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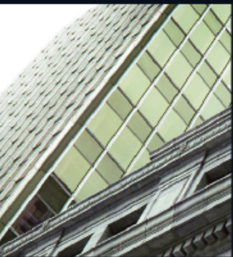
MONEY MAKERS

THE STOCK MARKET SECRETS OF BRITAIN'S TOP PROFESSIONAL INVESTMENT MANAGERS



JONATHAN DAVIS

Sample

MONEY MAKERS

THE STOCK MARKET SECRETS OF BRITAIN'S TOP PROFESSIONAL INVESTORS

Updated 2nd edition

Jonathan Davis

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I owe thanks to a great number of people for help in bringing this book to fruition. First, and most obviously, I am grateful to the eight professional investors who spared me the time to talk at length, and uncomplainingly, about their activities. As I note in the Introduction, collaborating on this book has led on, in many cases, to further fruitful professional contact over the years. Colin McLean's senior colleagues gave me a long and fascinating tutorial on his (and their) investment appraisal methods. Robin Angus has given me many insights into the character and achievements of his friend and colleague, Ian Rushbrook, as have Ian Hamilton Sharp and others. Mark Slater shared some fascinating thoughts on his father. My colleagues at Genagro Ltd have done the same. The following also proved invaluable in hunting down background material for the first edition: Paul Kafka and Jo Roddan (at Fidelity); Helen Tweddle (Scottish Value Management); Patricia Riddle (Foreign & Colonial); Claire Pallen (St James's Place Capital); Linda Macfarlane (ABN Amro Carrington Pembroke); and Graham Quick (Hemmington Scott, publishers of Jim Slater's *Really Essential Financial Statistics*).

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blog.independent-investor.com. Sandy Nairn, the CEO of Edinburgh Partners, and co-author of my most recent book, *Templeton's Way With Money*, has been a particularly productive source of ideas and inspiration over the past 15 years. Readers of my columns in *The Independent* and *Financial Times* have made many valuable suggestions.

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INTRODUCTION TO THE 2013 EDITION

When asked his opinion about what the stock market would do next, the banker J.P. Morgan replied, briefly but pointedly: "It will fluctuate." Ben Graham, the leading stock market authority of his day, searching for an appropriate theme for his last and probably his greatest book, *The Intelligent Investor*, turned to Virgil's epic poem *Aeneid* for the inscription: *Per varios casus, per tot discrimina rereum tendimus*. This he translated as: 'Through chances various, through all vicissitudes, we make our way.'

Since 1997, when the first edition of *Money Makers* was written, events have amply justified the wisdom of these two great investors in affirming the essential changeability of the stock market. The fifteen years that have elapsed since have been marked by some extraordinarily violent fluctuations. The Asian crisis of 1998, the extraordinary Internet bubble of 1999-2000, two severe bear markets during which share prices fell by around 50% from peak to trough (2000-03, 2007-09), followed by the global debt crisis and subsequent recovery; it has certainly been a rollercoaster ride.

As I write this introduction, the timeless cycle of rotation from fear to optimism and back again is once again at work. For most of the past year markets have been spooked by well-justified fears about the consequences of the unprecedented build up of debt in many Western countries. The Eurozone has struggled for months to contain fears that it was about to break up. Pundits everywhere have been warning bleakly of hard times ahead, sending investors scurrying into supposedly "safe haven" assets,

such as bonds and gold. Then suddenly a few weeks ago the mood changed once more and many so-called risk assets, including shares, recovered strongly, rising by an average of 20% in a matter of weeks.

Faced with such dramatic reversals of fortune, it is not surprising that many people seem to have given up on trying to understand, or benefit from, an investment in stocks and shares. There is no doubt that we are living through a period of relatively poor stock market returns, as always occurs after such extreme bubbles as we witnessed at the height of the Internet boom, when many investors lost all touch with reality and pushed share prices to absurdly high levels that were quite unjustified on any fundamental grounds – a mania as dramatic and as extraordinary as anything in recorded financial history. Such long cycles of market booms and busts have happened throughout history.

From 1982 to 2000, so we can see with hindsight, stock markets rose at an unprecedented rate, averaging annual after-inflation gains of 12% per annum, well above their long run average return. It was a period in which, notwithstanding such dramatic interludes as the 1987 stock market crash and the 1990-91 recession, making money from shares was as easy as it has ever been. Many people came to the stock market for the first time and prospered from the experience. A powerful combination of new technology and deregulation led to the rapid growth of new stock exchanges around the world and the advent of round-the-clock, real-time global trading.

Now, however, in the less favourable environment of the early twenty first century, the going has become much tougher. The best-known US and UK stock market indices, the S&P500 and FTSE All-Share, both finished the first decade of the new century lower in capital terms than they started it. Even allowing for dividends, investors in mainstream shares have suffered a largely barren decade. The severity of the banking crisis in 2008 and the periodic outbreaks of volatility since have heightened risk aversion. Interest rates have slumped to unprecedentedly low levels, dragging down the returns on many different types of investment, not just shares.

It is important however to draw the right conclusions from this generally unproductive period. The premise behind writing *Money Makers* the first time round was that there was much that investors could learn from studying the ideas and methods of the best professional investors of the day. Since the crazy market peak in 2000, with the search for successful investments becoming harder, the need to understand how the markets work continues to grow. In fact, in a period of low and declining nominal returns, I would argue that there has never been a greater need to learn from wise and impartial professional opinion, where it can be found. Today's investing conditions are difficult and challenging for professional and private investors alike.

The past fifteen years have certainly been a period when it has paid to be selective in deciding where to invest. While the UK and US stock markets have struggled to make ground since 2000, the same has not been true for example of gold, of emerging markets or of bonds. Gold has completed eleven straight years of annual increases, rising eightfold in value over the period. Emerging markets funds, such as the investment trust run by Mark Mobius, one of the investors featured in this book, has doubled in value over the past twelve years. The annualized rate of return on government bonds since 2000 has meanwhile been around 7.6% per annum, against just 3.2% for shares in the UK. (Please don't assume however that the superior performance of bonds can be repeated in future. It cannot and it won't be).

Many of these trends were spotted well in advance by those I write about in this book. In truth there is always money to be made if you know where to look – the question is: do you? If not, where can you learn how to do better? That is one reason for reissuing a new and updated version of *Money Makers*. A number of the professional investors I profile are sadly no longer active. Two of the wisest, Ian Rushbrook (who correctly forecast the onset of the 2008 global banking crisis), and Nils Taube (who had done the same for the 1987 stock market crash), have died since the first edition appeared. Two others, Michael Hart and John Carrington, have retired. The chapters on these four investors I have therefore left largely unchanged, with only a brief note at the end to update their personal biographies. Their wisdom and insights remain as relevant as ever.

For the other four, all of whom are still very much actively engaged in looking after their own or other people's money, I have made more substantive revisions, updating and revising the chapters as appropriate. In the case of Anthony Bolton, I have updated the chapter to take his story to the end of 2007, when he retired from running his main UK equity fund, with his reputation as the outstanding fund manager of his generation securely in place. I have not sought to look in detail at his subsequent post-retirement reappearance in Hong Kong as the manager of a Chinese equity fund, since it is too early to pass a definitive judgment on his performance in that interesting new venture (it has made a disappointing start). In the interests of readability, I have maintained the present tense for all eight of the profiles. I have also left the original Appendices unchanged.

One happy consequence of the first edition of *Money Makers* is that I have been able to deepen my knowledge of several of those I profiled at the time. Jim Slater, for example, knowing of my interest in the commodity cycle, persuaded me to become a founding shareholder and advisor to a Brazilian farmland fund, Agrifirma Brazil (now renamed Genagro Ltd), which he helped to set up in 2008. Shortly before that, I completed a full-length book about the methods of Anthony Bolton, based on further extensive conversations about his experiences and ideas. I have subsequently written a third book, this one on the methods of Sir John Templeton, published in 2012, for which Mark Mobius, one of his disciples, has provided several useful insights.

It has been a pleasant surprise to discover how little I have had to change my personal judgments as a result of these more extensive contacts. I have also felt little need to change the conclusions of the original edition. It remains the case that the basic principles of investment – buy low, sell high, spread your risk, acknowledge your limitations and tailor your methods to your temperament and experience – do not change with the passage of time. Attempts by academics to introduce more scientific methods to investment practice were all the rage in the 1990s, but the results have, by and large, been disappointing. The search for psychological and behavioural explanations for market movements has

turned out to be a more productive line of enquiry than the assumption that investors are driven by rational expectations.

If I had to add any emphasis to my original text, it would be to say that the case for using low cost index funds for building exposure to core assets in an investment portfolio is much stronger than I gave it credit for in the original edition. It is a well-documented fact that the great majority of professional fund managers and investment advisors fail to deliver consistent outperformance of their benchmarks over time. Index funds, which passively seek to track the performance of well-known market indices, have meanwhile become both much cheaper and more widely available, making them an increasingly attractive building block in any investor's portfolio. Any newcomer to the investment field should start in my view by reading the wonderful books of Jack Bogle and Charley Ellis which make the case for indexing and cost minimization as core disciplines in your investment portfolio.

That general principle does not in any way however invalidate the case for studying the methods of the most successful market practitioners, or indeed investing in their funds. It merely makes it imperative, as in any professional enquiry, to seek out the very best of the bunch. That is what I set out to do when I first wrote *Money Makers*. I know that my own portfolio has benefited hugely from what I learnt. It is gratifying to know that others have also profited. One pleasing example concerns an up-and-coming fund manager by the name of Sebastian Lyon, who so liked what he read in one chapter of the original edition that he subsequently travelled up to Edinburgh to meet and seek advice from its subject, Ian Rushbrook. The two men found they shared the same philosophy and remained in regular contact. When the board came to appoint a new Investment Adviser to Mr Rushbrook's investment trust Personal Assets after his untimely death, they had no hesitation in appointing Sebastian's firm Troy Asset Management to do the job, with what so far has been very satisfactory results.

Most investors are guilty of serial offences in their behaviour, not least in chasing what is popular rather than what is objectively good value. The

best and most profitable way to invest is of course exactly the other way round: trim and protect your profits when markets are overvalued and look for new opportunities when the reverse is true. Don't be afraid to think for yourself – and, most importantly of all, don't be detered by the inevitable reverses. A fascinating new field of scientific enquiry, behavioural finance, has started to chronicle the many emotional biases which prevent human beings from doing the most rational things with their money. "Investing is not a smooth graceful progression to wealth," observes the American authority Charles Ellis. "It is a bumpy road and requires persistence and constancy of purpose."

The long-term case for investing in the stock market remains robust; and to the extent that shares have recently become cheaper the current difficulties may already be creating more favourable opportunities for the future. (My personal view is that we are not yet quite through the long and painful adjustment that became necessary after the excesses and policy errors of the past decade, but it will not be that long coming). In order to profit, however, it is necessary to understand exactly what successful investment in practice entails.

There is no escaping the fact that active fund management is a little like professional golf – a field where the mediocre can earn handsome rewards, but where true champions, who can raise and keep their game at a higher plane for years at a time, are few and far between. It takes rare gifts to sustain success in this business over more than a few years, but the challenge to a certain type of individual is irresistible. It is evident that someone like Anthony Bolton has an ideal temperament to pursue his contrarian investment style; dedicated, unflappable, thoughtful, somewhat obsessed. It takes courage and commitment to go on, year in year out, taking a different view to everyone else in your profession. As the author John Train says in his outstanding study of successful professional investors of the modern era: "Although a professional investor can sometimes strike it rich with a big coup, there's no luck in professional portfolio investing, any more than in master chess. It's a skilled craft, involving many decisions a week. The year-in, year-out manager of a large

portfolio can no more pile up a superlative record by luck or accident than one can win a chess tournament by luck or accident."[1]

The point that both Morgan and Graham were at pains to make all those years ago is that it is the nature of the stock market to go up and down. You cannot have the periods of gain without the equivalent periods of retreat. It you don't like that fact, you shouldn't be in the market at all. The good news is that there are more up periods than down periods and it is the down periods that create the best buying opportunities. But never forget, either, that successful investment is not as easy as it is often made to appear. It pays to be forearmed – and to have wise and experienced counsel at your shoulder. I hope you will find just that in this book.

Jonathan Davis
February 2013

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[1] John Train, author of *Money Masters of Our Time*.

1. INTRODUCTION

This is a book about some of Britain's most successful professional investors – who they are, what they do and how they think. It is designed to appeal to anyone who shares my interest in the stock market and wants to know how the experts go about making money from it. It is, thank goodness, no longer politically incorrect, as it seemed to be thirty years ago, to believe that the stock market fulfils an important function in the working of an efficient economy, nor to suggest that there is anything wrong in people trying to maximise their wealth through buying stocks and shares. For good or ill, we are all capitalists now.

The stock market does enjoy one huge advantage over most other ways of risking your money. Unlike say, gambling on the horses, or buying a National Lottery ticket, stock market investment is an activity where the odds actually favour the ordinary investor making money over the medium to long term. There is no certainty about it, but the balance of probability is that anyone who invests sensibly over a period of years with some idea of what they are doing will earn a significant real return from their investment. "The stock market is a casino," says one of the professionals I quote in this book, "but it is also a very nice casino in which everyone can get to go home with a return of 10% *after* the house take." This book is designed for anyone who finds that thought appealing and would like to make some capital from it.

Over the past few years, I have been fortunate to spend a lot of time talking to those lucky few who are able to make their livings purely from their stock market expertise. Through my work as a columnist on a national newspaper,

and my consultancy work for large companies, I have been privileged to share the thinking of many of the sharpest investment minds in this country and watch them go about their work. This book is the result of many hours of conversation and research. It is my attempt to pass on to the general reader some of the professionals' insights into the art of investment.

It so happens that investment is something at which Britain is rather good. Although we still lag a long way behind the United States in our popular enthusiasm for the stock market, as a nation we are undoubtedly blessed with some of the most talented professional investors anywhere in the world. In a typically understated way, we have been managing money and investing on behalf of others longer than almost anyone in the world. London and Edinburgh are both established centres of excellence in the investment management world. Investment expertise is also one of our leading export industries.

An official report in 1996 estimated that fund management, although it employs no more than 35,000 people, contributes 0.4% of the country's Gross National Product. It brings in £425 million a year of income from abroad. This is one reason why so many of our best fund management firms are now being bought by large foreign banks, which want access to our long-standing expertise in this field. One of the benefits of Big Bang, the act of deregulation which swept away many of the restrictive practices in the stock market in 1986, is that it has opened the business of investment management to much greater completion than before. There had been an all-round improvement in professionalism and standards.

The effects have not all, admittedly, been for the good. The 1990s witnessed some deplorable cases of dishonesty and incompetence at some the largest and best-known City firms: Barings and Morgan Grenfell to name but two. The new century has produced other examples, calamitously in the great banking crisis of 2008. There have been worrying signs of the emergence of a 'star system' in the investment management business. Cut-throat competition to secure the services of the best fund managers has led to an unhealthy spiral in the rewards paid to top names and a dangerous obsession with short-term performance. Some of the biggest players in the business seem to have forgotten that, however highly

rewarded, they are ultimately paid to manage other people's money, and not merely to enrich themselves. While there are plenty of honest and competent investment managers around, there are only a handful of exceptional ones.

