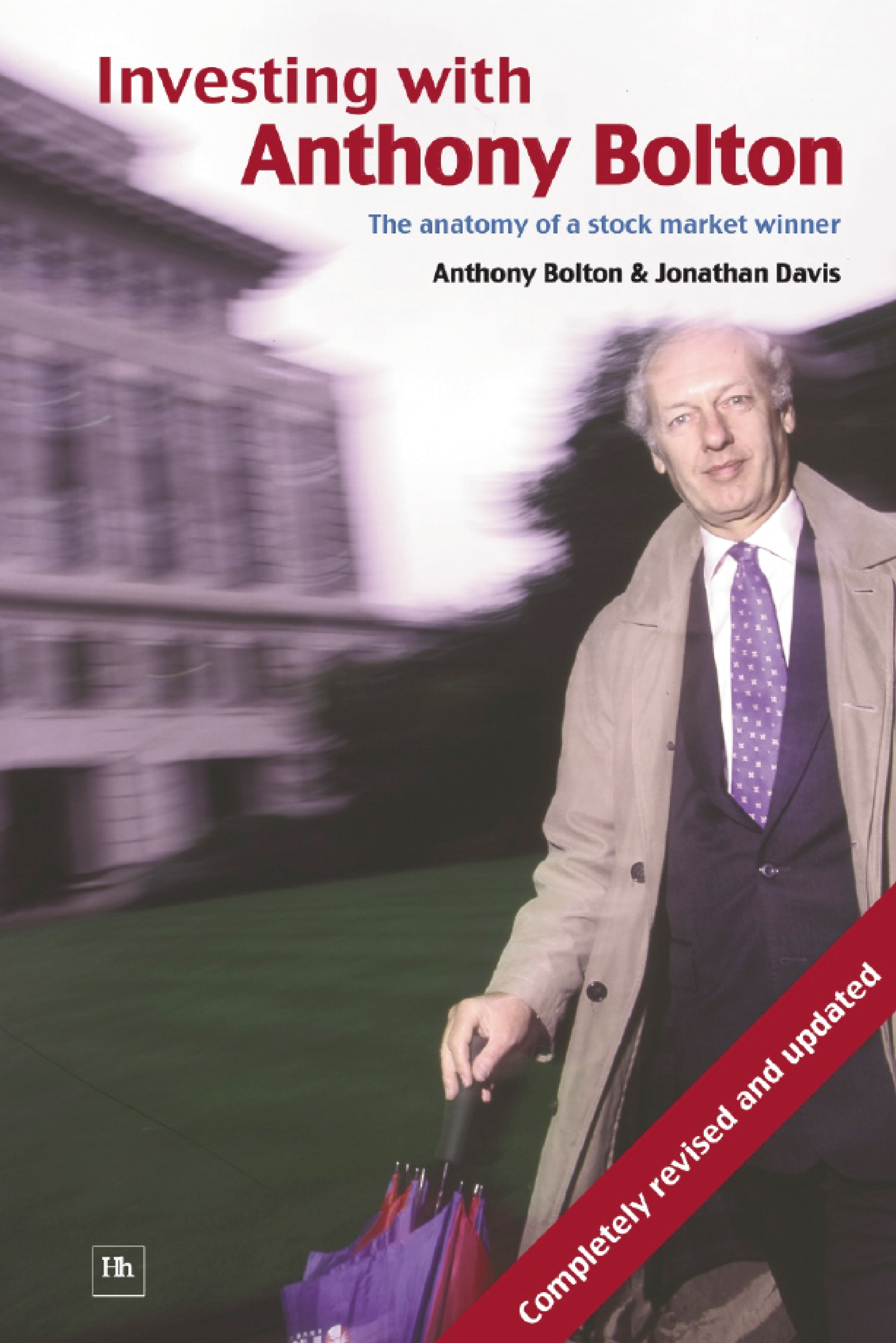
Investing with Anthony Bolton

The anatomy of a stock market winner

Anthony Bolton & Jonathan Davis



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By Anthony Bolton & Jonathan Davis

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About the authors

Anthony Bolton:

Anthony Bolton left Cambridge University with a degree in engineering to start a career in the City. In 1979, aged 29, he was recruited by Fidelity, the international fund management group, as one of its first London-based investment managers, a move that proved to be the launch of a long and successful career as an investment manager. In surveys of professional investors, he is regularly voted the fund manager most respected by his peers. He will be retiring from full-time investment management at the end of 2007, while continuing to work part-time at Fidelity and spending more time on his charitable interests and his hobby, composing classical music. Anthony Bolton is married with three children and lives in Sussex.

