book review

Investment Legends: The Wisdom that Leads to Wealth

by Barry Dunstan

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The book provides a very readable account of 15 of the most successful investors of the past two decades. It highlights that achieving legend status is not about overnight success, or one big win. It is about perseverance, in some cases even survival. Most importantly, what sets these legends apart is their commitment to learning.

CONSIDER THE PROVOCATIVE QUESTION: 'Warren Buffett's Berkshire Hathaway beat the S&P500 index in 27 out of 31 years between 1971 and 2006. What is the likelihood that this is pure chance?'

Statisticians will quickly realise that when stated this way the question reduces to a simple probability calculation. Some fairly trivial number-crunching might suggest that the chance of emulating (or bettering) Buffett's track record was 0.0017% or about 1 in 59,000.[1] That sounds like a remote possibility until you consider the enormous number of investors, advisers and funds management firms engaged in the activity over that period. Perhaps, then, Warren Buffett is simply one of the 'Black Swans' outed in Nicholas Taleb's now famous book, *Fooled by Randomness?*

Barrie Dunstan's book aims to dispel that notion. It provides a very readable account of 15 of the most successful investors of the past two decades. This is not a 'how to' book. Nor does it attempt to 'dish the dirt'. It is, however, a valuable source of insight into these exceptional men (and one woman).

Dunstan brings to the task the (un?) enviable experience of having interviewed literally hundreds of investment managers over the past 50 years. The investors he chose for this book include some with a high public profile (Bogle, Buffett and Munger, Gross) and some most likely familiar only to industry insiders (Bolton, Brinson, Dalio, Fisher, Grantham, Liebowitz, Sanders). It includes strategists (Biggs, Cohen, Faber), a corporate raider (Brierley) and one, who though an active investor, is more familiar to most people as an author (Bernstein). He notes that there were a few legends that slipped his net (including Sir John Templeton, Peter Lynch, David Swenson and George Soros) but there is little to regret in that. The individuals he chose all deserve the accolade of legend, and this is not intended to be an encyclopaedia, after all.

The book devotes a chapter to each of the legends. It mixes biography in each case with brief descriptions of the legends' investment beliefs. In many cases this is illustrated by reference to the legends' interpretation of the (then) unfolding global financial crisis. What emerges is not so much a recipe book of possible investment approaches as an impression of the passion and dedication required to achieve what these individuals have achieved. The challenge of staying the course when markets are running against you is a recurrent theme.

The book also highlights that achieving legend status is not about overnight success, or one big win. It is about perseverance, in some cases even survival; it is about knowing both when and how to bet. It dispels the notion that successful investing is about inspiration. Like the 'outliers' in Malcolm Gladwell's book of that name, these overachievers have some measure of personal intellectual and emotional capability and a certain amount of luck to be in the right place at the right time, but they also practice their craft intensively, honing their skills in the most global and competitive of environments, the major capital markets of the world. And, they all demonstrate a brand of intellectual honesty, vulcanised in unsentimental investment markets, that allows them to learn from their mistakes.

It is time, though, to return to the question with which this review started and to admit a sleight of hand, the consequence of which ought to be unsettling. Even ignoring the methodological issue identified in the footnote, the simple probability calculation misrepresents reality in a potentially important way. One way to illustrate this is to invoke the hypothetical urn, so beloved of probability theorists.

Consider an urn with an even number of green (outperforming) and red (underperforming) balls. The calculation above assumed that the ratio of red to green balls was the same in each period. However, consider what happens if each period sees attrition and replenishment, and that, on average, the balls being placed back in the urn are evenly balanced between red and green, but those taken out are more likely to be red? This is analogous to the way the investment manager universe actually operates. The skills distribution of new entrants probably conforms to the general population, but those that leave the industry are more likely to be underperformers. The result is marked. Over time, the urn will come to be filled increasingly with green balls (the rate will depend on the number replaced each time and the skew in the balls removed). In the investment context that is equivalent to a universe of investors who increasingly appear to have the skill to outperform. But here's the rub. As Sharpe pointed out, in any finite market, half the investors have to outperform and half underperform. So if we assume that skill is not simply red or green, but distributed in some other way, the level of skill required to be above median (and hence actually outperform) rises continually.

And this is the deeper lesson from Dunstan's book. The lessons we learn from the masters of the past, the legends, are not signposts to extraordinary outperformance. Of course, failure to learn the lessons will, over a relatively short period, condemn you to below median performance. But, over time, their techniques will become requisites simply to keep up with the pack. More importantly though, it is their commitment to learning that sets these legends apart.

Note

1 In fact, as a recent paper by Martin and Puthenpurackal remind us, a more theoretically robust way to gauge skill *after the fact* is to compare it to the distribution of best performances over a large number of trials; Gerald S. Martin, and John Puthenpurackal 2008, 'Imitation is the Sincerest Form of Flattery: Warren Buffett and Berkshire Hathaway', April 15. Available at SSRN: http://ssrn.com/abstract=806246.