What I have attempted to do in this book is to take a detailed look at a number of professional investors who I believe can with justice be called 'stars' of the investment business. These are investors who are held in the highest regard by their professional peers, not just for their performance over a period of years, but for their commitment to the art of investing. Apart perhaps from Jim Slater, none is a household name, yet all eight share the experience of having made a lot of money from practising their skills. Between them, I calculate that they manage something like £15 billion of other people's money, and earn their employers over £100 million a year for doing so. But for most of them the financial rewards have long ceased to be their primary motive. They carry on because they are hooked on the business of stock market investment itself.

Investment managers are also, of course, commercial animals. Fund management is a business like any other. It is not enough to be good. You have to convince others how good you are as well. According to Warren Buffett, the legendary American investor, the business of investment management is '25% performance, 75% marketing'. One has to allow for the fact that few professional investors are as good as their marketing departments would have you believe. Beating the market averages is a much tougher business than their seductive advertisements suggest. Academic research has demonstrated quite conclusively that only a small minority of professional investors consistently do better than average over a period of years and even in these cases, it is difficult to prove conclusively that this is the result of skill rather than luck. But while consistent outperformance is rare, it *can* be achieved; and those in this book have all done it for protracted periods. This is the reason why they are worth listening to.

Despite the advent of investment consultants whose sole function in life is to analyse the performance of professional fund managers, there is no one way of measuring success in investment. It is not just about making the most money, but doing so with an acceptable level of risk. There is

little point in trying to rank the performance of someone running a hedge fund – a highly geared specialist vehicle for professional investors, of the kind run by George Soros – with someone running a general unit or investment trust targeted at ordinary investors. As a matter of policy I have only included in this book those who operate in the mainstream of investment management. Explaining how the masters of the hedge fund business make their money is a fascinating subject, and one where the financial rewards can literally be fabulous, but is a subject that I have left for another time and place.

Although I have screened the performance figures of all those profiled here, I have allowed myself to be influenced by subjective factors as well in deciding who to include. Twenty years of working in and around the City have allowed me to consult many of the top names in the business about who, in their opinion, are the best professional investors. There is a surprising degree of consensus about the names, as there is also about those whom the experts regard as the most overrated. I am grateful to all those who have let me tap their brains and experience so exhaustively.

Apart from track record and the respect of their peers, one other criterion I have insisted on is that those profiled must have something of value to say about the craft of stock market investment – and be prepared to say it, since this book could not have been written without their co-operation. Deep Blue, IBM's chess computer, may have beaten the world champion Gary Kasparov for the first time, but would still make a very dull interviewee. In the same way there is no obvious correlation between being successful as an investor and having something of interest to say about it. In fact, as Ian Rushbrook pointed out to me, one of the great things about the stock market is precisely that it is oriented towards results. You don't have to be able to articulate why what you have done works and a number of experts who failed this test have been excluded for that reason. It ought to be said here that while the subjects of the book have all had the chance to correct factual errors, the final judgements are mine and mine alone.

The format of the book has deliberately been kept as simple as possible. Each chapter consists of a detailed account of one professional investor. It

describes his background, personality and views about investment. In the final chapter, I pull together the common threads that run through the previous chapters and make some observations about what lessons can be drawn from them. This is not a 'how to' book, but I will be disappointed if anyone who reads it does not come away with some valuable insights into how to improve their own investment performance.

A SHORT NOTE ON INVESTMENT TERMINOLOGY

The business of analysing investment performance has become a growth industry of its own in recent years, with a concomitant increase in new vocabulary and jargon. There is no reason why readers should bother themselves overly with it, but you may find some of the basic concepts helpful in differentiating between the investment styles of the investors described in this book.

Bottom up investment is the term used to describe those who base their choice of investments on the merits of individual stocks and shares rather than on broader economic or business trends. There is a parallel to the way that economists distinguish between *microeconomics*, the study of the behaviour of particular firms and individuals, and *macroeconomics*, the study of the behaviour of whole economies.

Top down investors, by contrast, believe that the most important decisions to make are not which particular shares to buy, but which stock markets, which currencies and which types of financial asset they should be invested in. The main classes of investment assets are: equities (shares), bonds (fixed interest securities), cash, property and index-linked gilts. For large investment institutions, in particular, these *asset allocation* decisions can often be the primary factors that determine their investment performance. The sheer size of their portfolios means that they cannot rely on just a few stocks and shares to determine their results, as individual investors can.

Active fund management is what most professional investors are paid to do. It is the business of trying to outperform the market by buying and

selling shares or other investments which are expected to provide an above-average return over a given period of time. A share's return each year is measured in two ways: by the income it pays and by the extent to which its capital value rises or falls. A share whose price rises from 100 pence to 120 pence during the year and pays dividends of 5 pence is said to have produced a *total return* of 25% (20 pence of capital appreciating plus 5 pence of dividend, expressed as a percentage of the 100 pence purchase price).

Passive fund management is an alternative approach which has grown in importance over the last ten years. The premise here is that, for many investors, the odds of consistently outperforming the main stock market indices are not good enough to justify the cost and effort involved. Better in these circumstances to buy a fund whose sole purpose is to mimic the performance of the main stock market indices (a policy known as *index tracking*). The market indices play another role in the life of professional investors. They are the *benchmarks* against which an investor's performance is measured. An investor that invests solely in UK equities will typically assess their results against one of the main UK stock market indices; either the FTSE Index (popularly known as Footsie) which records the performance of 100 of the large quoted companies, or the FTSE All-Share Index. The latter measures the performance of around 900 shares and gives a broader picture of the market's movements, including as it does many small and medium-sized companies. For international investors, there are any number of global, regional and country indices to choose from.

Of the two poles in the investor's universe, return is the easy one to measure. *Risk* is a much harder animal to pin down. In the absence of an agreed definition of what investment risk is, the measure most commonly adopted is that of *volatility*. This is a statistical measure of how far a fund's returns have deviated from the norm over time. In this narrow sense, a fund which demonstrates high volatility is deemed to be riskier than one with lower volatility. It makes more sense however to think of the risk as the probability of permanent capital loss.

Among active fund managers, a traditional distinction is between *value* and *growth investors*. *Value investors* are primarily interested in buying shares that they judge to be 'cheap'. That is, they appear undervalued when measured against one of a number of different criteria, such as the stock market value of companies in similar lines of business, or their own share price history, or the value of other competing types of security (for example, government bonds or gilts). The kind of shares that value investors look for typically have relatively low price/earnings (p/e) ratios or relatively high dividend yields. *Growth stock investors*, by contrast, are primarily interested in buying shares in companies whose businesses are growing rapidly. The shares may not necessarily appear cheap at the moment, but their growth potential is expected to produce an above-average growth in share price in the future.

These are some of the standard valuation tools that investors look at when judging the merits of a particular share.

Yield (or dividend yield). The value of a company's annual dividend payments, expressed as a percentage of the current share price. For example, a company with shares priced at 100 pence and paying dividends of 5 pence a year would have a dividend yield of 5%. (This is the gross dividend yield; it is also possible to refer to a share's net dividend yield, that is after the deduction of income tax.)

Price/earnings ratio. (Also known as *P/E ratio*, or *earnings multiple.*) This is a company's share price expressed as a multiple of its earnings (or profit after tax) per share. A company which has reported earnings per share of 10 pence and sells at a price of 100 pence has a *historic p/e ratio* of 10 (100 pence/10 pence). A company which is forecast to report earnings per share of 10 pence in its next year end statement and sells at 100 pence has a *prospective p/e ratio* of 10.

Return on capital. A company's profitability expressed as a percentage of the amount of capital invested in the business. There are a number of different ways of calculating this figure. A related concept is *return on equity*, which measures a company's profit as a percentage of the capital

that shareholders have subscribed or ploughed back in to the business (i.e. excluding capital raised in the form of debt).

Price to book value. The ratio between a company's share price and the company's net worth, as recorded in its balance sheet and expressed as a per share value. Thus, a company with a net worth of 100 pence a share, and whose shares sell for 150 pence, has a price to book value of 1.5 (150 pence/100 pence).

Net worth. Is calculated by taking the balance sheet volumes of a company's assets and subtracting all its liabilities. This figure is also known as shareholders' funds. Because accounting conventions record assets at cost, rather than at current market value, a share's book value will usually understate the current value of the business.

Price to sales ratio. The ratio between a company's share price and its sales, expressed as per share value. A company with sales of £100,000 a year and 100,000 issued shares has sales per share of £1. If the share price is £2, its price to sales ratio is 2.0 (£2/£1).

Real and nominal returns. All professional investors need to isolate the effect that inflation has on the investments they make. To make a real return, a share has to grow in value by more than the rate of inflation. If inflation is 3% a year, a share that returns 6% a year has produced a real return of approximately 3% (6% – 3%).

All the investors profiled in this book are active investors, but their styles are strikingly different in important respects. This is reflected in such things as the length of time they tend to own particular investments (the *holding period*), the rate at which they change their holdings (their *turnover* rate) and the range of markets in which they are prepared to invest.

2. ANTHONY BOLTON:

The professional's professional

AN ORDERLY MIND

To find Anthony Bolton's London office, you take a trip to the heart of the City, to a large modern office block that overlooks St Paul's Cathedral. The site formerly housed a large American bank whose global ambitions proved to be greater than its capabilities. It is unquestionably his employer Fidelity's grandest office yet, with a marbled entrance hall and a selection of David Hockney prints on the walls, reflecting the success of the firm's foray into Europe. Bolton's office is located on the second floor, where he sits at a standard issue desk, facing away from the view of Sir Christopher Wren's glorious creation outside. On a shelf behind his desk is a row of books that contain, in date order, his notes on all the meetings with companies that he has recorded and kept over the years. (There are over sixty in all, of which more than 80% concern his meetings with UK companies.) There is a computer screen in the corner, and on the walls family photographs, cartoons and a handful of the numerous industry awards his efforts have won over the years. The overall impression is strongly reminiscent of a university professor's office. This is orderly, functional space, and not much more. There is little to indicate that this is where arguably the best money manager the UK has ever produced goes about his business.

To meet, Bolton is a slim, unobtrusive figure with bright eyes and slightly curly, now greying hair. He speaks quietly and suprisingly haltingly, but mostly in complete sentences, the telltale sign of an orderly mind. He gives off an image of cool and quiet efficiency, is unfailingly courteous in company, and would certainly not look out of place in a serious university. You gain the impression that there is little he does with his life that is not deliberate. But that, intriguingly, proves not to be entirely the case. This is someone who had to be kicked out of bed by his father to get a job on leaving university, and who drifted into the City by chance rather than from any lifelong conviction that he was destined to make money from buying and selling shares. This leisurely start to life has not stopped him becoming one of the most highly sought-after fund managers in a highly competitive, well renumerated business whose top performers can earn multiple millions in a single year.

Quiet and thoughtful, and anything but flash, Bolton is a model of what the modern professional investment manager should be: clear-sighted, disciplined, hardworking and conscientious, with a track record of consistent outperformance in all his funds. Although the business of investment can never be reduced to a science, Bolton's career has demonstrated how a mixture of flair, common sense and hard work can be profitably applied to the art of picking stocks. He is a contrarian investor, someone who takes positive delight in scouring the bargain basement areas of the stock market, looking for shares that are damaged or unloved, but capable of redemption. The strategy has its risks, even for a diversified fund, but it has worked like a dream over the 28 years that his funds have been on the market, and that is what ultimately counts for any professional fund manager.

The two funds that have occupied the bulk of his career, Fidelity Special Situations and Fidelity European, have both achieved a compound annual rate of return of 20% while under his management, comfortably beating the market and their peer group in both cases. The funds and their manager have won a stack of industry awards, too numerous to mention, and both command best-of-class ratings from Standard & Poor's, Morningstar and other leading independent fund rating services. Serious

observers have described him in print as Britain's answer to Peter Lynch, the legendary Irish-American stockpicker who for thirteen years ran the world's largest mutual fund, the Magellan fund, for Fidelity in the United States. More significantly perhaps, in a poll of leading fund managers conducted by *Sunday Business* in 2003, when asked to nominate the competitor they most admired, no fewer than five out of the ten named Bolton.[1]

In his own view, as well as those of his admirers, Bolton's great strength as an investor is that he is an emotionally placid individual, more than capable of taking setbacks with fortitude. "You have to be a fairly calm person to be a fund manager" is his own assessment. "The great thing about him," says Peter Jeffreys, a former colleague who went on from Fidelity to co-found the ratings firm Fund Research, "is that everything he does is completely straight up and down. There is absolutely no side to him, none at all." Sir Charles Fraser, a fund director, asked to provide an anecdote about Bolton, replied simply: "I have none. He is not an anecdote sort of person." Less immediately obvious is the high degree of commitment and organisation that Bolton brings to his task. Like the majority of successful professional investment managers, he believes that to be a professional investor, you have to be wholly absorbed by the markets. "I think you have got to be fanatical about it", he says, "because investing is continuous and intangible. There's no beginning or end to it, and there is always something new that needs delving into. I think you have to be completely taken by it to do well. If I look at the investment managers I admire, none of them do it part time."[2]

He concedes that it may be different for those, such as George Soros, the hedge fund speculator, who specialise in making big bets on the macroeconomic outlook. For those two or three decisions a year, assuming they are the right ones, and they are backed heavily, can be all the

[1] It is an indication of the unassuming way that Bolton works that three of the five who nominated him said that they had never met him.

[2] Unless specifically attributed to another source, all the direct quotations in this section are from interviews with the author.

difference between success and failure. But for investors who specialise in picking stocks, as Bolton does, there is no alternative to being fanatical. When he started, he had only 20-30 shares to look after. But now, thanks to the success of his funds, which have grown two hundredfold in size since 1987, there are nearly two hundred stocks to track in his various portfolios. It requires not just hard work, but the support of a large team of analysts to keep tabs on what they are all doing. At the last count, there were more than 50 analysts at Fidelity in London whose work he could call upon. Bolton has helped to train many of them himself in the art of stock analysis, Fidelity style. They know what he wants and he has faith in what they produce.

DEVOTED TO DETAIL

Bolton's working week is a long one. Given the emphasis that Fidelity places on in-depth research, the amount of paperwork and electronic material he has to shift through every day is formidable. A typical day for Bolton begins with him leaving home in West Sussex at 6.30 a.m. to catch a train to London. He reads the *Financial Times* on the train and also does his homework on one or more of the companies he will be seeing later. On the way to and from the station he also catches up on the forty or so voicemails he has each day, many of them from colleagues reporting back on recent meetings with potential or current holdings. His working week revolves around company meetings. When he was covering both UK and continental companies, it was not unknown to do as many as five or six a day, and there are many others for which a colleague will provide a report. Fidelity as a group sees an average of fifteen to twenty companies a day in London, sometimes more, either in its offices, at the companies themselves or by conference call. This commitment to face-to-face meetings is, Bolton has no doubt, one of its main competitive strengths as a firm.

