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Four types of people

"There are four types of people in the world. There are ***entrepreneurs*** – who are the guys who get out of bed in the morning and say 'How can I make money by making things better for people ?' There are ***contra-preneurs*** – who are all the governments and bureaucrats and regulators who try to stop that happening, make it difficult or ban it. There are the ***con-trepreneurs***.. who pretend to be doing the first thing but are just lining their own pockets, usually with government subsidies, with the help of the second group. And there are the ***non-trepreneurs*** – which is all the rest of us, who must be pretty bloody thankful every time we jump out of bed that the first lot keep doing it."

- Sean Corrigan of Cantillon Consulting, interviewed on the latest State of the Markets podcast.

As Mike Tyson never quite said, everyone has a plan until they get punched in the Facebook. Just when it seemed that Elon Musk's notorious Q1 Tesla conference call couldn't be surpassed for CEO-inspired trainwreckery, or that Netflix's Q2 earnings miss and its associated 14% share price fall might be setting some new kind of financial market low standard for 2018, along comes Facebook's Q2 conference call, which managed to knock $156.6 billion off the company's market valuation in after-hours trading. As the FT's John Authers pointed out,

> That is, deliciously, very slightly bigger than the current $155.6bn market cap of Facebook's fellow FAANG Netflix.

As JK Galbraith remarked in *The Great Crash of 1929*,

> If there must be madness, something may be said for having it on a heroic scale.

Having never owned Facebook and having no short exposure to the stock, where its share price goes from here is a matter of sublime indifference to us. But it's possible to put together a plausible thesis along the following lines. As the glamour stock most conspicuously leading the charge for the FAANGs, a savage technical break in Facebook's share price badly wounds prospects for the group as a whole. And if the group loses momentum, so do the broad US stock markets which have been patiently trotting in their wake. Rob Isbitts for Forbes points out that as at the end of June, of the 11 sectors that make up the S&P 500 index, six were actually down for the year. The average return of the 11 sectors was just over 1%. Technology was up 11.87% and Consumer Discretionary up 13.24%. Aside from gains by Amazon and Netflix, "the other nearly 80 stocks in [Consumer Discretionary] have collectively added about nil to the return of the leading sector thus far in 2018." To put it another way, US market breadth was already dreadful, and now the most glamorous stocks are starting to fall from the top of the ugly tree and managing to hit every branch on the way down.

Readers are encouraged to listen to our latest podcast, not least because the so-called Austrian School of economics, on behalf of which our guest Sean Corrigan advocates, is perhaps the only school in economics that properly acknowledges the role of the entrepreneur in wealth creation. William Thorndike's book *The Outsiders* acts as a handy primer for the sort of characteristics to look for in business owners and managers. Thorndike uses Henry Singleton of Teledyne as a stand-out exemplar:

> Known today only to a small group of investors and cognoscenti, Henry Singleton was a remarkable man with an unusual background for a CEO. A world-class mathematician who enjoyed playing chess blindfolded, he had programmed MIT's first computer while earning a doctorate in electrical engineering. During World War II, he developed a "degaussing" technology that allowed Allied ships to avoid radar detection, and in the 1950s, he created an inertial guidance system that is still in use in most military and commercial aircraft. All that before he founded a conglomerate, Teledyne, in the early 1960s and became one of history's great CEOs.
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> Conglomerates were the Internet stocks of the 1960s, when large numbers of them went public. Singleton, however, ran a very unusual conglomerate. Long before it became popular, he aggressively repurchased his stock, eventually buying in over *90 percent* of Teledyne's shares; he avoided dividends, emphasized cash flow over reported earnings, ran a famously decentralized organization, and never split the company's stock, which for much of the 1970s and 1980s was the highest priced on the New York Stock Exchange (NYSE). He was known as "the Sphinx" for his reluctance to speak with either analysts or journalists, and he never once appeared on the cover of *Fortune* magazine. [***Nota bene***, Elon Musk.]
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> Singleton was an iconoclast, and the idiosyncratic path he chose to follow caused much comment and consternation on Wall Street and in the business press. It turned out that he was right to ignore the skeptics. The long-term returns of his better-known peers were generally mediocre—averaging only 11 percent per annum, a small improvement over the S&P 500.
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> Singleton, in contrast, ran Teledyne for almost thirty years, and the annual compound return to his investors was an extraordinary *20.4 percent.* If you had invested a dollar with Singleton in 1963, by 1990, when he retired as chairman in the teeth of a severe bear market, it would have been worth *$180*. That same dollar invested in a broad group of conglomerates would have been worth only $27, and $15 if invested in the S&P 500. Remarkably, Singleton outperformed the index by *over twelve times.*
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> Using our definition of success, Singleton was a greater CEO than Jack Welch. His numbers are simply better: not only were his per share returns higher relative to the market and his peers, but he sustained them over a longer period of time (twenty-eight years versus Welch's twenty) and in a market environment that featured several protracted bear markets.
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> His success did not stem from Teledyne's owning any unique, rapidly growing businesses. Rather, much of what distinguished Singleton from his peers lay in his

> mastery of the critical but somewhat mysterious field of *capital allocation*— the process of deciding how to deploy the firm's resources to earn the best possible return for shareholders..
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> CEOs need to do two things well to be successful: run their operations efficiently and deploy the cash generated by those operations. Most CEOs (and the management books they write or read) focus on managing operations, which is undeniably important. Singleton, in contrast, gave most of his attention to the latter task.
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> Basically, CEOs have five essential choices for deploying capital—investing in existing operations, acquiring other businesses, issuing dividends, paying down debt, or repurchasing stock—and three alternatives for raising it—tapping internal cash flow, issuing debt, or raising equity. Think of these options collectively as a tool kit. Over the long term, returns for shareholders will be determined largely by the decisions a CEO makes in choosing which tools to use (and which to avoid) among these various options. Stated simply, two companies with identical operating results and different approaches to allocating capital will derive two very different long-term outcomes for shareholders.
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> Essentially, capital allocation is investment, and as a result all CEOs are both capital allocators and investors. In fact, this role just might be the most important responsibility any CEO has, and yet despite its importance, *there are no courses on capital allocation at the top business schools..*

So there are two specific attributes that we seek for long term investment success. The first is a CEO with the proven, requisite skills in terms of capital allocation. The second is a share price trading at no great premium to the fundamental underlying value of that business, and ideally below it. Seek, and ye shall find. If there is something of a dearth of obvious value opportunities in the Anglo-Saxon markets, for example, simply cast your net wider. We're finding no shortage of these kind of opportunities in Asia (notably within Japan and Vietnam – where other international investors tend not to be looking, at present). There may be four types of people out there, but there's only one type worth co-investing with.

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Tim Price is co-manager of the VT Price Value Portfolio and author of 'Investing through the Looking Glass: a rational guide to irrational financial markets'. You can access a full archive of these weekly investment commentaries here.

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