

Marcellus: The Outsider's Advantage in Investing



The success of non-establishment figures in reshaping the investment landscape in America over the past 40 years gives India a useful template. The outsiders have already made their mark in the VC and PE space in India. Now such thinkers seem likely to make their mark in the public market as the traditional mutual fund format runs struggles to generate alpha.

“The successful iconoclast learns to see things for what they are and is not influenced by other people’s opinions. He keeps his amygdala [the fear centre of the brain] in check and doesn’t let fear rule his decisions. And he expertly navigates the complicated waters of social networking so that people eventually come to see things the way he does.” – Gregory Berns in ‘Iconoclast: a Neuroscientist Reveals How to Think Differently’ (2010) [square brackets are ours]

Outsiders – especially Jewish ones - have excelled on Wall Street...

George Soros was born in Budapest, survived Nazi Germany-occupied Hungary and immigrated to England in 1947 after Hungary was occupied by Soviet troops. After finishing his education in England, Soros migrated again, this time to the USA.

Michael Steinhardt was born to a Jewish family in New York. The son of Sol Frank Steinhardt, a compulsive high-stakes gambler, New York’s leading buyer of stolen jewellery, and a convicted felon who was sentenced to jail for ten years for buying & selling stolen jewellery.

Carl Icahn was raised in a Jewish family in Far Rockaway, a suburb of New York City, which thanks to the 2-hour commute to Manhattan has some of the lowest rents in the City. Icahn attended the local high school. His father was substitute teacher. His mother also worked as a schoolteacher.

All three men rose from humble origins, got themselves an elite education (Soros at the London School of Economics, Steinhardt at Wharton and Icahn at Princeton) and then broke into the White Anglo Saxon Protestant (WASP) dominated investment elite in America to become amongst the most successful investors of their generation. All three men pioneered new forms of investing, very distinct from the non-confrontational mutual fund format practiced by the WASPs.

Soros pioneered the concept of a macro hedge fund which, amongst other epic adventures, famously broke the British pound in 1992. Steinhardt was amongst the earliest exponents of the multi-asset long-short hedge fund which charged fixed fees of 2% & performance fees of 20%. In 2014, Bloomberg named him as “Wall Street’s Greatest Trader”. As the Chairman of Wisdomtree, Steinhardt pioneered the introduction of ETFs in Emerging Markets. Carl Icahn pioneered activist investing i.e. ask underperforming CEOs to perform and if they can’t do so, turf them out. In an epic 60 year career, Icahn has unseated the CEOs at some of America’s best known companies (including Time Warner, TransWorld Airlines, Revlon and Marvel) and earned tens of billions of dollars in the process.

...and their “Outsider” tag has been central to their success

At a practical level, it is relatively easy to see why someone who does not belong to the establishment will be able to pioneer a form of investing which takes on the establishment. If you belong to the same social club or community as the CEO of a prominent company, you are unlikely to turn the screws on him in public and then oust him if he does not deliver. If you went to college with the British establishment, you are unlikely to consider running down the Pound. Put simply, an outsider has simply less vested in supporting people or institutions who validate the status quo.

In addition, as the quote at the beginning of the piece says outsiders or iconoclasts also have a different mental make-up. In Ray Dalio’s words *“The number one principle says that you must think for yourself.”* The outsiders are independent thinkers – both curious and non-conformist at the same time and happy to *“act in the face of risk because their fear of not succeeding exceeds their fear of failing...the greatest shapers don’t stop at introducing originality in the world. They create cultures that unleash originality in others.”* (Source: Adam Grant in ‘Originals: How Non-conformists Change the World’)

Investment implications

As the asset management industry in India moves beyond the traditional mutual fund format (where delivering alpha has become a challenge), Indians with more unconventional backgrounds will enter the investment arena and pioneer new styles of investing. Already, we can see that the pioneering efforts in the VC and PIPE (private investment in public equity) segments have occurred in Indian investment houses not based in Mumbai.

More unconventional styles of investing will not only shake up things for the traditionally dominant mutual fund houses but they will also require the intermediaries – who take investment products to HNWs – to see the world through a new lens. Out of the window will go portfolios with 50+ holdings and annual churn in excess of 30%. Into the arena will come tighter portfolios with low churn which gives the fund manager no place to hide. Out of the window will go juicy fixed fees which fund expensive overheads in central Mumbai. Into the mainstream will come fee structures where the investor and the fund manager share the upside.

It took a full generation (the thirty years to 2010) in America for the mutual fund to be gradually replaced by low cost tracker funds (as the mass market product) and by hedge funds and Private Equity (as the products for the elites). The transition will happen sooner in India as both the Indian regulator and intermediaries have seen how the story panned out in the West. But what is clear is that in this transition it is the outsiders – rather than the established elite – who will bring the fresh ideas to the table. As Adam Grant says in his bestselling book 'Originals: how Non-conformists Change the World' (2016): *“Ultimately, the people who choose to champion originality are the ones who propel us forward...their inner experiences are not any different from our own. They feel the same fear, the same doubt as the rest of us. What sets them apart is that they take action anyway. They know in their hearts that failing would yield less regret than failing to try.”*

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