Each company is analysed beforehand in detail by the in-house analysts, and becomes the subject of a detailed pack of information, several pages long, covering the key financial data, plus brokers' views and any other

relevant material, such as press cuttings and so on. The meetings are an opportunity for Bolton and his colleagues to ask questions of the management and keep up to date on how the business is going. All these meetings are written up afterwards. Bolton himself takes his own hand-written notes, usually two or three pages long, which he files neatly away in the books behind his desk. He brings them out later to check that companies have not changed their tune since he last saw them. Browsing through them gives an insight into the austerity of his methods: in the dozen or so volumes I looked at one day, there was not a single anecdote, piece of gossip or personal remark to be found (and not even a doodle, for that matter). It requires, not least, an ability to concentrate intensively on the task in hand.

Unusually, in addition to Fidelity's own analysis and research bought in from brokers and others, Bolton also likes to look at a number of share price charts before seeing companies, in order to see what their recent price action has been. Add all this up, and you have a pile of daily paperwork that would make Sir Humphrey Appleby, the mandarin in the television series 'Yes Minister', proud. It is one reason why he normally gets home at eight in the evening, and says he dreads the end of holidays because of the huge pile of files that he knows will be awaiting him on his return. One way he escapes from the pressure of work is by composing classical music, an activity he has recently resumed after having been very keen as a child. It leaves little time for socialising with his professional peers, or even his Fidelity colleagues. He is not by his own admission "a going out for a beer person. I commute in from the country. I don't do a lot of evening things. I like to get home."[3]

"There is an awful lot of reading", he says. "One reason I commute by train is that I can kill off quite a lot of it that way. You have to know what you are looking for because you can become mesmerised by the sheer volume of it all, and lulled into complete inactivity. I like to screen a lot of things and most of the broker material is frankly unnecessary, at least for my purpose. There are certain analysts whom I rate, and I know to look out

[3] *Daily Telegraph*, January 10th 2004.

for their stuff. If the note is a sell and it's a company I don't own, I won't even look at it. If it's a sell and I do own it, then obviously I'll want to have a quick look. But you have got to weed out the dross."

The background briefing material that Fidelity analysts prepare on each company is presented in a standardised house format. Even so, the sheer weight of material means, says Bolton, that "you have to have a system to get through, otherwise you are sunk". Some of his fund manager colleagues survive by ignoring all the brokers' research, preferring to stick to in-house material alone. But this is not Bolton's style. "I don't have that approach. You never know where the next idea is going to come from." An eclectic mind, he insists, is needed to make his style of investing have any chance of working.

When companies come to visit, as they do in ever growing numbers, Bolton says that what he is mainly looking for is evidence that the managements know their business. But he is far from starry-eyed about the importance of management in the success of a company. "While some investors put a lot of emphasis on the quality of management, I'm more of a Warren Buffett follower in that I would rather have a good business run by average management than the other way round. I find that people who impress you in meetings are not necessarily the best managers." He mentions John Gunn, who was widely lauded for a while in the 1980s as the best manager in the City. A few years later, his company, British & Commonwealth, was bust.

"I like managements who are consistent in what they say. I dislike hyperbole, managers who consistently overegg the pudding." He is more concerned to see what companies are saying about their products: "If they put great emphasis on one product when they come to see us, and next time fail to mention it at all, we will obviously start to get worried. You are obviously looking to read between the lines." If a competitor says something positive about a company's product range, it counts for twice as much as the company saying the same thing itself.

A CHANCE BEGINNING

Given such a highly formalised approach to his work, it comes as something of a surprise to learn that Bolton only drifted into the business of investing by chance. His early experience was gained at a small and rather risqué merchant bank called Keyser Ullmann. In its heyday in the early 1970s, it enjoyed a reputation for adventurousness, later somewhat tarnished by a number of unsuccessful and controversial deals that eventually resulted in the bank disappearing as an independent entity. Bolton went there as the bank's "first and last graduate trainee". He had studied engineering at Cambridge, but says that after two years of the subject the "one thing I was pretty certain of was that I didn't want to become an engineer". When the time came to leave university in 1971, he did so without having a job lined up.

About three weeks after the end of his final summer holidays, Bolton's barrister father, who had previously encouraged him to take his time over deciding what to do, suddenly began to apply pressure on him to make a more positive attempt to find a job. A businessman friend of the family suggested he think about the City, and another family friend, a stockbroker, gave him an introduction to Keyser Ullmann, which at the time was still growing fast and had decided (according to Bolton) that "this graduate training business sounded a good idea". By such strange quirks of chance are successful careers often launched.

Unlike many other successful investors, Bolton did not set out to find a job as an investment manager, nor did he arrive in the business with any burning ambition to make money from the markets. As he points out, amongst his peer group at university, corporate finance was still very much the 'in thing' for those who went into the City. Investment management was regarded as second-division stuff. "Corporate finance had the glamour attached to it", he recalls, "and investment management was hardly known as an industry." He himself had no prior interest in the markets, and knew nothing about them. Not for him a history of trading stamps, or other moneymaking schemes, while he was a child. Unlike many of the greatest investors, whose motivation to succeed often stems from a poor

background, Bolton had a conventional and comfortable middle class upbringing.

Bolton spent five years at Keyser Ullmann, and reckons he got good training while he was there, despite the bank's subsequent problems. He started as a general trainee, "behind the tills, doling out the money, trooping off to the money markets, where they all went around in top hats in those days". After a brief stint in administration, he spent a little time on the investment side, and it was there that he finally "picked up the bug of stocks and shares". He was offered a job as a research assistant in the investment arm of the bank. It was here that his career as an investment manager began. The investment side was separate from the rest of the bank and most of the money it managed was in investment trusts. This meant, says Bolton, that when the bank got into difficulties and depositors started taking their money away, his side of the business remained largely unaffected.

DEVELOPING A STYLE

Three things about the way that Keyser Ullmann managed money proved influential in the development of Bolton's style as an investor. One was that they specialised in smaller companies, something that remains one of his trademarks today. The second was that they went out and visited the companies they owned. This was rather novel at the time, when most investment managers still relied heavily on stockbrokers to bring them information and ideas. Third, one of the directors was interested in technical analysis, or the use of share price charts, to supplement conventional fundamental analysis of shares. This too remains one of Bolton's interests.

His job as an assistant to one of the fund managers included writing a few paragraphs on each company's half-yearly and annual results, saying whether or not the shares still looked reasonable investments. He remembers the fascination of discovering the Datastream machine, then

something of a novelty in the City, which allowed him to search ('screen') the universe of stocks and shares looking for those which met common specified characteristics.[4] Nevertheless, he says, it took him quite a while before he fully understood how the business worked.

Bolton had to cut his teeth as an investor in the scary markets of 1973/75, when the secondary banking crisis was at its height, and the stock market endured its worst decline in living memory. He remembers lunches at which all the other fund managers spent their time boasting about how little money they actually had invested. Instead they seemed to be competing against each other to see who had most of their money in cash. "There was a feeling of: What have I got into? Is the whole world going to end? Would the stock market ever stop going down?" It did, but it was not long before Bolton had decided that, with all the problems at Keyser Ullmann, now was a good time to move on. After a few interviews, he was offered a job as a fund manager by the Schlesinger group, which was owned by a wealthy South African family with property and financial interests in London. Among them was a unit trust company, run by Richard Timberlake and Peter Baker.

Both men proved influential in the development of Bolton's career as an investor. Baker was the one with most of the investment ideas, while Timberlake, something of a pioneer in the modern fund management business, concentrated on the marketing. The former, says Bolton, had a very objective view of investment and was always willing to judge an idea on its merits. "If you could make a good case for something, he would look at it. I always felt that if the tea lady came in and said you ought to buy ICI and these are the reasons why, he would be prepared to listen."

Baker was also mathematically minded, with an interest in how to price options using mathematical models. He was one of the first people in this country to take an interest in the quantitative techniques associated with

[4] Datastream is an information service whose extensive database allows the user to trawl through a huge raft of historical information, including share prices, bond prices, economic data and company results. Thanks to the internet and improved telecommunications, allowing fast data transfer, such information is now virtually a commodity for any professional working in the City or the West End.

modern portfolio theory. Noting how academic research had demonstrated the difficulty of beating the market averages, he also launched an index-tracking fund, a concept that in those days was well ahead of its time. During this period Bolton had a hand in running seven or eight different funds, doing "a bit of everything". One of these funds was a 'special situations' fund, a type with which Bolton has been closely associated ever since.

Schlesingers was not all that stable an environment however. There were constant rumours that it was for sale. South Africans, says Bolton, are "very much dealers, they like to buy and sell things, not to hang on to them". So when the second of his bosses, Richard Timberlake, was recruited by Fidelity to help set up a UK operation for the first time in 1979, Bolton let him know that he was interested in following him there. At the time, he says, he did not even know who Fidelity were. When he discovered that they were the biggest independent investment management firm in the United States, with a reputation for consistent performance based on in-depth fundamental analysis, it clearly helped. As a result, he became one of the first two investment managers that Fidelity International recruited. He was 29, with only limited experience but the great advantage of being known to the new managing director.

STARTING OUT AT FIDELITY

While from today's perspective opting to join Fidelity may seem like an obvious career move, that was not the way it appeared to many at the time. The Department of Trade, says Timberlake, had never authorised a foreign group to run retail funds in the UK before, and insisted on several conditions before allowing Fidelity even to set up its stall. Big Bang, the act of deregulation which was to sweep away many of the cosy closed shops and restrictive practices that had long prevailed in the Square Mile, was still seven years in the future. Exchange controls had only been lifted a few months before and business sentiment remained fragile. Inflation was in double digits and seemingly out of control. The pro-capitalist

government of Margaret Thatcher was still very much feeling its way after the Conservative Party's election victory earlier in the year.

Few in the City had heard of Fidelity, and those who had were often not impressed by the workaholic methods of American business. "My brother worked for Fidelity's auditors and I was told all sorts of horrific things about hiring and firing and what Americans were like", recalls Timberlake. Bill Byrnes, the Fidelity man charged with overseeing the launch of its UK operations, says; "We were a fledgling investment management company struggling to establish itself in the United Kingdom, operating in a recessionary period of soaring inflation, sky-high interest rates and wobbly equity markets. To top it off, Fidelity International had an association with an American company at a time when American invaders were viewed (not entirely unfairly) as short-term opportunists who fled the scene at the first indication of adverse circumstances." It therefore took some courage to join this unknown ship: indeed, he recalls, it was only after prompting by his wife that Bolton finally picked up the phone and confirmed his interest to Timberlake.

Timberlake asked Bolton to run a special situations fund, as this was the one that he had most enjoyed when he was at Schlesingers, though it was not top of Fidelity's priorities in the early years. (Byrnes and Timberlake in fact tried to persuade their new recruit to run a Japanese fund for them, an invitation that was politely refused.) Ironically, in view of what was to happen later, Special Situations proved the hardest of Fidelity's original funds to sell. The fund struggled along at around £2-£3 million in size for quite some time. At one stage, the sales team were even offered double commission to help get sales moving. It was only in the second half of the 1980s, when the fund appeared at the top of the five-year performance tables for the first time, that investors began to buy the fund in substantial volumes.

What, exactly, is a special situations fund? At one level, the answer is obvious. It is a fund that looks to invest in companies which are facing unusual and exceptional circumstances, and where any turnaround in fortunes can be anticipated to produce a profit within a relatively short time. "Almost any share at a particular time can be a special situation", is

how Bolton described it in his first manager's report on the new fund. "In general it will be a company attractively valued in relation to net assets, dividend yield or future earnings per share, but additionally having some other specific attraction that could have a positive short term influence on the share price." This might be a takeover, a new issue, a change of management, a recapitalisation or some other triggering event — over the years, as we shall see, Bolton has refined and analysed what he does in some detail.

But at the time he started his Fidelity fund, one of its greatest advantages, he admits now, was precisely the fact that hardly anybody was actually quite sure what the term meant. There was, he recalls, a general perception that it was an 'aggressive' (i.e. risk-seeking) fund which looked for capital growth opportunities outside the ranks of the blue chips. Tipping potential takeover candidates was one of the routes that investors found relatively easy to grasp. The initial reports emphasised that Bolton was looking for quick profits, and willing to live with above average volatility. But beyond that, there was – and remains – plenty of scope to experiment. The flexibility of the 'special situations' concept has given Bolton the leeway over the years to develop his own distinctive style of investment. It is the kind of fund that appeals to those who believe that investment managers with exceptional talent can make a big difference, whatever the academics may say about the difficulty of finding a manager who can beat the market consistently over time.

The association with Fidelity has clearly worked out well for both parties. It is difficult for anyone unfamiliar with the American investment scene to conceive of the huge influence that Fidelity enjoys in the United States. It is not only the world's largest independent investment management company, but has long been prominent in helping to shape the way that both the marketing of the investment business and professional standards in investment management have developed since World War II. Fidelity was one of the first firms to invest heavily in fundamental research, one of the first to see the need for recruiting and training the best brains to a business previously regarded as something of a backwater in the financial industry, and also one of the first to pioneer the direct marketing of collective investment vehicles to ordinary investors.

The great bull market of the 1980s and 1990s put vast amounts of money in its hands. The rapid growth has created periodic adjustment problems, but the company rolled on like a juggernaut through the bear market of 2000-2003. In 2004, Fidelity Management and Research, the Boston company, was running over 180 different funds and had more than $1 trillion in funds under its management. This, to put it in some context, is equivalent to around 40% of the entire capitalisation of the London stock market. So large and influential has the firm become that the US now boasts newsletters that do nothing but monitor what is happening to Fidelity's army of funds. Its international affiliate, Fidelity International, of which the UK office is a part, has also grown steadily with more than $180 billion in assets under management. Its fund range today includes more than 30 UK retail funds and more than 250 offshore funds.

Despite its many years of growth, the original Fidelity business in Boston remains a private company controlled by the Johnson family, which started it in 1946, and other senior management. Although there are overlaps among the shareholders, Fidelity's International arm is set up to operate as an independent business. Ned Johnson is the second generation of the family to preside over its operations and, unusually for such family dynasties, his tenure has been every bit as successful as that of his father, a charismatic figure known to everyone inside and outside the industry simply as 'Mister Johnson'.[5] Unusually also, for a family firm in the fund business, the investment methods favoured by father and son are rather different. Whereas Mister Johnson liked to give individual fund managers their heads to invest in whatever personal style suited them, however idiosyncratic, his son has shaped the modern firm around a belief in the overriding importance of research, both fundamental and technical. He also takes a ruthlessly utilitarian approach to his employees. While Fidelity's fund managers are paid handsomely, and enjoy high quality technical support, those who fail to deliver sustained performance are ultimately shown the door.

[5] Ned Johnson's daughter Abigail is now President of Fidelity Management and Research.

