"Outperformance Anxiety"

August 19th, 2018

To Focused Compounding members:

I spend a surprising amount of time talking with members about other investors – investors who are doing better than them. The truth is: returns much beyond 20% a year aren't even worth thinking about. Sure, you can find investors who have done better than 30% a year for a ten year stretch. I have a copy of Joel Greenblatt's "You Can Be a Stock Market Genius" sitting here on my desk. And if I flip to the back of that book, I'll find a performance table that goes like this: 70% (1985), 54% ('86), 30% ('87), 64% ('88), 32% ('89), 32% ('90), 29% ('91), 31% ('92), 115% ('93), and 49% ('94). The works out to a 10-year compound annual return of 50%. Then there's Warren Buffett's partnership record which reads: 10% (1957), 41% ('58), 26% ('59), 23% ('60), 46% ('61), 14% ('62), 39% ('63), 28% ('64), 47% ('65), 20% ('66), 36% ('67), 59% ('68), and 7% ('69). That works out to a 13-year compound annual return of 30%. One member wanted to talk to me about the performance of a fund manager – better than 30% a year for longer than 5 years – who followed a concentrated portfolio. For the managed accounts, Andrew and I target six equally weighted positions. So, I'm always interested in seeing what a concentrated portfolio looks like. This fund manager had most of his portfolio in 4 stocks: Herbalife, Cimpress, Credit Acceptance, and World Acceptance. A portfolio like that is taking risks very different from the ones you're taking. They may be right about all those risks. But, they have to have opinions about subprime credit risks, pyramid schemes, tax avoidance strategies, etc. It isn't just that those stocks are often shorted, controversial, etc. as stocks. The actual businesses are doing riskier things than the businesses you likely own. You don't have to take big risks to get rich. But, you often do have to take big risks to get rich quick. I mentioned Joel Greenblatt's record at Gotham Capital. It was 50% a year over 10 years. Charlie Munger's record was just 20% a year over 14 years. Warren Buffett's record at Berkshire – not his partnership – has been 22% a year over 53 years (and Walter Schloss did 15% a year over something like 45 years managing smaller sums). During the time Berkshire did 22% a year, the S&P 500 did 10% a year. Those are the two yardsticks you should look at: 10% a year and 20% a year. In every year where you manage to do 10% a year, you are on pace to match or beat the long-term rate for the S&P 500. In ever year where you manage to do 20% a year, you are on pace to match or beat the long-term rate for some of the very best investors in the world. People mention the performance of investors like Joel Greenblatt and Peter Lynch a lot. But those performances are for less than 15 year stretches. You have more than 15 years of investing left in you. So, you should be thinking in terms of what kind of performance you can ***sustain*** for 20 years or more.

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