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Do the work and the rewards are there for investors

TIM KELLEY THE AUSTRALIAN AUGUST 30, 2014 12:00AM

IS there a sure-fire way to beat the market? It certainly can't be easy — because while a great many investors try only a small percentage of them consistently succeed. For this reason, a lot of commentators favour index investing as a low-cost way of ensuring the market doesn't beat you — at least not by too much.

But, while it's not easy, there are some investors who do consistently beat the market, so before we surrender to the law of averages let's look at one way you can expect to succeed.

I should warn you at the outset that it involves a little work on your part. It has been proposed that there are three potential sources of investment outperformance.

• Having better information than others. This is what a lot of fundamental investors try to do (by fair means and sometimes foul). In simple terms, it refers to having a better earnings forecast for a company than the rest of the market.

• Processing the available information better. This is what a lot of quantitative investors do — essentially pouring large volumes of readily available data into computer algorithms to sort the good from the bad.

• Being more rational than others. This just means keeping your head when others around you are losing theirs. Buying when things are dire and selling when things are going swimmingly. This is perhaps what separates Warren Buffet from the rest of the field.

Different investors may or may not be able to exploit each of these drivers, depending on their individual circumstances and resources. However, if you are reading this article then at least one of them is within your reach. Having better information than others can be achieved by anyone with the patience to sit down and properly read annual reports and prospectuses. These are big documents with a great deal packed into them. They are long and boring and not many people read them from cover to cover. More should.

The good thing about these documents is that they are carefully prepared by an army of smart people who know a great deal about the affairs of the company, and there is an obligation on those people to set out everything an investor might reasonably want to know.

The bad thing is management doesn't always want investors to know everything they might reasonably want to know, and sometimes the good bits can be hidden away in dark corners of the notes to the accounts. It can take quite a bit of digging to unearth it.

For example, the statutory accounts in a prospectus might tell you that the chief executive is being paid a large one-off retention bonus to remain with the company for the 12 months following the IPO. Since this is a one-off, the
pro forma accounts in the investor presentation might proudly declare you should ignore it in calculating the profitability of the business. Based on the pro forma accounts, the business looks to be generating fulsome profits for its shareholders.

Dig a little deeper, however, and you might discover in the fine print that the CEO received a retention bonus last year. Dig deeper still and you might find he received a retention bonus the year before that as well. Before long, you may find yourself thinking this year's payment is not quite as "one-off" as the pro forma accounts would have you believe. At this point, you have something other investors don't have. You have better information because they just looked at the pro forma accounts and you worked harder than them.

That this is not easy to do is what makes it valuable, and that — for better or worse — is the nature of the equity market. I don't know of any easy ways to get rich in share investing, but I can assure you that if you are willing to roll up your sleeves and do the work, the rewards are there. You might even start to enjoy it.

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