The highly competitive environment and cohesive culture does not suit every kind of fund manager, but those who like it tend to like it a lot and prosper, as Bolton has done. A key feature of the Fidelity approach is that the fund managers are left to get on with running their funds, largely unhindered by other responsibilities. The running of the fund management team and investment process is left to the chief investment officer, while more recently, in response to the growing emphasis placed on corporate governance, another director handles the routine (though sometimes delicate) business of managing relationships with the companies in which the firm's funds own shares. The marketing and administration of the business is run from a separate office outside London. Whereas at many investment banks, a spell in investment management is seen merely as a stepping stone on the ladder to the top of the bank, at Fidelity fund management is the end itself.

"The Peter Lynch mould at Fidelity", says Bolton, "is that you've got to let the investment people spend all their time running their investments. If you mix in other things as well, the investment is likely to suffer." The round of daily meetings with companies leaves little time for anything else. It is an article of faith that the Fidelity way is the best, an attitude that prompts some outsiders to accuse it of insularity. Rather than recruiting from outside, virtually all the firm's portfolio managers, and a number of its analysts, are trained from scratch in-house to ensure consistency in the firm's investment approach. Again it may not be everyone's cup of tea, but for those who enjoy the discipline of being part of a tightly managed family, it works. The recruitment process is undoubtedly helped by the power of the Fidelity brand. In a survey of 500 investment professionals reported by the *Financial Times* in 2003, Fidelity topped the list of most highly regarded fund managers for the fourth year in a row.

ONE SIMPLE INSIGHT

Bolton started managing his Special Situations fund in 1979. In 1985 he took on the management of Fidelity's first European fund as well, and ran it and its sister investment trust until 2001, when he began the handover to a colleague, Tim McCarron.[6] For a number of years he also managed an offshore European fund based in Luxembourg. In 1994 he added a UK investment trust, Fidelity Special Values, which mirrors the investments of the Special Situations fund, to his portfolio. At one point Bolton had overall responsibility for some £10 billion of other people's money, a prodigious sum for one individual to manage. His two pools of money – Europe and UK Special Situations – are properly judged in isolation, but there are some common underlying principles that have governed the way he has managed all the money entrusted to him. Most of these principles can be clearly traced back to the ideas that Bolton identified as having force in his very early years at Keyser Ullmann and Schlesingers.

The big insight that Bolton has carried with him throughout his career can be easily summarised. It is simply this: that in order to achieve better results than other people, you have to do something different from everyone else. Or in his words: "If you want to outperform other people, you have got to hold something different from other people. If you want to outperform the market, as everyone expects you to do, the one thing you mustn't hold is the market itself. You certainly shouldn't hold the market and do lots of dealing as well, because the transaction costs will punish you. You have got to be different." In his case, this has pushed him first in the direction of small, rather than large, quoted companies; and then towards companies which for a variety of reasons are unloved and unfashionable, but where it is possible to foresee a positive change in the near to medium-term future.

"I manage my funds with an above average risk profile, based on contrarian type stocks", is how he sums up his approach. "My ideal is a

[6] McCarron took responsibility for the investment trust first, and after that went well took on the unit trust as well, completing the transition in January 2003. Another Fidelity fund manager, Graham Clapp, took on the offshore European fund at that point.

company where things have gone wrong, but where it looks as if things may be changing. I am looking for stocks that are unfashionable and cheap, but where there is something which will recapture investors' attention before too long." The idea of looking at shares which are out of favour is not of course new. In the UK, it is almost seventy years since M&G, the pioneer of the unit trust industry, launched its first Recovery Fund. That was based on the idea that you could do well out of buying shares in companies which were recovering from recession or some other setback, either external or self-inflicted. Conventional recovery stocks of this type have always been a big component of Bolton's special situation portfolios, and indeed have become more prominent in the last few years.

But they are not the only types of special situation he looks for. He also looks for companies which are under-researched, and which are therefore unlikely to be properly valued, and for companies that have growth potential that nobody else has yet recognised. In fact, Bolton's main achievement is to have taken his basic concept of being different from the pack and pushed it further than M&G, or any other mainstream fund management company, has so far dared to take it. There is a price to be paid for this in terms of risk. Although he has always insisted on a well-diversified fund, it means he has found himself holding a lot of stocks that most people would think twice about owning. That doesn't always play well with the armies of consultants who these days routinely pore over the statistical properties of every fund: one of the measures that most excites their attention is the extent to which a fund's holdings deviate from those of the market as a whole (its so-called 'tracking error'). Bolton's funds have one of the highest 'tracking errors' of all UK equity funds.[7]

Whether or not contrarian stockpicking of the kind that Bolton goes in for is in reality unusually risky is a moot point. What it does mean, unquestionably, is that it places an onus on the fund manager to pick his stocks with more than average care. Mishaps and the occasional disaster

[7] Calling deviation from an index 'tracking error' is evidence of how far the concept of indexing has advanced in modern investment management: for an index fund, which is specifically designed to match the performance of an index, such deviation is indeed reprehensible. For an actively managed fund such as Special Situations, the reverse is often the case.

are an inevitable consequence. Bolton has had his fair share of disasters along the way, including such horror stories as Polly Peck, Mountleigh and the Parkfield group, all of which either went bust or had to be rescued while in his ownership. A similar experience threatened to befall him more recently when Railtrack, the rail network operator, was threatened with effective renationalisation, a situation that was only redeemed when Fidelity and other leading shareholders banded together to take legal action against the Government. Without the strength of a broadly diversified fund, and the market clout of Fidelity behind him, these bad experiences might have proved too much for a less highly regarded manager, but Bolton is now sufficiently well established to be able to shrug off the occasional failure. He is playing a numbers game, and is confident that the gems will, on average, outnumber the duds.

THE SHARES HE LIKES

Being an analytical sort, and being constantly required to justify his methods to potential investors in his funds, Bolton has broken down the types of special situation he wants to buy into a number of different categories, all in the general category of 'unfashionable or undervalued' stocks. This has shown some subtle changes over the years, though the underlying philosophy is unchanged. In his early reports to investors, Bolton listed eight categories: small growth stocks, recovery shares, asset situations, new issues, companies involved in bids, energy and resource stocks, companies reorganising or changing their business, and new technology companies. Now in his presentations, he has refined the list to cover six generic types of situation. The headings are recovery, unrecognised growth, valuation anomalies, corporate potential (mainly shorthand for takeover prospects), asset plays and industry arbitrage. The philosophy behind this categorisation is set out in more detail by Bolton himself in his book *Investing Against The Tide*.

Of all his many early successes, Bolton is particularly proud of his success in finding the Mersey Docks and Harbour Board. This was a classic

example of a business that conventional opinion thought to be a disaster, but which turned out to be what Peter Lynch liked to call a ‘tenbagger’ (a share which makes investors ten times their money). For years, the Board had been lumbered with the cost of enforcing the disastrous dock labour scheme introduced by the Labour government. This guaranteed employment to all dockers in the area, whatever the state of demand. Mrs Thatcher’s government ended the dock labour scheme, but left most of the companies which operated the docks with the burden of meeting the resulting redundancy payments to dockers.

What Bolton saw, but which many others did not, was that the company was sitting on a highly valuable property portfolio. When the Conservative government privatised another docks company, Associated British Ports, it wrote off most of the company’s liability for its redundancy payments in order to make sure the issue was a success. Bolton took a bet that something similar would happen with the Mersey Docks and Harbour Board. He was proved right: in fact, the government wrote off 100% of its liabilities for redundancy payments, leaving a business that was both asset rich and, for the first time in years, capable of making a worthwhile profit on its activities. The shares rose tenfold in just a few years.

The ‘corporate potential’ category is also of note. It is not quite right to say that this is purely a euphemism for ‘takeover prospects’, but Bolton has never disguised his interest in trying to spot companies that are likely to experience a change in management or control. He regards this as a legitimate activity for a professional fund manager, and one that many of his professional peers unwisely neglect. He had spectacular success in buying independent television companies in the 1990s. Five of the six he bought shares in were later taken over, reflecting the industry-wide consensus that the small regional monopolies originally set up by the government could not survive in the modern age of satellite and digital technology. (He was later to play a pivotal and unexpectedly high profile part in the merger that combined the last two surviving ITV companies, Carlton and Granada, in 2003.) Privatised electricity firms were another case where he found it was possible, on general principles alone, to foresee an industry-wide round of takeovers well in advance.

The general moral for investors in his approach is that there can often be something remarkably fragrant lurking behind a bad smell, provided you are prepared to go and sniff it out. Not all companies that perform badly are necessarily beyond redemption. The trick for a contrarian investor is to put yourself in the way of interesting ideas of this kind, where you can see the potential for change and also have a chance to get in early enough to take advantage of the change before it is fully recognised by the market as a whole. "My experience", says Bolton, "is that most investors tend to avoid companies that have not done well recently, and this reaction creates the buying opportunity." More recently, the much increased size and clout of the fund means that Bolton's emergence on a company's share register often now leaves him in a powerful position to promote or block changes in a company's ownership. In underperforming companies, where he has a major stake, he has become more of an agent for change, and less of a passive investor.

CASTING THE NET WIDE

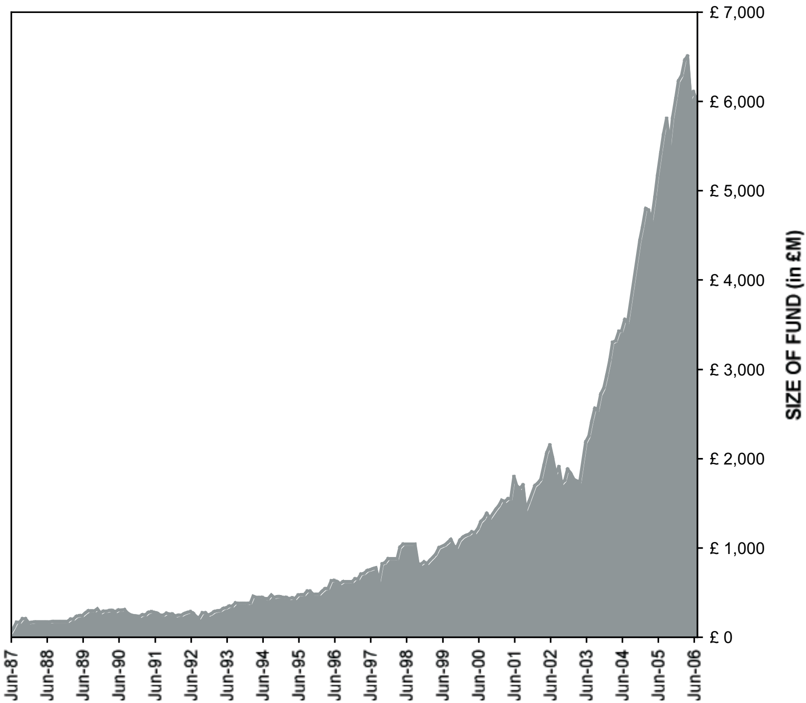
In his early days running the fund, Bolton had little internal research to fall back on and says that most of his ideas came from brokers, something that his early notebooks reflect. Early reports to fundholders note approvingly that Fidelity had relationships with more than fifty London and regional stockbrokers, the latter especially useful for analysing small local companies.[8] Even then, however, he liked to cast the net quite widely. "I have always worked on the basis of having lots of ideas put to you from many sources and then choosing quite selectively from them. It is like a big sieving process. You get all these ideas brought to you, and then you choose just a few of them." He still uses a lot of broking material now, despite Fidelity's own extensive in-house research capability. That is partly because it is impossible to cover every stock across such a wide universe,

[8] For example, the Special Situations Trust's report May 1981.

but it also stems from an innate belief that it pays investors to expose themselves to as many new ideas as possible.

The trouble with relying on brokers is, says Bolton, that "they tend to be good at getting you into something but aren't so good at getting you out of it. If they get you into something that doesn't go that well, then they tend to lose interest in helping you to follow it. Time was when they thought something was a buy, they would tell a few of their favoured clients first. Now the regulators insist that they have to tell everyone at the same time, so there is a sort of scramble and if it is a very good idea, a few people get in and the bigger clients don't." The trick for a big investor such as Fidelity, even when it has a good idea, is therefore to find a way of getting in, and getting out of, shares earlier than the market as a whole. These days the firm has a dedicated trading desk to execute the orders that Bolton and all the other fund managers place, but the issue of managing liquidity remains an ever present one – not least because, given the scale of its operations today, Fidelity can quickly become the largest single shareholder in the small and midcap companies that he favours.

HOW FIDELITY SPECIAL SITUATIONS HAS GROWN
Total net assets 1987-2006



As a result, moving in and out of stocks is no longer as easy as it once was for Bolton, at least in the UK market. As his funds have grown in size, his choice has been between sticking to his last, hunting for small out of fashion stocks and simply looking for more of them, or changing his approach and looking for value among bigger quoted companies instead. Since the mid 1990s, when the fund catapulted in size to become the largest single fund of its kind, he has opted to take both approaches. In the main he continues to prefer to stick in the small and midcap area of the market, partly because that is the way that Lynch and others in Fidelity have tended to do it. But he is equally happy to own more stocks in the upper reaches of the market when valuations appear attractive, as they began to do, for example, he found, towards the end of 2003. For the last few years, his fund has owned what for him is an unprecedented number

of large capitalisation stocks, even though in percentage terms his combined holdings in this segment of the market still account for under half the weight they have in his benchmark, the FTSE All-Share Index.

Why does investing in recovery stocks, and all the other out of favour categories he likes, seem to work so well? It comes back, in Bolton's view, to the herdlike behaviour of the market. "You have got to use the excesses of the stock market to your advantage. Looking at recovery stocks forces you to go against the herd. Most people feel confident doing what the herd's doing. If everyone tells them Vodafone is a good company, then they want to believe that Vodafone is a good company. If three brokers ring me and tell me something is a buy, then I normally say 'that doesn't look too good'. The market is excessive. It gets too optimistic on things and then gets too pessimistic on things. I also think it is quite short term and won't look at things like the longer-term dynamics of a business."

The key thing any serious investor must have is an information advantage over the rest of the market. "Generally I would feel uncomfortable taking a view on some of the macroeconomic stuff, and on things like oil prices. Why should I have a better view than hundreds of other people on them? But if you are looking at a small company in particular, there are times when you come out of some of our meetings with companies, and you can say, 'Gosh, I probably know more about this company than anyone else at this moment'. It is Jim Slater's Zulu Principle at work: if you are the expert on something, however small it may be in the broader context of things, you have an advantage over other people.[9] I want to put my bets on things where I have some advantage over others. We're also using the power of Fidelity as one of the biggest investors in the world to get access to companies and information. I am not talking about inside information, but about lots of little bits of things that when you put them together gives you a better informed view than the average investor."[10]

[9] Jim Slater was a high-flying financier in the bull market before last, the one that ended in the late 1960s/early 1970s. His credo, dubbed the Zulu Principle after a remark by his wife, has always been that the way to success is to know a lot about a little. See chapter 8.

[10] Under modern insider trading laws, it is illegal to buy or sell shares on the basis of information which is not publicly available.

