The Six Traits of Successful Money Managers

As investment managers we spend a lot of time thinking about success. Successful products. Successful business models. Successful management teams. Successful companies. And most importantly, we continually try to understand what makes a successful money manager. To that end, we recently came upon a quote attributed to legendary (and very successful) hedge fund manager Seth Klarman. He said,

> *"Nothing you can do will guarantee success, though you can tilt the odds significantly in your favor by having the right philosophy, mindset, process, team, clients, and culture. Getting those six things right is just about everything."*

In this article we want to explore Klarman's assertion on success, specifically how it relates to investment advisers. Let's examine each of Klarman's six measures in more detail.

Philosophy

A well-defined and consistent investment philosophy is arguably the most important characteristic of successful money managers. Investment philosophies are varied, but the two most common are usually referred to as "growth" and "value." Growth investors look to buy companies whose sales and earnings are growing rapidly, but valuation (e.g., having a low P/E ratio) is not their most important consideration. Value investors, on the other hand, look to buy companies that are selling cheaply in the market; growth is not a necessary condition.

While we tend to gravitate towards the value investing camp, due to our temperament and our admiration for successful practitioners of the art such as Warren Buffett and Benjamin Graham, we do not profess to single out value investing as the one-and-only successful methodology. What we do believe is that being consistent in following a specific investment philosophy, no matter the investing climate, is paramount to success.

And that is easier said than done. Industries, companies, and investing returns tend to be cyclical in nature. It is quite easy to be tempted to follow the latest trend in Wall Street, making what seem to be "easy" bets. In our studies, we have found that those adventures usually exhibit one simple trend: they tend to decrease the size of investors' wallets.

Mindset

Carol Dweck is a psychology professor at Stanford University, mostly known for her 2006 book *Mindset: The New Psychology of Success*. According to Dweck, individuals have one of two views of where their abilities come from. Those with a *fixed* mindset believe their success is based on their innate ability. They believe that their talents and intelligence are merely fixed traits and that they have a fixed amount of them. On the other hand, those with a *growth* mindset believe that their success in based more on hard work, learning, and training. They understand that their talents and abilities can be developed through effort and persistence, and they believe that everyone can get smarter if they work hard at it.

In the investing realm, we have found that the most successful money managers tend to have a growth mindset. Investing is a field that rewards knowledge, experience, continuous learning, and hard work. Every investor will, at some point or another, pick a losing stock. But investors with a growth mindset learn from their mistakes and become better investors because of those negative experiences.

Process

When selling an investment that has produced a nice gain, one can describe the favorable result in one of two ways. One can say something like, “We made a profit on that stock, as we made a 20% return in just over a year.” Another person might explain the same investment in this manner, “We made a profit on the stock, as we bought it when it was undervalued in the market. Investors were expecting flat sales and declining margins, while our research indicated a slight improvement in sales and stable margins. When our research was vindicated, the stock reacted positively to the news. In fact, the stock now seems overvalued, so we sold and took our gain.”

The first person in the above example focused on the *result* of the investment, while the second person stressed the *process* in achieving that result. Results-oriented thinking versus process-oriented thinking differentiates many investment managers. In our experience, most successful investors concentrate on process instead of results.

As we described in our recent article What Dilbert Can Teach Us About Investing, it’s entirely possible for an investor to follow a sensible research process, only to achieve a poor result. This is what’s known as a bad break. However, it’s important to remember that a good process can be analyzed and replicated, while a good result teaches nothing. After all, a bad process that leads to a good result is nothing more than dumb luck.

Team

Team members at successful money management firms do not all come from the same business school mold. In fact, many come from varied backgrounds, bringing different strengths to the investment process. With their different experiences, they do share some traits that seem imperative: wide intellectual curiosity; a confident yet humble demeanor; a deep understanding of accounting, which is, after all, the language of business; and a profound interest in understanding business models, spending more of their time as an investigative reporter or accounting student than as a stock trader.

Clients

Having the “right” clients might not seem like an important element of a successful investment management enterprise. After all, what is a “right” client anyway? The “right” client is actually more of a passive partner than a client. He is completely on-board with the investment philosophy of the investment manager. While he is critical, he is also objective and understands the cyclical nature of markets. We have found that the best clients are those that have a long-term investing perspective and take advantage of the sometimes irrational nature of markets; they tend to do the opposite of the crowd, not panicking during the inevitable bear markets but instead wanting to buy when everyone is selling.

Culture

A strong culture is one that brings together all of the above elements and ensures that a successful investment organization outlives its founders and/or current management teams. A strong culture is cultivated and molded over many years. It has everyone committed to the investing philosophy and rewards a growth mindset and process-oriented thinking.

Culture also refers to the ethical environment of the firm. It saddens us when we read in the news about an investment firm that has shirked its fiduciary duty or otherwise run afoul of its duties to its clients or regulators. We believe it’s important to play “in the center of the field,” and not to get too close to the sidelines with regard to the rules and regulations.

Conclusion

When evaluating investment managers, it makes sense to look at the obvious parameters such as performance numbers. But looking at other, more qualitative factors might be even more important. The right philosophy, mindset, process, team, clients, and culture are all-important in evaluating the long-term success of any money manager.

Felipe

Felipe Garcia, CFA
Chief Investment Officer
INKWELL CAPITAL LLC

Aaron

Aaron Byrd, CFA
President
INKWELL CAPITAL LLC