chancellor, the author of the excellent book *Devil Takes the Hindmost*, has selected, edited and sorted a number of essays from Marathon Asset Management's investment letter into chapters on various subjects. Marathon is a London based independent asset manager that often takes contrarian positions. Each essay is only 2 or 3 pages long but with 6 or 7 of them per topic they give a varied description.

The reason that I'm rereading the book is that the sequel was published this year and I wanted to get the timeline right. It's fascinating to again be taken back to the period building up to the TMT crash. Everything feels highly familiar but yet much would be quite alien in today's environment. The first that is striking is the unbridled market optimism – or over-optimism as Marathon correctly views much of what's happening. The stock market was in the final stages of one of its longest bull markets ever. A Western world muddling through a Japanese scenario and a stock market that myopically speculates in monetary policy was inconceivable.

The focus on technology issues like fiber optics is naturally pretty feverish. Although I'm not sure that the attention paid to cloud, big data, fintech etc. in Silicon Valley today truly differs much. Still, it was much more widespread then. Economic Value Added and the shareholder value movement were seen as something constructively creative and not as a short-termist scheme to rob other stakeholders as popular press would have it today.

Interestingly though, Marathon warns very early that the concept of EVA was started to be used in a much too simple manner. I also find a picture or two that I have used over the years and that I didn't realize that Marathon was the source to.

Even though it clearly was a different time the book never feels dated. The key investment tenants of Marathon are timeless and much of the discussions could as such be taken directly from a 2016 investment letter. I appreciate the focus on corporate managers capital allocation, the clear thinking on incentive schemes and the picture they paint of the temptation of diving into the short-term IPO-frenzy (with it's folly of relative valuation multiples).

What really stands out however is the firm's usage of the concept The Capital Cycle. When investors analyze the future economic and stock market environment it's all too easy to focus on future supply. What is then equally easy is to sideline any deep thinking on supply. Marathon has specialized in analyzing how swings in competitive intensity and capital investments influence the economic cycle of sectors and this has apparently served them well when looking at their investment results. From The Capital Cycle two types of investment cases arise; the franchise stock that will keep its high ROIC longer than the market price and the turnaround with a better fate than feared.

Chancellor creates a flowing narrative out of the stand-alone pieces of puzzle that the essays were. The overlaps are few. The task is considerably helped by the fact that Marathon has a very strong investment philosophy that ties everything they say and do together to a coherent view of the investment world.

At the same time as this book takes you back to the heat of the moment you must admire the theoretical overview that Marathon Asset Management had when analyzing their investment environment at the time.

Mats Larsson, August 04, 2016