PROSPERING IN EUROPE

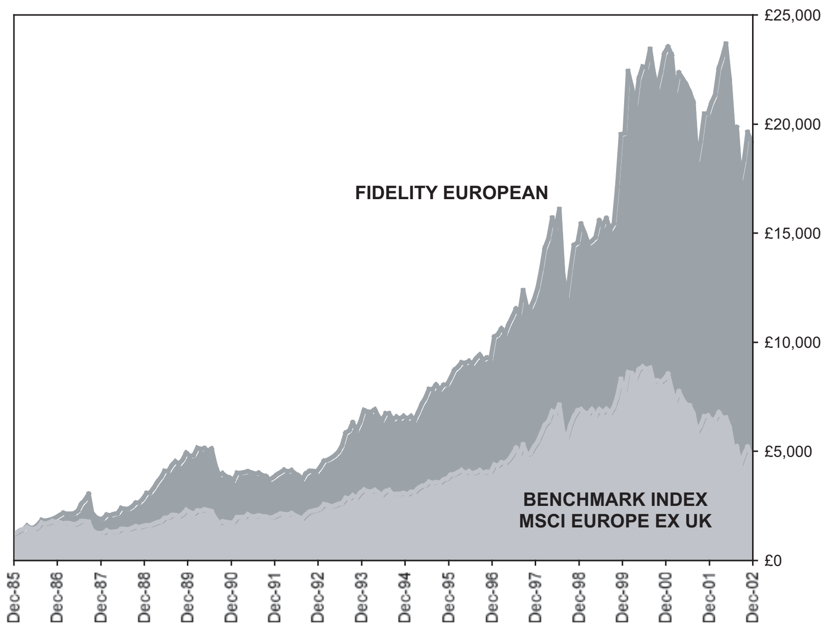
One of the notable things about Bolton's career is that he has managed to demonstrate that his stockpicking methods can work in two distinct investment arenas. Very few fund managers succeed in running an active equity portfolio in both the UK and European markets simultaneously, as he has done. (Nils Taube is one, but there are not many others.) Bolton's early interest in European stocks can be explained in part by his desire to be looking for shares where other investors are not. "I started getting interested in Europe in the early 1980s. For somebody who likes unresearched stocks, Europe was amazing at that time, because it was completely undercovered. The stock markets were very unsophisticated in the way they reacted to news. Now that has changed dramatically; not completely, but it has changed dramatically."

Traditionally, fund managers had tended to regard the UK and Europe as quite distinct sectors. "You put your linguists onto Continental Europe", he recalls, "but it was very much the poor relation. Your best people were in the UK, America and Japan, and then Continental Europe was last." The combination of unsophisticated markets and limited competition made Europe look a good bet at the time, though Bolton adds: "As I was useless at languages, I was probably the last person who should have been put onto Europe. But at least I knew a bit about investment, so I was able to spot things that others had not."

There are good reasons why European stocks are harder for investors trained in the UK to analyse than their American or British counterparts. Accounting conventions are different, for example; the level of information disclosure has historically been less good; and in countries such as France, there are often complex cross-holdings and ownership structures to resolve as well. If you think earnings figures are unreliable in the UK, then the figures reported by Continental companies are much worse. Bolton therefore prefers to rely on other types of valuation ratio, such as the ratio of enterprise value to cash flow, in preference to

conventional price/earnings ratios.[11] This, he points out, is how most companies value each other when weighing up whether or not to make a takeover bid which makes it a useful tool for investors too — especially ones who, like Bolton, are interested in spotting potential bid targets.

FIDELITY EUROPEAN 1985-2002
Value of £1,000 invested at launch



The way Fidelity goes about analysing European shares is to compare sector valuations from one country to another. "Someone will look at, say, the food retailers here, Sainsbury's and Tesco, and then compare the valuations with the Carrefour, and so on, on the Continent. I believe that

[11] To work out an enterprise to cash flow ratio, you take the economic value of the company - the market capitalisation of its shares and its net debt, added together – and divide it by gross cash flow (roughly speaking, operating profit plus depreciation).

if you are looking at an Italian insurance company, you want to look at it first through the eyes of someone who knows about insurance, and only later through the eyes of someone who knows all about Italy. The things you have learnt in the more sophisticated markets such as the UK and America help you to spot anomalies and opportunities in Europe. That is generally what I try to do." Sometimes the trend actually works the other way round. Bolton bought shares in British Energy, the privatised company which runs the country's nuclear power stations, not just because other investors were reluctant to buy – 'nuclear' being a classic 'bad smell' word – but because similar European utilities were trading on higher multiples and there was less of a 'nuclear discount'.

Wherever he is investing, Bolton has always been careful not to base the case for owning the shares he buys on broad macroeconomic grounds alone. (In the same way he makes little attempt to try and time the market.) In economic terms, he once told me, the macro argument for being an owner of European equities, for example, was "not that great". He reckoned that the drive towards federalism in Europe was actually quite negative for growth. But that was counterbalanced in the early years by the structural changes which have made equities more popular on the Continent, and companies much more open in the amount of information that they will disclose to investors. German companies, says Bolton, are the only ones which still adopt the traditional Continental habit of refusing to see investors who want to come and visit them, but even that is now slowly changing for the better.

Bolton's European portfolios were run on broadly the same principles as his UK ones, but with a greater bias towards larger companies. The primary emphasis was still on small and medium-sized companies, with a market capitalisation in the £50 million to £500 million range, but there was a large leavening (about 25% of the portfolio) of leading companies too. He says he found there were fewer turnaround situations than in the UK but more companies selling at a discount to their asset value. One reason for this is that the potential for takeover has historically been much greater in the UK than in most European countries. Companies which sell at a discount to their asset value for too long are liable to find themselves

bid for in the UK market. By contrast, contested takeovers are much rarer on the Continent, where banks, rather than institutional investors, are the dominant shareholders. The main thing that differentiated him from the competition was that his approach was resolutely bottom-up. Many other European funds are run on asset allocation grounds — so much in France, so much in Germany — but Bolton's funds are driven almost exclusively by where he finds the best value.

As a result, the shape of his funds looked very different to that of his average competitor: for much of the 1990s, for example, they were heavily weighted towards Scandinavian countries. This is partly, he says now, because companies in the northern countries of Europe are more willing to talk to investors, and to take shareholder interests into account, than they are in, say, France or Italy. But it also reinforces the basic premise that Bolton brings to his investment approach: namely, that if you do the same as everybody else, then you will end up performing just the same way. In fact, it would be an affront to Bolton's entire philosophy if he found that his portfolios had the same weightings as the rest of his competitors. They rarely do, as the analysis by outside fund analysts repeatedly demonstrates.

He does however keep an eye on the overall balance of the portfolio to make sure that it has not become too reliant on any one theme or market; in his European funds, for example, with the exception of the major markets (Germany, France, Switzerland and Holland), no other country ever exceeded 20% of the total. The same goes for his UK funds, where his weightings in the various market sectors, regularly recorded in his funds' annual reports, bear only a tangential relationship to the market as a whole. He sees no point in trying to stack the odds against himself by filling his funds with shares in one sector, just because that is what everyone else is doing, when he would rather be buying more attractively priced shares in another. Except in very exceptional circumstances, however, such as the height of the bull market in 1999-2000, when he owned virtually nothing in the modish TMT sectors, it is rare for him to have no exposure at all to a sector. The main way that Bolton manages risk in his portfolios is by making sure that no single bet can put his whole fund at risk: it is unusual for any holding to exceed 3% of the total fund, or for him to be more than 30% 'overweight' in any one sector.

LOOKING BEYOND THE UK

Although he gave up his European responsibilities between 2001 and 2003, the legacy of Bolton's time running money outside the boundaries of the UK persists. The UK Special Situations fund has a remit that allows him to invest up to 20% of the fund outside the UK; and the opportunity is one of which Bolton has regularly taken advantage. Indeed, although he only occasionally approaches the 20% threshold these days, in the 1980s he sometimes had as much as 25% in holdings classified as being outside the UK at balance sheet date. The early reports by the Special Situations Trust are punctuated by the sudden emergence of obscure overseas companies that subsequently disappear as fast as they appear. In September 1981, for example, he had more than 5% of the fund in both Norway and Australia, mainly in the form of oil and mining stocks. Five years later a crop of Italian shares appear fleetingly in the portfolio. At another point he is reported to have been buying Eurobond warrants. In the 1990s Bolton again built up positions in Norwegian oil companies; and more recently, he has taken advantage of the economic boom in China to invest in a number of companies there.

Although it inevitably confounds the 'thought police' in the investment consultancy world, whose sophisticated analytical models depend on the funds they analyse displaying so-called 'style purity', the ability to invest in other areas adds a further moneymaking dimension to Bolton's armoury. His rationale is simple: "Investing in other countries is something that I have always done. It fits in with my style and has served the fundholders well. There is no reason not to go on doing so, particularly where I have a special knowledge of a market or industry."[12] That said, he emphasises that the overseas stocks he buys are almost always those that aren't well followed by other analysts, or ones where he believes he can bring some kind of personal competitive advantage to bear. Although he has occasionally owned some American stocks they won't be well-known names, but smaller companies that typically may have a particular British angle – for example, Cadiz Inc, a Californian company that owns water

[12] That said, the non-UK exposure makes it harder to make fair comparisons between his fund and that of other UK equity funds, which may be 100% invested in the UK.

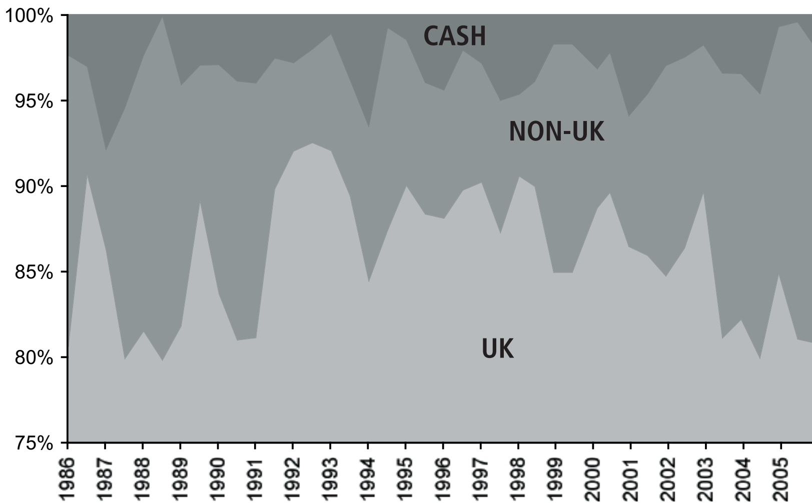
rights in the United States and is listed on an American stock exchange, but was mainly financed by British investors and is run by a British CEO. By the same token, when he owned shares in TNT, the Australian transport company, 80% of its business was in Europe at the time.

His years of tramping round Europe, calling on companies means that he still has a solid core of knowledge on which to draw, and he has increased his holdings of European shares in his UK funds since giving up responsibility for Fidelity's European funds. They continue to add a bit of spice to the portfolio. His interest in China, meanwhile, is driven in part by a bargain-hunter's sense of value, but also by a feeling that this is now the most promising part of the world for any investor to be looking for new stocks. In the autumn of 2004, he spent two weeks in China and Hong Kong, visiting some forty companies. Shortly afterwards he also paid a visit to India. His verdict: "China interests me for three reasons. One is that it is one of the most exciting places that I have come across in recent times to find new stocks. The second is that China has become such an important factor in determining what happens to the rest of the world from an investment perspective. Going there and finding out what is happening on the ground gives me a good chance of establishing an advantage over other investors. Finally, having given up my European responsibilities, learning about a new area is itself a new mental challenge, something to keep me interested and on my toes."

Fidelity has a local research team based in the Far East, and Bolton has been using his experience of watching the European markets develop to help them spot the companies that he believes have the greatest potential for the future. The biggest risk for investors in China is not finding attractive buying opportunities, he says, but the corporate governance system (that is, the answer to the question "Will you get your money back?") is not as certain as it could be. This is one reason why the few investments Bolton has made to date are mostly in firms that have established Western partners. The Chinese stocks remain a modest proportion of his overall portfolio. He says, surprisingly, that he has never stopped to work out whether his overseas holdings have contributed materially to his performance over the years. The chart below, which

measures the size of his non-UK holdings over many years, underlines the important role that they have played in the fund's history.

MORE INTERNATIONAL THAN IT LOOKS
Proportion of assets in Fidelity Special Situations by location



WHERE THE IDEAS COME FROM

Bolton says that his ideas rarely come as bolts from the blue, but accumulate in his mind until he has a conviction that something is the right thing to buy or sell. You need both knowledge of what constitutes a good company and an insight into how a company of its type should be valued. It is then a question of spotting anomalies, assimilating new information as it comes in and waiting for convictions to develop. "Conviction waxes and wanes and a lot of the time you're uncertain about everything, but when you do get a strong conviction, then it is important to back it strongly." In other words, when he feels strongly that he has found a winner, he will put a lot of money behind it, even if that means making his funds more heavily concentrated than many of his rivals. Even so, unless a large line of shares suddenly becomes available, his normal

style is to build his positions in stages, testing the water with an initial purchase and then, if the market action supports his idea, to add to it as his conviction grows. He freely confesses that he is not always sure, even after making a sizeable investment, that he has done the right thing. “Some seem to think people like myself are hugely sure about what they are doing all the time”, he told an interviewer in 2002, “but this business is not like that. You are in a constant state of questioning your convictions.”[13]

Unlike ‘buy and hold’ investors, who like to hold shares for long periods, Bolton’s policy is normally to sell shares as soon as they have become fully valued. At that point, it is time to move on to something else. His normal time frame for an investment is one to two years, though in exceptional cases it may be much longer. That helps to explain why turnover in his portfolios is reasonably high: something like 70% of the portfolio turns over every year. This is what comes from being an investor who looks for pricing anomalies and draws his ideas from so many sources. It is not the style of, say, Ian Rushbrook. Nevertheless, when I asked Bolton who had influenced him most as an investor, the first name he mentioned was Warren Buffett, even though the latter’s style as an investor could not be more different. Although he owns nothing like as many stocks and deals only rarely, Buffett was responsible, says Bolton, for implanting in him two ideas: the value of companies with strong business franchises, and the value of businesses that are capable of generating free cash flow.

He also says he takes on board ‘a lot of the Peter Lynch approach’, which he defined as ‘hands-on investment, seeing the companies, the strong view that if you predict earnings, you predict share prices’. Finally, he also echoed Nils Taube’s view that, in one sense, the game of successful professional investment is also about plagiarism: looking for good ideas that other people have had, and copying them like mad when you find them. Rather like the stocks he buys, which come in all shapes and sizes, Bolton has something of a ‘Smorgasbord approach’ when it comes to

[13] Citywire Funds Insider April 2002. He also said in this interview: “Investment is a funny combination of being flexible and open-minded at times, and at others having the conviction to back something you feel is mis-priced and undervalued.”

articulating the major influences of his investment style. There is, for example, an obvious tension between his desire to be a contrarian and his willingness to look at charts to see what other investors have been buying and selling. And although he is known, and regards himself as a 'value investor', he clearly also has a keen eye for a company that others might more readily classify as 'growth stock'.[14]

USING TECHNICAL ANALYSIS

Bolton is unusual among top-class investors in admitting quite happily that he has always used a lot of technical analysis, or charts, to support his investment analysis. A chartist in investment terms is someone who attempts to predict future winners and losers in the stock market by analysing the past performance of shares, using a variety of techniques which vary, quite literally, from the sublime to the ridiculous. The rationale for technical analysis is that it is possible to make deductions about the next movement in a share's price from the information contained in its recent price history. From the early days of Mister Johnson, Fidelity has always recognised that technical analysis has a place in an investor's armoury, so much so that all its investment management offices, including the London one, have chart rooms where scores of printed charts, some almost as big as plate glass windows, are displayed on banks of wooden screens ranged around the walls.

