*Wednesday, June 27th – Maui Land & Pineapple by **GEOFF GANNON***

"Stylistic Skew"

July 1st, 2018

To Focused Compounding members:

This week, Vetle Forsland was our guest for two podcast episodes. One was about GameStop (GME). The other was about Entercom (ETM). You should listen to them both. What stood out to me in those two episodes was Vetle's style as a stock picker. GameStop sells – among other things – physical copies of video games. Entercom owns terrestrial radio stations. A lot of investors think these two stocks are in buggy whip businesses. And so, these investors don't even bother trying to come up with an appraisal value for the businesses and compare that to the market price of the stocks. For most investors, these two stocks are unsafe at any price. But Vetle is willing to search through other investors' trash to see if there is any treasure hidden there. That's his stock picking style.

Vetle's two podcast episodes went up the same week I started thinking about exactly what I'm going to put in the first letter I will have to write to clients of Focused Compounding Capital Management. The first letter to clients went out today. Andrew wrote that one. It discussed the general strategy those managed accounts will employ. But next month's letter will be written by me, not Andrew. And it won't be discussing general strategy – it'll be talking specific stocks. That letter would be easier to write if each stock stood out as an utterly unique case. I could just rattle off five paragraphs about five different stocks. The problem is that there's clearly a common – yet unconsciously woven – thread running through those five stocks. I noticed it the other day. I was looking over the five stocks sitting in the planned "Buy" pile for those managed accounts and glanced at a number we don't normally talk about in these memos: "beta". As you probably know, beta is an indicator of a stock's volatility scaled to some index's volatility. A beta of 1 would suggest similar volatility to the S&P 500. The five stocks in that "Buy" pile for the managed accounts have betas of: 0.64, 0.33, 0.19, 0.17, and ***negative*** 0.10. Now, I don't put much stock in those betas because the actual correlation with the market for these stocks is probably pretty low. I doubt these stocks tend to be green on days when the market is green just to one-third or so of the extent the market is up and red on days when market is red just to one-third or so of the extent the market is down. So, that series of five betas doesn't mean much. But, it does mean one thing. That wasn't luck. You don't draw betas of 0.64, 0.33, 0.19. 0.17, and ***negative*** 0.10 randomly out of a hat with every stock in it. Likewise, Vetle probably (a sample size of two is awfully small) doesn't draw two investment write-up subjects out of a hat randomly and find that both of them just happen to be in industries most investors consider to be on the brink of extinction. The way you end up writing about two such stocks is if there is some inherent bias in your stock selection – a signature stylistic skew to the way your mind sorts the entire investment universe.

Is Vetle a contrarian investor? Are Andrew and I risk-averse investors? We can't know that. But, we can know we each have our own unique style – and it shows even in ways we don't intend it to. Till this past week, I'd never checked the betas on the stocks Andrew and I picked for the managed accounts. So, "low beta" certainly wasn't a conscious choice. Rather, it was an unconscious outcome of our stock picking style. My question for you this week is: what's your stylistic skew? And then the harder follow-up: what is it about your stock picking style that skews your portfolio away from the norm?

Geoffrey Gannon