Traits of Successful Money Managers

Successful long-term money managers, Whitney Tilson says, share 16 traits, divided equally between personal characteristics and professional habits. Understanding these traits not only helps you identify exemplary professional money managers, but may also help you understand how you stack up as an individual investor.

My goal has been to learn from their successes -- and equally importantly, their failures. Given that investment mistakes are inevitable, I'd at least like mine to be original ones.

So what have I learned? That long-term investment success is a function of two things: the right approach and the right person.

The right approach
There are many ways to make money, but this doesn't mean every way is equally valid. In fact, I believe strongly -- and there is ample evidence to back me up -- that the odds of long-term investment success are greatly enhanced with an approach that embodies most or all of the following characteristics:

- Think about **investing as the purchasing of companies, rather than the trading of stocks**.

- **Ignore the market, other than to take advantage of its occasional mistakes**. As Graham wrote in his classic, *The Intelligent Investor* *<http://www.amazon.com/exec/obidos/ASIN/0060155477/themotleyfool-features/>*, "Basically, price fluctuations have only one significant meaning for the true investor. They provide him an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal. At other times, he will do better if he forgets about the stock market."

- **Only buy a stock when it is on sale**. Graham's most famous saying is: "To distill the secret of sound investment into three words, we venture the motto, MARGIN OF SAFETY." (For more on this topic, see my column, "Trembling With Greed <http://www.fool.com/news/foth/2001/foth010213.htm>.")

- **Focus first on avoiding losses, and only then think about potential gains**. "We look for businesses that in general aren't going to be susceptible to very much change," Buffett said at Berkshire Hathaway's 1999 annual meeting. "It means we miss a lot of very big winners but it also means we have very few big losers.... We're perfectly willing to trade away a *big* payoff for a *certain* payoff."

- **Invest only when the odds are highly favorable -- and then invest heavily**. As Fisher argued in *Common Stocks and Uncommon Profits* *<http://www.amazon.com/exec/obidos/ASIN/047111927X/themotleyfool-features>*, "Investors have been so oversold on diversification that fear of having too many eggs in one basket has caused them to put far too little into companies they thoroughly know and far too much in others about which they know nothing at all."

- **Do not focus on predicting macroeconomic factors**. "I spend about 15 minutes a year on economic analysis," said Lynch. "The way you lose money in the stock market is to start off with an economic picture. I also spend 15 minutes a year on where the stock market is going."

- **Be flexible!** <http://www.fool.com/boringport/2000/boringport000124.htm> It makes little sense to limit investments to a particular industry or type of stock (large-cap growth, mid-cap value, etc.). Notes Legg Mason's Bill Miller, the only manager of a diversified mutual fund to beat the S&P 500 index in each of the past 10 years, "We employ no rigid industry, sector, or position limits."

- **Shun consensus decision-making, as investment committees are generally a route to mediocrity**. One of my all-time favorite Buffett quotes is, "My idea of a group decision is looking in a mirror."

The right person
The right approach is necessary but not sufficient to long-term investment success. The other key ingredient is the right person. My observation reveals that most successful investors have the following characteristics:

- **They are businesspeople, and understand how industries work and companies compete**. As Buffett said, "I am a better investor because I am a businessman, and a better businessman because I am an investor."

- **While this may sound elitist, they have a lot of intellectual horsepower**. John Templeton, for example, graduated first in his class at Yale and was a Rhodes Scholar. I don't disagree with Buffett -- who noted that "investing is not a game where the guy with the 160 IQ beats the guy with the 130 IQ" -- but would point out that he didn't use the numbers 160 and 100.

- **They are good with numbers -- though advanced math is irrelevant** -- and are able to seize on the most important nuggets of information in a sea of data.

- **They are simultaneously confident and humble. Almost all money managers have the former in abundance, while few are blessed with the latter**. "Although humility is a trait I much admire," Munger once said, "I don't think I quite got my full share." Of course, Munger also said: "The game of investing is one of making better predictions about the future than other people. How are you going to do that? One way is to limit your tries to areas of competence. If you try to predict the future of everything, you attempt too much." In addition to what Munger is talking about -- understanding and staying within one's circle of competence -- there are many other areas of investing in which humility is critical, which I discussed in "The Perils of Investor Overconfidence <http://www.fool.com/BoringPort/1999/BoringPort990920.htm>."

- **They are independent, and neither take comfort in standing with the crowd nor derive pride from standing alone**. (The latter is more common since, I argued last week <http://www.fool.com/news/foth/2001/foth010710.htm>, bargains are rarely found among the crowd. John Neff said he typically bought stocks that were "misunderstood and woebegone.")

- **They are patient. ("Long-term greedy," as Buffett once said.)** Templeton noted that, "if you find shares that are low in price, they don't suddenly go up. Our average holding period is five years."

- **They make decisions based on analysis, not emotion**. Buffet wrote in his Q4 '98 letter to investors: "Most of the activity that makes active portfolio management active is wasted... [and is] often triggered by ineffective psychological responses such as overweighting recent data, anchoring on irrelevant criteria, and a whole host of other less than optimal decision procedures currently being investigated by cognitive psychologists."

- **They love what they do**. Buffett has said at various times: "I'm the luckiest guy in the world in terms of what I do for a living" and "I wouldn't trade my job for any job" and "I feel like tap dancing all the time."

Obvious?

Much of what I've written may seem obvious, but I would argue that the vast majority of money in this country is managed by people who neither have the right approach nor the right personal characteristics. Consider that the average mutual fund has 86% annual turnover, 132 holdings, and no investment larger than 5% of the fund.

Those statistics are disgraceful! Do you think someone flipping a portfolio nearly 100% every year is investing in companies or trading in stocks? And does 132 holdings indicate patience and discipline in buying stocks only when they are on sale and odds are highly favorable? Of course not. It smacks of closet indexing, attempting to predict the herd's next move (but more often mindlessly following it), and ridiculous overconfidence -- in short, rampant speculation rather than prudent and sensible investing.

The performance trap

I have not discussed **historical performance as a metric** for evaluating money managers, not because it's unimportant, but rather because **it's not as important as most people think.** Consider this: If you took 1,000 people and had them throw darts to pick stocks, it is certain that a few of them, due simply to randomness, would have stellar track records, but would these people be likely to outperform in the future? Of course not.

The same factors are at work on the lists of top-performing money managers. Some undoubtedly have talent but most are just lucky, which is why countless studies -- I recommend a 1999 article <http://www.efficientfrontier.com/ef/799/apeman.htm> by William Bernstein -- have shown that mutual funds with the highest returns in one period do not outperform in future periods. (Look at the Janus family of funds for good recent examples of this phenomenon.)

As a result, the **key is to find money managers who have both a good track record *and* the investment approach and personal characteristics I've noted above.**

Conclusion

The characteristics I've described here are not only useful in evaluating professional money managers. They can also be invaluable in helping you decide whether to pick stocks for yourself. Do you have the right approach and characteristics?

-- Whitney Tilson

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