Jonathan Davis:

Jonathan Davis has been writing about financial markets and the City for more than 25 years. After graduating from Cambridge University his early career was spent as a business journalist on national newspapers, the *Sunday Telegraph*, *The Times* and *The Economist*. Since 1991, after a year on the Sloan Fellowship programme at MIT's Sloan School of Management, he has run his own specialist publishing and consultancy business. He has been writing a popular weekly column about investment in *The Independent* since 1995 and contributes monthly to *The Spectator* and *Financial Times*. His other books include *Money Makers*, a study of successful professional investors, and a primer on the game of bridge. He is chairman of Half Moon Publishing, which specialises in publishing high quality material on money and investment, and the founding editor of the specialist newsletter *Independent Investor*. For more information, visit: www.independent-investor.com

What they say about Anthony Bolton

Neil Woodford, Head of Investment, Invesco Perpetual

"Anthony Bolton is an exceptional investor. His focus on producing excellent long-term performance has never been swayed by fashion or market pressures and he has maintained his investment integrity throughout varying market conditions. These are the disciplines that quality fund managers exhibit."

John Armitage, Director, Egerton Capital

"Anthony Bolton's professional achievement has been combined with great modesty. He has all the good attributes of success and none of the bad. Many people underestimate what it takes to be as successful as he has been."

Jeff Prestridge, Personal Finance Editor, Mail on Sunday

"In an industry where fund manager loyalty is sadly lacking, Anthony Bolton is living proof that loyalty can pay handsomely, not only for employers but more importantly for investors. For the past 25 years, he has run the good ship Fidelity Special Situations like a master commander. His investment record is exemplary and living proof that long term investment in equities can really pay."

Patrick Collinson, Personal Finance Editor, The Guardian

"Anthony Bolton's name adds enormous weight and gravitas to any article on investment. Over the years he has become perhaps the most respected and powerful fund manager in the country. In other individuals, such power would make them fearsomely self-important, yet Anthony Bolton has always remained accessible to the press and investors. He's alert to the fact that behind it all, he's running money on behalf of tens of thousands of small investors, and it's their interests, rather than his ego, that count above all."

Nigel Thomas, UK equity fund manager at Framlington

"Anthony Bolton's intellect and agile mind make him the very best in our industry. His ability to manage a large fund, with such foresight, is without peer in the UK stockmarket."

Introduction

Anthony Bolton in his office overlooking St Paul's Cathedral

Introduction

There are very few professional investors of whom it can truly be said: "this is one of the greats". Scan the pages of the newspapers and the specialist investment magazines, where promises of exceptional performance are liberally distributed, in editorial and advertising alike, and you might all too easily form a different impression. Fund management remains a highly competitive, sales-driven business: "25% performance and 75% marketing", as the legendary Warren Buffett once drily observed.

Hundreds of academic studies over the past thirty years have underlined what many investors have learnt for themselves through experience: that it is surprisingly difficult even for highly talented professional fund managers to beat the market consistently over any length of time. That is one reason why so-called 'passive investing', in which investors buy funds that mechanically track the performance of the major stock market indices, has grown to become such a significant part of the modern investment game.

Yet exceptional talents who have shown they can outperform their benchmark indices on a consistent basis over many years do exist. They are rightly able to command a hefty premium for their services, as well as the attention of headhunters and the plaudits of their peers. Some of the best and brightest go off these days to join hedge funds, the current investment fad (not always with spectacular results). Others opt to set up their own specialist investment companies where they can pursue their craft without the pressures that working in a large corporate environment usually brings.

In the field of unit trusts and OEICs, the staple diet of millions of private investors, it is rare for the best fund managers to avoid these tempting alternatives and stay the course of an entire career. Of those who have done just that, one man by common consent stands head and shoulders above the rest for the consistency and integrity of his performance. In polls of professional investors, he is the fund manager most regularly rated the one his peers admire most. The flagship fund he runs for Fidelity International has the best record of any unit trust over the past 27 years.

That man is Anthony Bolton, the subject of this book. If you had been smart enough to invest £1,000 in his Fidelity Special Situations fund at its launch in 1979, you would now have an investment worth more than 120 times that amount. Your initial investment would today be worth more than four times the sum you would have if you had simply tracked the UK stock market over the same period (which, it should be remembered, has itself been one of the greatest times in modern history to own shares). More than 250,000 people have invested in the fund. By 2006, shortly before the announcement of plans for Bolton's eventual retirement, the fund had grown to more than £6 billion in size, a two thousand fold increase on its size at launch.

