Eleon Capital Management Ltd.

- MARKET OUTLOOK -

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Bill Miller was the legendary investor at Legg Mason (LM), managing the LM Value Trust that, at its peak, had approximately AUM of $16b. He is known for outperforming the S&P 500 for 15 consecutive years to 2005 – something no fund manager has ever achieved. Despite the fund's 'value' orientation, he had made significant investments in Google, Amazon, Dell, and America Online, arguing correctly that all investing (compared to speculation) should be value investing, i.e. buying an asset for less than what it is worth. By 2011 he stepped down from managing the LM Value Trust post a poor performance run, especially in 2008, following investments in Yahoo, Countrywide and Bear Stearns (doubling down on these even as the financial crisis pummeled these stocks).

Miller's investment style was value orientation taking "counterintuitive bets", having a concentrated portfolio and generally holding his stocks over the long term irrespective of market movements. So the operative question is, how did things go so wrong for a fund manager with such a stellar track record, high intellect and fundamentally sound investment philosophy and process?

Some industry experts, such as John Boggle, argued that the fund size was too big: For one, "as the fund size increases, the number of investment opportunities just shrinks dramatically" and secondly,

"the bigger you get, the fewer the number of stocks you can hold with meaningful positions."

Bill Miller, at the time, argued: "The thing I didn't do, from Day One, was properly assess the severity of this liquidity crisis." He went further and said: "The question we are asking ourselves is:...

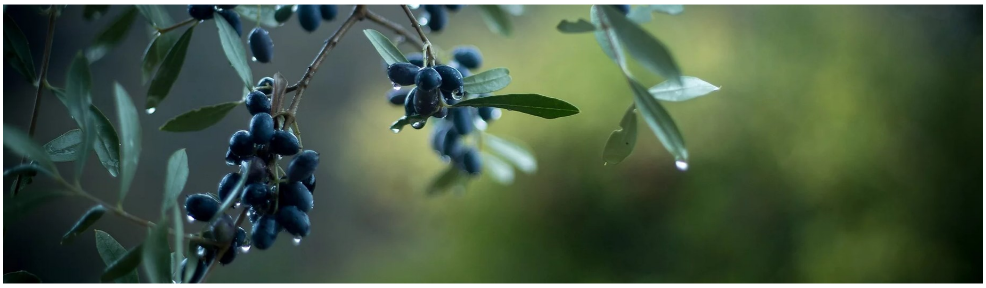
"Should we think more broadly now about probability, about high-impact events and protecting against them by having broader exposure to the market?"

With twenty-twenty hindsight, one could argue that low probability high impact events always exit and that portfolios should always be constructed in such a way as to protect against such eventualities irrespective of the fact that, in all likelihood, most investors won't be able to predict them in advance.

It would be instructive to look at one of Miller's stock holdings, namely Eastman Kodak: "He thought that Kodak, a pillar of film-based photography whose stock he still owns, would adapt faster to the pressures presented by the rise of digital photography". The truth is that Kodak never managed to restore its competitive advantage. In fact, Kodak was one of the most innovative companies in its heyday - it had technologies that both Apple and Microsoft used. But the real irony was that Kodak had developed the digital camera first and then killed it to protect its high-margin and profitable film-based business. A similar thought process can be extended to Yahoo and Bear Stearns.

In essence, Bill Miller's fundamental error was his primary focus on the share price (and buying them when they were low) and a secondary, consideration of the business economics of the asset. While not intended as a criticism, given just how fraught with dangers business analysis and predictions can be, it can be perceived that emphasis on the fundamentals, i.e. what the company will look like from an economic perspective ten years out and a secondary consideration on price is more likely to yield better results. In addition, an emphasis on business "quality" should future-proof the portfolio against those high-impact low probability events that periodically occur. As Charlie Munger said:

"Over the long term, it's hard for a stock to earn a much better return than the business which underlies it earns. If the business earns six percent on capital over forty years and you hold it for that forty years, you're not going to make much different than a six percent return - even if you originally buy it at a huge discount. Conversely, if a business earns eighteen percent on capital over twenty or thirty years, even if you pay an expensive looking price, you'll end up with one hell of a result." 6 April 2023



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Strong Roots, Sustainable Growth

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