What chartists look for, typically, are common patterns which they believe signal a future change in a share's direction. Many investors regard this form of investment analysis as dangerous nonsense, although it has a long history and has proved remarkably resilient. The American writer and investment counsellor John Train speaks for most of the sceptics when he

[14] In reality, the line between 'growth' and 'value' is a blurred one – a fast growing company can offer value by being too lowly rated, even though it fails to meet the conventional value stock criteria such as an above average dividend yield, or a low price to book value. One of Bolton's greatest successes was spotting Nokia long before it became a world leading mobile phone company.

says, "I find charting as a matter of practical experience to be useless." Thirty years ago, Jim Slater won an easy laugh from his audiences by observing that chartists usually had "dirty raincoats and large overdrafts". The conventional thing to ask is: 'When did you last see one who looks rich?'

But Bolton is not so sceptical.[15] He uses charts to help screen out possible buying ideas, and as an early warning signal that something may be going wrong at a company he already owns. He finds technical analysis particularly useful when looking at large companies, as he increasingly has to do, given the size of his funds. GlaxoSmithKline is a good example. It is a world-class drugs company, and a leading blue chip share, but its shares, Bolton notes, are unusually volatile for such a large company. It goes from being "very in favour to very out of favour", even though the fundamentals of the business are well known. Looking at the charts on companies such as Glaxo often gives Bolton a first clue about when it is about to move into a new phase of its cycle. He has experimented with a number of different services over the years, but now relies mainly on Fidelity's own in-house technical analysts and an American service, QAS, for international stocks. The great advantage of the American service is that it routinely classifies where in the cycle the charts suggest each of the leading stocks in its universe has reached.

One day when I was in his office, Bolton gave me two topical examples of how charts had helped his thinking. One was the French computer company Axime, which he had owned for some time. It looked reasonably valued compared to other international computer companies. As he liked the sector, it was a stock he would normally have been looking to buy more of, but the charts suggested that the shares were in the process of 'topping out' on technical grounds, and this had made him cautious instead. A second example was the French television company TF1. Having owned

[15] Nor actually now is Slater. He too says there is value to be had in looking at charts to see how the balance between buyers and sellers is shaping up.

it for ages, not only had the Fidelity in-house analyst turned negative on the shares, but the charts were also suggesting that the technical position of the shares was deteriorating. So Bolton sold out of his position completely. The reason why charts do have some value, he explains, is that they give important clues about the current balance of advantage between buyers and sellers: they are the footprints which investors have left behind them.

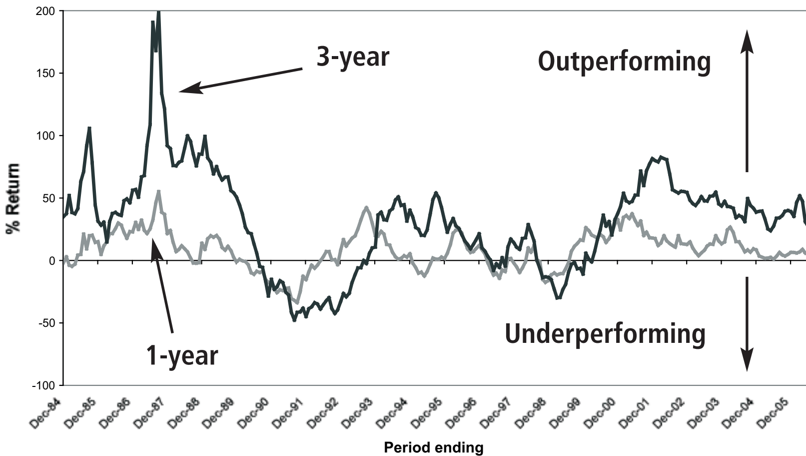
COPING WITH SETBACKS

Despite his spectacular long term record, life has not always gone smoothly for Bolton as an investor. His biggest setback came in the 1990-91 recession, when his funds suddenly started to perform very badly. His run until then had been quite spectacular. In its first ten years, the Special Situations fund clocked up a cumulative return of more than 1,000%, a pace that was clearly unsustainable. The fund recorded nine years of positive returns out of ten: not only that, the nine good calendar years all delivered an annual return of more than 23%, an incredible run, even for a roaring bull market (not least because the decade included 1987, the year when Wall Street fell by a quarter in just a few days). Ironically enough, because the fund's reporting period never ran to the end of the calendar year, and the movement in the fund's asset value was quite volatile, Bolton's reports to shareholders are surprisingly often taken up with explaining away shorter periods of relatively poor results. By chance, one of the fund's reports appeared in October 1987, only days before so-called 'Black Monday', with this hapless statement: "Although valuation levels are high and the poor performance of gilts is a cause for concern, at the moment we believe the bull market is not yet over." In one sense, this was correct: the market did make a strong recovery from the October 1987 crash and the bull market powered on for anther two years, but the timing, to put it mildly, could have been better.[16]

[16] The statement nonetheless underlines the dangers in making forward market projections, something Bolton usually tries to avoid wherever possible.

By the start of the 1990s however, a recession did hit both the UK economy and the financial markets hard. In 1990, the fund lost 28.8% of its value in a year, a bad hit. In 1991, the return was a positive one, but only just (3.0%). A number of Bolton's holdings, instead of recovering from the economic downturn, as he had expected, simply went bust on him instead. Fund management, being a highly competitive business, can also be rather bitchy, and there were a lot of mutterings around the City that the great Bolton, whose reputation as the best performing manager in his sector was by then already known, had lost his touch. For the first time in its history, the fund's five-year performance record fell behind that of the FTSE All-Share Index. In its October 1991 report, Fidelity reported: "The last six months have continued to be a very depressing period for investors in this Trust and they are owed a detailed explanation of why this was the case and what went wrong. In the last report we wrote that we believed a new strong upward trend or 'bull phase' had started in the UK market and that – as in past cycles – it had started in the recession and before the recovery is clear..... We were too early in identifying a better environment for the type of company which accounts for the majority of the portfolio." One shareholder was so disgruntled at the decline in the fund's fortunes that he wrote to tell Bolton that his performance was so bad that he ought to be outside "sweeping the streets", a comment that is now immortalised in a cartoon on the wall of his office.

MOSTLY, NOT ALWAYS SUPERIOR
Difference in rolling one and three year returns
Fidelity Special Situations vs FTSE All-Share Index



Bolton, his own harshest critic, conceded later that this was his toughest period. In hindsight, the downturn of 1990-1991 can be seen for what it proved to be, namely an 18-month setback on the way to a renewed long run of future superior performance. At the time it was nothing like so obvious. "I did a lot of soul searching in the early 1990s, when I had a bad patch", he told me in 1998. "If you hit a bad economic recession, it is obviously bad for my type of investing. But the question was: should I change my approach or not? Thank goodness, I didn't because that would have been the kiss of death. If you start doing a type of investment that you don't feel confident in, that's where you become completely unstuck." Since then, he and his colleagues at Fidelity have put a lot more effort into tracking 'z scores' and other tools used by credit analysts for spotting potential corporate failures.[17] The implication at the time was that Bolton had been skimping a bit on his homework. He denies that charge, but admits that he has learnt a lot from his experience at the time.

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[17] 'z scores' are composite ratios which analyse the strength or weakness of a company's finances and have been shown to be successful at highlighting impending insolvencies.

His argument was then, and has been ever since, that the above average-volatility of his funds is something that both he and his investors simply have to learn to live with. “In recession, the kind of medium-sized companies that I invest in will often fall further than the big cap companies. It is a price that I have to pay. There is little I can do about it.” His attitude now, he told me, is: “I don’t mind buying a high risk, badly financed company provided I know the business well. It was the few where the finances were far worse than we realised that hurt us. We don’t want to make that mistake again. That is why we do a lot more balance sheet work now.” Another reason why his shares underperformed so badly during the 1990-91 recession may ironically, he thinks now, have been a result of the Fidelity policy of staying close to the companies they own. What made that particular recession different from previous ones was that even the companies which suffered most from the economic change were taken aback by the scale of the downturn. There was, for example, no cluster of share sales by directors which is what you would normally expect if the companies had been fully aware of what was about to hit them.

But while he is open about the above average volatility of his funds, he has come to the conclusion that “I have an approach that delivers in the medium and longer term. Why mess it up because once in a while people have an uncomfortable period?”[18] In any case, he says, good investment managers should not be over sensitive about their failures. Taking their lumps is part of the business. “You have to be comfortable in taking a different view from most other people. Most people like it if five people tell them they’re right – that makes them feel more confident. I am not a very emotional person, and I think that’s the only way you can run money. You’ve got to be very unemotional about stocks, and you have to be prepared to say you were wrong. This is the sort of business where you get bitten by the bug. It’s constantly changing, constantly challenging. You must change with the changing climate, and not fall in love with what worked last year or the year before. Just as importantly, you need the support of an employer who is prepared to ride over the lumpy periods.”[19]

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[18] Interview with *Bloomberg*, January 1997.

[19] Quoted in *Financial Adviser*, October 1991.

THE BULL MARKET AND BEYOND

In the event, the 1990s proved to be a good, though not the best, decade of Bolton's career. Perhaps it had something to do with the fact that he was by now running two large pools of money, one for European stocks and the other his UK funds, but there were times when Bolton's UK funds, measured by their rolling three and five year performance, for once failed to beat their benchmarks by a handsome margin. True, investors in the Special Situations fund still had good cause to be happy, as their absolute returns were invariably positive. The average five-year return on the fund for investors who joined since January 1990 has been 106%, against 65% for the FTSE All-Share Index. But style trends in the market do not always favour Bolton's approach, and his relative performance, in the UK at least, suffered for a while, not least towards the end of the bull market when euphoria reached a new and unsustainable peak.

In 1998, Bolton told me in an interview for *Institutional Investor* magazine that he could not recall a time in his career when small and medium company shares, of the kind he favours, were so shunned by other investors – or so attractively valued for a bargain-hunting investor. He was right, but the market being as always a slave to fashion, and soon to be bewitched by the wonders of the internet craze, investors studiously ignored him for nearly 18 months. The discount on his investment trust, a barometer of his fund's standing in the eyes of the market, widened to an unprecedented 25%, creating a rare (and so far unrepeated) opportunity for savvy investors to buy into his stockpicking skills on the cheap. Shares in the investment trust, which owns almost exactly the same shares as the Special Situations unit trust, went to a premium in 2001 and have rarely gone to a discount since. Over the five years to the end of 2003, the unit trust produced a return of 120% and the investment trust 168%, in a period when the market itself, reeling from the bear market, lost 5% of its value.

In fact, the way that Bolton's funds have performed since the end of the great bull market has revealed another side to his talents as an investor. While he made his name by outperforming the market on the way up, his performance since the market peaked in March 2000 has, if anything, been even more impressive. It has certainly reinforced his reputation. As we

now know, the pricking of the internet bubble, and the associated fashion for 'TMT stocks' (telecom, media and technology shares), was followed by the severest bear market for a generation. From its peak in March 2000 to its nadir in March 2003, the UK stock market, as measured by the FTSE All-Share Index, fell by nearly 50%. The great majority of actively managed equity funds tanked with it.

Many of the managers whose funds had soared in the last stages of the bull market turned out to be paper tigers, or one-trick ponies; scores of aggressively managed funds lost 70% or more of their investors' money. By rights Bolton's fund too, being of above average risk according to conventional classifications, should have suffered more than the market. Yet Fidelity Special Situations, while not immune from the market decline, has suffered nothing like as much, as these figures show. In fact, his was one of only a handful of funds that managed to produce a positive return over the period March 2000 – March 2003.[20] When the bull market resumed in the spring of 2003, the fund resumed its superior winning ways, outperforming the market once more on the way up, as it had done on the way down.

	BOLTON	MARKET	DIFFERENCE
MID 1990s BULL MARKET March 1993 - March 1996	73.2%	48.5%	24.7%
LATE BULL MARKET March 1996 - March 1999	40.3%	71.2%	-30.9%
LAST YEAR OF BULL MARKET March 1999 - March 2000	29.3%	9.9%	19.4%
BEAR MARKET March 2000 - March 2003	3.8%	-39.3%	43.1%
RECOVERY March 2003 - August 2006	144.8%	93.8%	51.0%

[20] The difference between the fall in the FTSE All-Share Index of nearly 50% and the total return loss of 39.3% shown in the table is accounted for by dividends. In this book all comparisons between the performance of Fidelity Special Situations (which does not pay a dividend) and the FTSE All-Share Index (many of whose component companies do) are adjusted for dividends to ensure a like-for-like comparison.

There are a number of reasons, Bolton says, why his performance has continued to be so strong. One can be traced back to the months before the market peaked, when shares in three sectors of the market, telecommunications, technology and media, all loosely and indiscriminately linked to the emergence of the internet, were so 'hot' that their valuations lost all touch with reality. At one point these three sectors accounted for some 40% of the entire value of the UK stock market. Yet Bolton owned virtually none of them: refusing to abandon his value disciplines, he was quietly loading up on scores of other shares whose prices had been untouched by the market bubble, and indeed were trading at what, historically, were absurdly low ratings.

That led his fund to lag the market at the time, but ensured that once the bubble burst, his performance would recover strongly. Alex Hammond-Chambers, the chairman of Fidelity Special Values, thinks this was one of Bolton's finest hours. "At the time, there was nothing unusual about having nearly half your portfolio in the TMT stocks, because that was where the index was and everybody else was doing it. But if you want to be a special investor, and you are naturally risk-averse, you have got to do what you believe is right, and absolutely not be swayed by the herd. Most fund managers are lemmings, and Anthony is the absolute antithesis of a lemming." In particular he did not fall into the trap of thinking that just because a stock in the most favoured sectors was trading on half the price-earnings multiple of the market leaders, it had therefore to be cheap. As it turned out, even the 'cheapest' stocks in the TMT arena were grossly overvalued.

A second reason why the UK funds have done so well since the bull market ended is that value investing as a discipline, having been increasingly overlooked as investors chased ever more improbable technology-fuelled growth stories during the boom, came back into fashion. Almost overnight, shares that paid dividends and enjoyed high dividend yields, or traded on low multiples of earnings or book value, the classic value criteria, started to come back into favour. As a value-minded investor, Bolton was always likely to do relatively well in this climate. At the same time, the period since 2000 has been one in which small and medium-

sized companies as a group have, for the most part, outperformed larger stocks. This too has helped Bolton's performance, as did the fact that in 1999 an exceptionally large number of stocks in his portfolio were taken over.

