

## The Search for Excellence and the Loser's Game

We're on a continual search for the very best ideas for our concentrated portfolio. The "best ideas" component not only requires a continuous and rigorous analysis and reanalysis of the buy case for each of our names (and a continuous monitoring of expected returns), but a similar inspection of the sell case. With the perfect crystal ball, we'd love to know ahead of time which of our positions aren't going to work out.

As Charles Ellis suggested in "The Loser's Game" in 1975<sup>1</sup>, whether we are playing tennis or golf, fighting wars, or picking stocks, that the best strategy for "winning" may simply be a strategy that avoids the most mistakes.

If we take a direct read-across of the "avoid losers" mantra, there is an immediate conflict with the Alpha Europe philosophy of taking risk, and preparing for – if not embracing – losers and "mistakes". So long as we are more accurate than not, and so long as the winners contribute as much or more as the losers detract, then we should actually *want* to see big losers in the portfolio.



Sometimes

Additionally, the part of our process that embraces risks, and attempts to de-bias ourselves as stock pickers, is actually very much aligned with Ellis's "Loser's Game" message. As he eloquently (and presciently) states (way back in 1975):

*"The more important (success) is to (the stock-pickers) self-esteem and sense of inner worth –the more tenaciously he will hold on to old concepts, and the more insistently ignore or reject new evidence that conflicts with his old and familiar concept of the world."*

Moreover, perhaps counterintuitively, he adds that the problem is even more acute for higher-achievers:

*"This behaviour is particularly common among very bright people because they can so easily develop and articulate self-persuasive logic to justify the conclusions they want to keep."*

Of course, fast forward by 40+ years, and we all know this as confirmation bias. Thus, as we construct our buy and sell cases for each Focus List name at Alpha Europe, some of which eventually do qualify for the portfolio, our job is stay on top of these names after their entry, poking holes in the buy case, and seeking disconfirming information throughout the process.

As we do so, we want to have a culture where it is exceedingly acceptable for *any* of us to raise our hand and say "we just lost a key point of the buy case" or "this element of the sell case just became much more likely" or even "this isn't playing out like I expected it to, doesn't feel right, and I am losing conviction." **In other words, it is okay, at Alpha Europe, to be wrong. Our ultimate success here, and evaluation thereof, will not be as much based on whether we had individual positive outcomes, but by how we followed the process.**

We actually *want* to be wrong on occasion, and should realize that being wrong is the necessary counterpart of being right. Additionally, given our desire to have a very concentrated portfolio, this means that our search for the perfect ideas is continual. With a less concentrated, more diversified portfolio, we perhaps wouldn't be as stringent, but in a portfolio of 15-25 names, an integral part of the process is discarding those that we think won't be strong contributors, and developing even stronger conviction in those that will.

In the words (again) of Charles Ellis:

*"Most researchers should spend their time making sell decisions. Almost all of the really big trouble that you're going to experience in the next year is in your portfolio right now."*

Of course we don't know what the future holds, other than we should continue our search for excellence. If an investment stops ticking any of our boxes, we don't have to own it. **We should never be encumbered by where, or when, we bought a security.** Instead, we should keep repeating to ourselves:

*"If we were launching the fund tomorrow, and you wouldn't buy the stock, then we shouldn't own it today."*

<sup>1</sup> [The Loser's Game](https://www.ifa.com/pdfs/ellis_charles_the_losers_game_1975.pdf), C.D. Ellis, The Financial Analysts Journal, Vol. 31, No. 4, July/August 1975, 19-26. New York: Financial Analysts Federation. [https://www.ifa.com/pdfs/ellis\\_charles\\_the\\_losers\\_game\\_1975.pdf](https://www.ifa.com/pdfs/ellis_charles_the_losers_game_1975.pdf)

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