Andrew Macken's journey from the school of value to the school of fads

Andrew Macken from Montgomery Investment Management. **Peter Rae**

by **Jonathan Shapiro**

Columbia Business School is considered the birthplace of value investing. Warren Buffett famously studied there under Benjamin Graham before teaming up with Charlie Munger to become the most successful investor of all time.

But Wagga Wagga-born stock picker Andrew Macken found a modern day mentor at the famed school in the form of Michael Mauboussin.

"It was money well spent because his class in security analysis basically shaped my entire perspective on investing and my career," he tells *The Australian Financial Review*.

Mauboussin is a well-known author and figure in the US funds management industry and Macken says he took to his axiomatic approach to security selection – expectations investing – during his time at Columbia.

"Everyone has to be investing this way, it's just that 99 per cent of the population just don't realise it," says Macken, who runs the global equities team at Montgomery Global Investment Management.

So what is "expectations investing"? First, it's a recognition that a share price is a "numerical representation of a set of future expectations about the key value drivers of the business". That can be revenue growth or profit margin expansion.

Second, it's a recognition that, to beat the market, one needs to find stocks that have unreasonably conservative expectations built into the share price.

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That means the investor must first work out what the key value drivers of the underlying business are, reverse engineer what the current share price implies about those drivers, then buy the stock if those expectations are too conservative.

"It focuses you on what is priced in today, and to ask 'what is the market's view, where do you have a differentiated view to what is priced in, and why do you think it's right?'

"Howard Marks says you have to be different and you have to be right. And, by using Mauboussin's framework, you are at least explicit about where you are different and why you think you are right."

Macken was now armed with the tools required to find undervalued stocks. But his first hedge fund role required him to do the opposite.

From the school of value investing Macken was accepted into the school of finding frauds and fads at Kynikos Associates, the short-selling fund founded by famed hedge fund manager Jim Chanos.

Chanos attained legendary status for his short bet on Enron but has long been a thorn in the side of executives of overvalued stocks.

Macken quickly learnt that shorting is not simply applying value investing in reverse.

'Overvalued stocks become more overvalued'

"The big insight is you can't do that. It's where many budding short sellers fall down because they try to do the reverse of what works on the long side.

"That just doesn't work because you just end up shorting a whole lot of overvalued stocks that become more overvalued."

Macken's first task at Kynikos, in 2010, was to examine a complex, unnamed insurance company.

After sifting through the tangled capital structure, he concluded its value was half of what the share price implied.

A 1 per cent short position [in the tens of millions of dollars] was initiated, at which point the stock rallied 50 per cent.

"As a junior, when you short your first stock for a big hedge fund, you end up staring at the stock price all day, watching it like a hawk. It was incredibly painful."

But Macken says he was struck about how "calm the senior guys were".

"They were not worried at all. Their attitude was that, if you believe in the thesis, you will get it all back at the end."

To his relief, the trade worked and Macken enjoyed several years of finding stocks to short.

Maintaining discipline

If there's one lesson he learnt from the short side it is to maintain discipline about processes and "get the simple things right, that gets you 90 per cent of the way".

An example of this is to just make sure to read the company statements.

"It is remarkable how powerful and under-appreciated the insights that can be generated by reading every word of the primary filings are.

"The reason it still works is that the vast majority of the market don't read the filings. Even though they say they do."

Since 2015, Macken has been applying those insights at Montgomery, and applies his shorting skills in the Montaka Long/Short fund.

At the moment it is his "long only" fund that is the focus of particular attention.

The fund got 11th-hour approval to list its Exchange Traded Managed Fund before the end of the year and will go live in the penultimate trading week of the year.

The Montgomery Global Equities Fund will list at a price of $3.34, a homage to cricketer Donald Bradman, whose highest score was 334. Bradman has the highest batting average in Test cricket history but only hit six sixes. Macken says the fund's own approach is, metaphorically, to score their runs by "keeping the ball on the ground".

Getting perserverance

Macken himself was a national junior orienteering champion and says it's how he explains to his mother what he does now, that is, navigation, strategising and avoiding the temptation to follow your competitors.

Now he is a triathlete, which he says has given him the perserverance required to set up a new business.

The listing is the latest ASX offering of a global fund that has come in the form of listed investment companies, listed investment trusts and exchange-traded managed funds as more investors embrace the asset class.

Macken says too many investors are becoming "thematic" investors. "It's all about China, or tech disruption. You name the theme."

The fund does own a number of the large tech stocks but says it won't own them at any price. In fact their largest holding – London-listed financial services group St James's Place – doesn't sound very new economy at all.

"Their business model is a platform model, it's just not as sexy as Amazon and Tencent."

St James's Place also has a market capitalisation under $US10 billion ($13.4 billion), which means it's too small for the large managers to consider.

Buy in bulk

But Macken says St James's Place, which has 3500 financial advisers on its platform, and therefore significant assets under management, can buy in bulk to command wholesale fees from investment firms.

Among them are Magellan, which noted its £2 billion mandate with St James's Place in February 2013 as a major milestone in its history.

"They are using their scale to extract the economics out of the fund manager and, like all platforms, it has the network effect. The more advisers that join, the more value accrues, so more advisers want to join," Macken says.

The British wealth management industry has been growing at about 4.5 per cent a year for more than a decade. That on its own is not enough but Macken's fund owns the stock because, by their numbers, the share price implies St James's is growing its advisers at 2 per cent, while they believe the current 8 per cent is sustainable.

"The real value is identifying expectations that are too low because, if you don't do that, nothing else matters. It's all a waste of time."