Even so, to outperform the market and his peers so handsomely during the bear market underlines that his success is anything but a bull market phenomenon. Although he insists that he is primarily a stockpicker, not a market timer, Bolton has since shown too that he has developed an informed better nose for the currents that are running through the market. In the spring of 2003, to the surprise of his audience at the time, who had mostly never heard him offer such a definitive view on the market before, he correctly called the bottom of the bear market, almost to the day. This was no idle comment either. A few weeks earlier he had, it turns out, suggested to the board of his investment trust, Fidelity Special Values, that it would be a good moment to consider increasing the amount of gearing in the fund to take advantage of an expected upturn in the market.[21] Three years later, in the spring of 2006, having given some public warnings about his feeling that the bull market had largely run its course, Bolton reversed tack, suggesting to the board that it should eliminate all the fund's gearing and take out a put option to protect the value of the fund against a possible general fall in share prices. This again proved to be a timely and profitable call.

INTO THE LIMELIGHT: THE ITV SAGA

Bolton has always taken care to develop and sustain good relationships with financial advisers and the media, recognising that they are the two external groups that have the most influence over the direction of fund flows in the UK. While he responds regularly to requests to give interviews and presentations, it would be wrong to describe him as a publicity-seeker.

[21] Bolton made his remarks at a seminar for financial advisers organised by Jupiter Asset Management (at which the author was present). It is not clear whether he realised that his prediction was going to be reported in the media. I suspect not.

Though happy to talk about the markets and his current thinking, it is not his style to gossip about his competitors, or to use the media to talk up the shares in his fund, as some professional investors have been known to do. That kind of approach does not sit easily with his character. When he does talk to outsiders, he tends to err on the side of caution, being measured to the point sometimes of blandness in his comments about companies and their managers.

Those who know him well were therefore surprised to find his name being spread all over the business news pages in the summer of 2003 as the alleged leader of 'a plot' to oust the leaders of the two largest surviving independent television companies, Carlton and Granada. According to the *Sunday Times*, in a front page story in its business section, "the City's most respected fund manager" was canvassing the television industry for candidates to replace both Michael Green, the chairman of Carlton, and Charles Allen, his counterpart at Granada, when the two companies merged. The merger was something that the two companies had announced they were planning to do a few weeks earlier. The paper went on to quote an unnamed City analyst describing Bolton as "the City's quiet assassin".

It was a vivid phrase, one that helped to give the story a striking headline. In reality, Bolton's stance was at that stage merely that of the concerned shareholder. He had been an investor in both Carlton and Granada since at least 2001. This is how he recalls the matter now: "I did not propose the idea of merger between the two companies, but once it had been aired as a possibility, I was definitely in favour. There were some obvious inefficiencies in the existing ITV structure, and I could see that the merger was capable of bringing great benefits, provided that it was structured in the right way." Over a period of weeks he talked to a number of people in the media industry to canvas their views on who should best run ITV if the merger of Carlton and Granada was to go through. He had not at this stage, he says, talked to any other shareholders in the two companies concerned. The story of what the paper chose to call Bolton's "back-room plotting" was, he discovered, leaked to the *Sunday Times* by a senior figure in the media industry, for reasons that remain unknown.

The biggest hurdle to any merger at that stage was whether or not the Competition Commission, to whom the matter had been referred, would allow the two largest ITV companies to put their businesses together. When he raised his concerns with the companies or their advisers, their line, Bolton recalls, was always that raising issues about the structure of the new merged company while the commission was still debating the issue would "rock the boat". It could even, he was told, threaten the chances of a deal taking place. Once the initial story came out, Bolton therefore opted to keep his counsel until the Competition Commission had reached its decision, something he now rather regrets, while continuing to canvas opinion in private. Fidelity put out a carefully worded press release after the *Sunday Times* story, saying that it supported the merger proposal 'in all respects', but pointedly (in its own opinion, at least) saying nothing specific about the management issue.[22]

It was not until the autumn of 2003, when the Commission finally cleared the idea of a merger, that Bolton and his colleagues decided to press the issue of who would run the company in the event of a merger going through. The proposal from the two companies was that the top jobs should be shared between the top executives of each company, with Michael Green, chairman of Carlton, taking the chairman's job in the new company, and Charles Allen of Granada, becoming chief executive. There was a general recognition, says Bolton, that if any changes to the proposed management of the company were going to be made, they would have to be agreed before the listing particulars for the newly merged company were finalised. Time was therefore short. The need for urgency, coupled with the strength of some of the personalities involved, played a part in turning what began as a serious but not terminal point of difference into a headline-grabbing showdown between the two companies and their leading institutional shareholders, all played out in a blaze of media publicity.

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[22] William Lewis, the editor of the *Sunday Times* business section at the time, disputes that the statement could be read as anything other than a denial that Fidelity was seeking management changes.

Although Bolton was the first person inside Fidelity to express concerns about the management of the merged entity, he was by no means the only player involved. Other fund managers in the Fidelity stable also owned sizeable shareholdings in the two companies, and it quickly became a matter for the company's senior management team as a whole to handle. When Fidelity went to talk to the non-executive directors of the two companies, Bolton was typically accompanied by Simon Fraser, the chief investment officer, and Trelawny Williams, the recently appointed director responsible for corporate governance. In fact, at one meeting that the trio attended, Fraser recalls, Bolton said nothing at all, somewhat scotching the idea that he was the sole driving force behind an activist shareholder plot.

THE BATTLE INTENSIFIES

What is not in dispute is that the non-executive directors of the ITV companies expressed doubt at their meetings with Fidelity whether its reservations were in fact shared by other shareholders. It was only at that point, says Bolton, that he and his colleagues set out to canvas the views of other large institutional shareholders. Fidelity's contacts with several other institutions revealed that there was near-universal support for his views about the undesirability of Green and Allen splitting the top jobs between them. The two men were known not to be huge admirers of each other and could hardly have been more different in personality and behaviour. The proposed board structure looked, as it clearly was, a compromise that owed more to realpolitik than to the best interests of the merged business. Bolton and his Fidelity colleagues thought it imperative that there should be an independent non-executive chairman instead, capable of holding the ring between the two merger partners. This view was relayed back to the two companies, both directly in meetings with the non-executive directors, and indirectly through the companies' banking and broking advisers.

All this while the business sections of the national newspapers, having spotted a good story in the making, continued to give the ITV saga

prominent coverage. To Bolton's intense irritation, they continued to present the issue in a highly personalised way, making out that he was using his position as a leading shareholder to pursue a personal vendetta against the top management of the two ITV companies. The 'quiet assassin' epithet, once coined, proved hard to shake off. This was far from fair, though doubtless it suited the other shareholders involved to allow Fidelity to take most of the public heat. Inside Fidelity, it is clear that the issue of how to deal with this unexpected publicity attracted a lot of head-scratching. Making waves in public is most definitely not the house style, though in retrospect it is not easy to see how the publicity that surrounded the ITV story could have done anything but enhance the firm's reputation. Bolton was careful to say throughout that there was nothing personal in his attempts to block the original proposals. If Allen rather than Green had been proposed as chairman, he would still have sought the appointment of an independent chairman from outside the business.

In the end, when it came to a showdown, the ITV companies relented, though only at the last minute. This was virtually inevitable once the boards were confronted with evidence that so many of their largest shareholders were opposed to the original proposed boardroom structure. The board of Granada was the first to blink, deciding that the proposals could not go through as originally planned. Their decision was seen as something of a betrayal at Carlton, which then reluctantly followed suit. The Carlton chairman, Michael Green, was the one who departed, leaving Charles Allen of Granada in place as the chief executive of the newly merged company. Some time later, Sir Peter Burt, the former governor of Bank of Scotland, and a man with a reputation for toughness, accepted the job of ITV chairman and in due course confirmed the appointment of Allen as chief executive. Bolton, who had earlier touted another name as a possible chairman, says he was happy with the choice and remains a shareholder in the new ITV company. Its subsequent performance has, however, been a continued disappointment, implying that his original pressure for change was more than justified.

In hindsight, could the whole messy ITV saga have been avoided with more careful handling on all sides? Given the high stakes involved for

those on the company side, arguably not. Bolton's view throughout was that the row would best have been dealt with quietly behind closed doors, as happens, he claims, in a good many other corporate governance cases that never reach the public eye. The ITV saga is interesting mainly because it points to the growing influence that institutional shareholders as a group are now starting to exert on the behaviour of quoted companies, something which they have been criticised for not doing in the past. In an interview with *Real IR* magazine in 2004, Bolton said that Fidelity typically intervenes in some 50 cases a year, of which only a fraction are likely to be reported. While it remains the job of company boards to decide how businesses should be run, he says that Fidelity expects to be consulted about big strategic decisions, such as M&A proposals, or disposals of business, that are likely to rebound on the value of the company's shares.

The irony is that if whoever leaked the original story intended to try and spike Bolton's guns, it probably had the reverse effect: once challenged by the companies to prove his views were widely shared, Fidelity had no option but to join forces with other leading shareholders and insist on a change. In the process, although he found the intense media coverage uncomfortable, and the 'quiet assassin' tag distressing, the episode has served to underline how much influence Bolton now enjoys in the City. "Because his manner is so quiet", says his colleague Simon Fraser, "it is easy for those who don't know Anthony well to underestimate the strength of his feelings. The non-executive directors of the ITV companies may genuinely not have appreciated initially quite how serious his reservations about the proposed management of the merged company were." When it came to a showdown, however, the fact that Bolton was prepared to put his hard-earned reputation on the line over the issue was clearly a decisive factor in persuading Fidelity to press the issue, and the boards of the two companies to back down. The outcome is one more indication of how far the shy and thoughtful 29-year-old recruit of 1979 with a flair for picking stocks has travelled in the ensuing quarter of a century.

ENTERING THE HOME STRAIGHT

Speculation about when Bolton might decide that enough was enough and hand over his remaining fund management responsibilities has been a perennial topic of discussion in the professional community for several years. Given the size of the fund, and its commercial importance not just to Fidelity, but to those who make a living advising clients on where to invest their money, this was hardly a surprise. Most funds in Britain are sold on a commission basis: that is to say, the financial advisers and other professional intermediaries who recommend the fund to their clients are rewarded by being paid commissions by the fund provider. The typical commission on sales of a fund such as Fidelity Special Situations is of the order of 3% of the value of the initial investment. In addition, although this is less widely known, advisers and others who recommend a fund typically also benefit from an annual "renewal commission" for every year that the investor remains in a fund they have recommended. Renewal fees, sometimes also known as "trail commission", is normally paid at the rate of 0.5% of the current value of the fund.

A back of the envelope calculation therefore suggests that at its peak, with assets of more than £6 billion, Fidelity Special Situations was earning advisers and other intermediaries up to £30 million a year for their foresight in having guided their clients to his fund. While it is not part of this book's remit to analyse the rights and wrongs of the commission system, it is evident that these are significant sums of money (and made all the more agreeable for those who benefit by the fact that the trail commissions roll in every year without the need for additional effort on behalf of the advisers). The question of who would replace Bolton as the manager of his UK fund was always therefore going to be one that commanded close attention. For Fidelity's part, the challenge was to find a replacement who could realistically entertain the hope of continuing in Bolton's footsteps without materially damaging either the interests of the investors, who have done so well from his success in running the fund, or Fidelity's own business, for which Special Situations is the largest single source of revenue. The financial stakes surrounding the succession, in other words, could hardly have been higher.

Bolton himself, it is clear, was determined to take a strong lead in the internal debates with his management colleagues about the best way forward. Rather than handing over the entire Special Situations fund to a single successor, the solution that the company eventually came up with was to propose splitting the fund in two with effect from September 2006 and phase in the handover to two new managers over a period of 15 months. Splitting a fund is something that had never been attempted before in the UK. Half of the assets were to remain in the UK Special Situations fund under Bolton's continued management until his final handover in December 2007, while the balance was to be transferred immediately to a new Global Special Situations fund. This would attempt to do on a global scale what Bolton himself has done so successfully in the UK. After months of speculation about who would be chosen to run the new global fund, Fidelity announced that it would be a hitherto largely unknown Finnish employee of Fidelity named Jorma Korhonen. He would work alongside Bolton in setting up the new fund in September 2006 and take over completely in January 2007. The announcement inevitably attracted acres of newsprint in the national and trade press, confirming the extraordinary high profile that the manager of Fidelity Special Situations enjoys within the fund industry.

While it is possible to feel a measure of sympathy for Mr Korhonen, thrust into the shoes of such a successful predecessor in the full glare of the media spotlight, for Bolton himself the transition is a more ambivalent event, as his own account makes clear. His hands on approach to the task of selling the new arrangements to a sometimes sceptical audience bears testimony to his continuing commitment to Fidelity and the interests of investors in his fund. He publicly extolled the virtues of his chosen successor and talked sincerely of the similarities in their approaches. In private he surely would have been less than human if he were not to worry about what effect the handover might have on his legacy. In one of the many newspaper interviews carried out over the summer of 2006, to coincide with the impending splitting of the fund, he confessed to some anxiety also about how his final year in charge of the remaining UK portion of the Special Situations fund might go. Because market headwinds have been so favourable in recent years, with value as a style of investing enjoying an

exceptional run, and his favoured midcap sectors of the stock market comfortably outperforming the other sectors of the market, the risk of those trends reversing and damaging the fund's performance during his last 12 months in charge had clearly crossed his mind.

Time will tell whether such anxieties are justified or not.[23] In the event, the proposal to split the fund was approved by the fundholders in September 2006, with more than 95% of those voting in support. While Fidelity had prepared contingency plans for a possible wave of redemptions, it was clear that the majority of Bolton's investors would do what he urged them to do, which was to give Jorma Korhonen, the first of his two chosen successors, a chance to show what he could do with the new Global Special Situations mandate. Going into his final year in charge, the UK fund meanwhile still had a higher proportion of shares amongst the top 100 quoted companies on the London market than for most of its history. Reduced in size by the split to some £3 billion in assets, the fund surrendered its position as the largest equity fund in the UK to one run by Neil Woodford of Invesco Perpetual, another dyed-in-the-wool value investor whom many in the business regard as the man most likely to succeed to Bolton's long held title as the number one fund manager in this country. What was most striking however about the reams of coverage that filled the newspapers for weeks on end was how little new there was to say about his methods. The markets may move on, but the qualities that make a successful fund manager – discipline, hard work, a phlegmatic temperament and that elusive nose for value – change but little.

INTERPRETING THE PERFORMANCE

For those who appreciate the dynamics of the investment business, the message from the performance of Bolton's funds is an unequivocal one.

[23] They were, in the sense that neither the global nor the UK fund have performed as well under their new managers as they did in Bolton's hands. He was however able to retire some months before the 2007-09 bear market, during which the UK stock market lost some 50% of its value.

Three things in particular are striking: the consistency of his funds' performance; the fact that Bolton has managed to build a comparable track record in two major markets (the UK and Europe) at the same time; and the fact that he has been able to sustain his track record despite running a fund that has grown so big that it dwarfs almost every other in the retail fund sector. How can this exceptional performance be explained? And what lessons can investors draw from his success?

Bolton would be the first to admit that he has benefited from running in his fund during a period that has mostly been exceptionally favourable to equity investment. The long and powerful bull market that ran from 1982 to 2000, fuelled by strong disinflationary impulses, was without question the best period in which to own shares in the 20th century. Over those 18 years the annualised return from the stock market (11% per annum in real terms) was 50% greater than the long run historical average for equity investment. It was clearly an exceptional time to be a fund manager; and if ever there was a time to set up shop as a stockpicker, the beginning of the 1980s was that time. The bull market created powerful tailwinds for an aggressive risk-seeking fund manager of Bolton's type.

It was also, we can see now, his good fortune to have the chance to join a world class fund management house just at the point it was launching its push into Europe. At the time, as we have seen, there was no guarantee that Fidelity would enjoy the success that it has done subsequently. In 30 years the firm has gone from nowhere to the number one position in the UK unit trust and OEIC business, where it has an 8% market share of retail sales. As events have turned out, there can have been few more congenial or supportive environments in which to pursue a stockpicking career. As a privately owned company whose sole business is fund management, Fidelity has largely been able to avoid the internal battles and multiple changes of ownership that bedevil the lives of fund managers elsewhere.[24]

[24] It may be no accident that the American group Capital International, which is widely regarded as one of the more successful modern fund management groups, is also a private company with a strong internal culture and no distractions from the central fund management effort.

By his own admission, the Fidelity way of doing business, with its intensive focus on research-led equity investment, has suited Bolton well. “Investment people are well protected in Fidelity”, says Richard Timberlake, Bolton’s first boss, who now runs a fund of funds business that brings him into regular contact with all the main fund management groups. “They don’t get drawn into the marketing or administration of the business. Most other fund managers spend a huge amount of their time doing marketing, doing their own admin and doing their own client service. If you can separate the three elements, investment, IT/administration, and marketing, and you can find the best team in each area, and rely on the others to do the other bits, you have a much greater chance of creating a good organisation. In recent years Anthony has been strongly supported by good analysts. I think he is good at getting what he wants from them.”

But neither the happy circumstance of his time running money coinciding with a glorious bull market, nor the good fortune of landing his job with such a favourable employer, can fully explain Bolton’s success in beating the market so consistently over so many different phases in the market cycle. The fact that he continued to outperform the market by the same margin during the savage bear market that succeeded the bullish conditions of the years up to 2000 is testament to the fact that his working methods capture something that other fund managers seem to lack. Although he has had poor patches in relative terms, some lasting 18 months or more, the longer the holding period in his fund, the better and more consistent its performance has been.

HOW OTHERS SEE IT

Canvassing the opinions of those who have worked closely with Bolton over the years produces a number of explanations for what it is that has helped to make his time as a fund manager so successful. Everyone that I have spoken to has talked eloquently about the discipline with which he approaches his job. According to Sally Walden, who worked alongside him

for more than twenty years, Bolton manages his time extremely carefully. "He is not the kind of guy who lingers for a chat at the coffee machine. He goes out of his way to make sure that no part of his working day is wasted. While he is never unpleasant to anyone, he has the knack of letting you know, in the most charming way, when he has got what he wants from you."

Drawing on his many years of working with fund managers, Timberlake says that one of the keys to Bolton's success has been his uncanny ability to measure and interpret what the market's expectations for a share are."The most important thing to understand about Anthony, in my view, is that he is two-brained. Good fund managers are not usually the first class degrees in maths, or someone who is a brilliant accountant or actuary. They usually make poor fund managers. It is far more important to understand crowd psychology, which is a creative skill. A degree in crowd psychology is a far better qualification than being an accountant or an economist. People who are both right and left brained, as Anthony is, are the ones you want. Not only has he got a first class all round brain, but he also understands the market and crowd psychology. He has a creative side that understands other people's behaviour."

Alex Hammond-Chambers, the chairman of the Fidelity Special Values investment trust, agrees. His view is that Bolton has "the most uncanny knack for understanding what the market is discounting in a stock. There aren't many people who can look at a stock and immediately understand what the market's view is. People think they do. You ask 90% of people what the market thought of Vodafone in March 2000 and they would have been wrong. But Anthony has an instinctive understanding of what the share price is telling him the market thinks about a company, and with his perception and experience, he knows whether to agree or not. If he doesn't agree, then that's a buying opportunity."

Simon Fraser, who worked with Bolton for more than 20 years, latterly as Fidelity's Chief Investment Officer, says that his colleague's confidence in buying unloved stocks is underpinned by his acute sense of what the value of a business is, not just to the stock market but to potential trade or private equity investors as well. "One reason that he is happy to buy

illiquid stocks that nobody else is prepared to touch", says Fraser, "is that he knows from his innate sense of value that one day someone will come along and bid for them." His success in finding stocks that are later taken over suggests that this is well-founded. In one miraculous year (1999), 30 companies that he owned that year were the subject of takeover bids or some other form of corporate activity. "At the end of the day successful investment is about seeing things more clearly than the rest of the market and acting on them before everyone else has come to the same conclusion. Anthony has the ability to do it, not just to think or talk about it." The most important thing about Bolton, however, says his colleague Sally Walden, is his temperament, which is unshakeably implacable. A good deal of his intelligence, she thinks, is internalised. "He is a very difficult person to read. What he says always sounds very simple, even simplistic. Quite frankly there a lot of fund managers out there who sound a whole lot better when they get up to speak. But none of them has done anything like as well. Anthony is very dispassionate. Whatever happens, he just gets on with the next job on his list. In my view, there is no question that he is a better fund manager today than he was 15 years ago." His colleague Barry Bateman, makes the same assessment. "Aside from his performance, which has obviously been exceptional, the fact that Anthony is such a nice guy, quiet and not in any way a prima donna, has helped to set the tone for the whole investment operation. Let us face it, many so-called 'star' fund managers can be unreasonable and difficult to manage. We haven't had that problem, and in large part that is because Anthony has set such a tremendous example."

THE QUALITIES GREAT INVESTORS NEED

Peter Jeffreys, who worked alongside Bolton in his early days at Fidelity before leaving to co-found Fund Research with Timberlake, says there is no question in his mind that Bolton is one of the few true 'greats' in the UK fund management industry. "There are a number of attributes common to all good fund managers – knowledge, skill, enthusiasm,

dedication and 'love of the game', to list only the more obvious ones. Great fund managers, however, have something extra, something less easily definable, which sets them apart from the field." Bolton shares a number of these attributes with Peter Lynch, Fidelity's high profile fund manager in the United States, with whom, says Jeffreys, he can validly be bracketed. "The most important one I would say is that both are their own men. Anyone who has worked with Anthony will know he possesses an independence of mind that is second to none. When researching a company, he will draw on the widest possible range of fact and opinion, but his final analysis will be driven solely by his judgement of a situation, a company's future prospects, or a share's valuation. He will not be influenced by fashion or fad, or the current market view." It may be no accident that, in contrast to many of his colleagues, Bolton likes to draw on other ideas than simply those generated by Fidelity's research machine.

Alex Hammond-Chambers, who carried out his own analysis of Bolton's performance shortly after being appointed the chairman of Fidelity Special Values, says there are many analogies that you can use about good fund managers. "Jimmy Gammell [the founder and guiding light of the Edinburgh investment house Ivory & Sime] always said that the best analogy was sailing; even though you went sailing from point A to point B, you didn't always just go in a straight line. Sometimes you tacked, sometimes you ran, and sometimes you reached. Sometimes, because the winds were very vicious, you had to pull in a reef or two. In other words, you had to adjust your sail and your sailing to the conditions. That's what investment brains do very well, and that's what Anthony does very well. I think he has a very good hand on the tiller."

According to John Chatfeild-Roberts, who runs a successful fund of funds operation for a rival fund management company, Jupiter Asset Management, and has invested in Fidelity Special Situations for many years, Bolton is a rare example of the 'complete' fund manager. The things Chatfeild-Roberts and his team look for when seeking out the best fund managers are "capacity and desire for hard work, the ability to spot opportunities and act on them quickly and decisively, and the imagination to see further ahead than most around you". Bolton has all three in strong

measure. “If you see him on the train home, you will find him reading research which, when read, he then deposits in the litter bin before alighting at his station; this is still as true today as it was twenty years ago. Opportunities? Over the years there have been themes that ran through his portfolio. A recent example was the Lloyd’s insurance vehicles, which many people didn't believe, or if they did, sold them too soon to reap the full rewards. Imagination? Well you only have to look at the long term holding in Nokia from the early 1990s, when mobile phones were bricks and most people (myself included) swore blind that we would never countenance having such interruptions. What would we all do without them now? Any one of these abilities may make a good fund manager, but to have all three makes a great one.”

Chatfeild-Roberts also speculates that there might be something in the fact that Bolton likes to compose music in his spare time. “It has been found that if you play classical music to babies in the womb this stimulates the parts of the brain responsible for both musical ability and mathematical skills. Anecdotal evidence also suggests a strong link between music and maths. In the University of Oxford, maths students approaching their final exams are reported to have a preference for attending Bach recitals. An innate appreciation of pattern in numbers – which might appear in something mundane as company financial statistics – may therefore be something which helps give Anthony an edge.” Bolton himself promised that he would spend more time listening to and composing music when he finally retired at the end of 2007.

Hammond-Chambers adds: “It is the amount of thought that goes into the investments Anthony makes and his ability to think differently from the crowd that more than anything else has enabled him to spot value in a stock in a way that others cannot. The thing I noted was how incredibly few failures he has. He doesn’t bomb. He doesn’t make big mistakes. I think that’s in part because he’s so value conscious, so many of the investments he makes don’t have a huge big downside. He doesn’t chase popular stocks. I’m sure he makes mistakes – we all do – but you need to look at his gains/losses ratio. You normally reckon that a very good portfolio manager is going to get perhaps six pluses, two equals and two minuses for every

ten stocks he owns. That will certainly be enough to produce good returns. Anthony does better than that, with the emphasis on very low minuses." The figures given earlier, showing how rarely his fund's loss-making months exceed those of the market as a whole, bear out the truth in this observation.

This in turn plays well with those who make their living out of selling funds. Mark Dampier, head of research at Hargreaves Lansdown, a Bristol-based stockbroker that has grown to become the largest player in the fund broking business, says that while Bolton exudes self-confidence, he lacks the arrogance that is so often the downfall of fund managers. "His style of management is difficult to pin down, but his ability to look at stocks in a different way to the market as a whole seems to be his real talent. In other words, he believes in his own valuation techniques, rather than those employed by others." His investment process, finding cheap stocks that the market has overlooked, is not complicated. "While this style can go out of fashion over certain stock market cycles, particularly when we are in recession, he bounces back strongly and makes up for any losses when it does come back into style. Investors have tended to forget that after the stock market crash of 1987, and through the recession of the early 1990s, Anthony's performance was relatively poor. In order to make money with his fund, you have to be patient and hold him through the hard times. He has rewarded you amply if you do this."

HOW THE PRIVATE INVESTOR CAN PROFIT

Bolton has some excellent advice on how his methods can be adapted by private investors to make money out of investing in smaller companies.[25] This can be summarised as follows:

- Know what you own. Think of what you are doing as buying 100% of a private business rather than a small fraction of a public one. Read as much about the company as you can. Do your own research, rather than relying on tips in newspapers or magazines.
- Concentrate on a few stocks that you can follow closely, rather than a lot which you cannot, and avoid areas such as high technology unless you have a specific personal knowledge of the area and know a lot about what the companies are doing.
- You should be able to sum up in a few sentences the reasons that you own each company in which you have shares. The point about sticking to companies in businesses that you know something about is that "the stock market deals in perceptions: if you know the reality is different, then you may be able to use this to your advantage."
- The best companies to own are ones which are, for reasons that you can readily identify, likely to grow consistently over the long term. This may be a niche area of the market, a product for which there is no substitute or an industry which is unregulated. Ideally, the companies should have some sort of unique franchise and be capable of generating cash.
- In the long term, the ability to produce free cash flow is the most attractive attribute that a company can have. It pays to distinguish between companies whose growth is due to temporary circumstances and those which look more durably based.
- When it comes to rating management, look for those managers who patently have their shareholders' interest as their first priority and who are honest with their investors about their successes and failures.

[25] It is contained in a small section of *The FT Global Guide to Investing* (FT Pitman, 1995).

- Try to buy shares when the market is depressed or when a stock is going through a temporary hiccup. Don't sell a share just because it has gone up – i.e. do run your profits. Selling too soon is the best way to miss out on some of the most spectacular winners in the stock market.
- Don't waste time on the futile pastime of trying to guess which way the markets as a whole are going to move. Don't expect too much. You will be doing well if your successes outnumber your failures by a ratio of two to one.
- Given the choice, stick to buying companies which are well financed.
- Ignore directors' dealings at your peril, especially if two or more directors are acting the same way and buying or selling shares in their companies in reasonable size.

If all this sounds rather familiar, then remember finally, says Bolton, that "there is little original thought in investment". If the cardinal sin is to follow what the herd is doing, there is still an awful lot of money to be made by following the ideas of those gifted few who do have the happy knack of being able to sort the wheat from the chaff, and can cock a snook at the prevailing wisdom. To do exceptionally well in the stock market, you have to dare to be different.

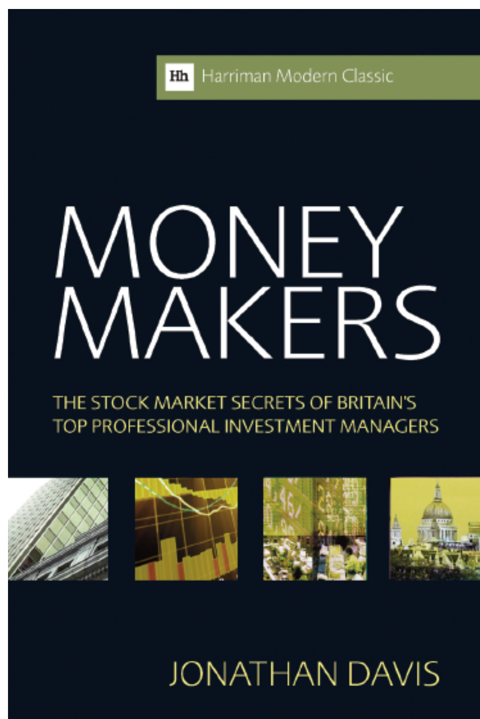
UPDATE (2012)

Anthony Bolton retired from running his UK Special Situations fund at the end of December 2007, with his reputation and track record firmly intact. A little over two years later he came out of retirement to launch a new China "special situations" fund for Fidelity, based in Hong Kong. Although this new investment trust raised more than £600m at launch its initial performance has so far been disappointing, with the stock price falling some 30% below its issue price at its lowest point. He remains confident of its longer term potential.

Money Makers

The Stock Market Secrets of Britain's Top Professional Investment Managers

Jonathan Davis



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