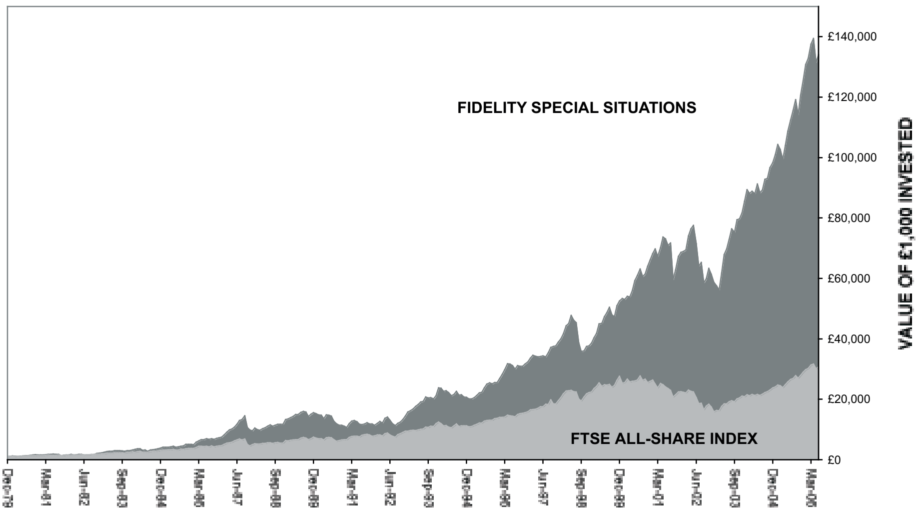
The fund's performance translates to a compound rate of return of slightly over 20% per annum, sustained over more than a quarter of a century – a record that stands comparison with the best names in American fund management, the likes of Warren Buffett, Peter Lynch and John Templeton. Just as remarkable is the fact that his performance has remained so consistently strong over the whole period, despite the dramatic increase in the size of the fund. For 17 years, from 1985 to 2002, Bolton also ran a second fund, this one specialising in European equities, that consistently outperformed all his peers by a similarly impressive margin.

No other professional working in Bolton's field can match this record of enduring and simultaneous success in both the UK and European markets. The obvious question that arises is: how has he done it? This book, which was originally published to coincide with the 25th anniversary of the Special Situations fund's launch in December 2004, looks in depth at the things that have contributed to its success. The current paperback edition has been thoroughly revised and updated and brings the story of Bolton's career fully up to date.

The latest edition falls into four distinct sections:

- In the first chapter, Anthony Bolton gives his own account of his time at the helm of Fidelity Special Situations – how it began, the methods he uses to achieve his results, and the lessons he has learnt from his many years mastering the art of professional investment. Although he has been the subject of numerous short profiles in the past, this is the first time that he has set out his own account of the fund and his philosophy of investment at length. For the paperback edition, he has added new sections explaining his interest in China as an investment opportunity of the future and outlining his plans for the future and outlining what he plans to do when he finally hands over management of his UK fund at the end of 2007.

HOW THE FUND HAS GROWN
The value of £1,000 invested at launch



- The second chapter is an extended profile of Anthony Bolton and the methods that have enabled him to earn his reputation as the outstanding stock market investor of his generation. It builds on and comprehensively updates an account of his methods that originally formed part of my book *Money Makers* (1998). Researching my newspaper columns, newsletter and books has given me the opportunity to hold many conversations with Bolton in the last ten years. The chapter draws on these conversations to provide a detailed independent account of the way that this most dedicated and professional of investors goes about his business.

- The third chapter takes an in-depth look at the performance of the Fidelity Special Situations fund over the course of its 27-year history and asks the question: how good and how consistent has it really been? Interpreting fund performance statistics can be a hazardous business, notoriously full of pitfalls for the unwary. The chapter seeks to guide the reader through these thickets and goes on to analyse the reasons for his exceptional performance. In addition to my own observations, it draws on the views of a number of those who know him well professionally.
- The short final section draws together various themes that run throughout the book. In the first part, Anthony offers his personal observations about the lessons that he has learnt over the course of his career. in the second, I offer some pointers to how fund investors looking for the next Bolton might sensibly approach that daunting task. Although the financial markets chop and change like the seasons, there are also some timeless principles from which investors of all kinds can benefit. There are very few new ideas in investment, but that does not make the old ones any less valid.
- In the Appendices, the reader will find more data on the performance of Fidelity Special Situations; detailed assessments of the fund's style and risk profile by professional fund analysts; extracts from an early fund report; an interview with Bolton about Fidelity's approach to corporate governance issues in companies; and an example of a typical piece of corporate analysis produced by Fidelity's research team. This supplementary material is designed to fill out, for those who are professionally interested in the detail, the picture of how Bolton goes about his work. On a lighter note, and to provide a more rounded picture of the man, the section also includes for the first time a revealing piece about his favourite pieces of music.

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A few years ago I asked one of America's most respected investment consultants, Charlie Ellis, what he had learnt to value most in his many years of studying and working with professional investors. His answer was that people spent far too much time looking at performance data, which is all too often misleading rather than informative. When it came to deciding where to put his own money, he said: “I am not looking for something extraordinarily different. I am just looking for integrity, character and brains. And while brainpower is important, it is not nearly as important as integrity”. I have since come to learn how wise an observation this was.

It has been an agreeable task to undertake a project that analyses the achievements of one fund manager whose integrity has never been in question, and who has rarely disappointed the faith of those who have put their money into his care. The fact that he is one of the nicest men you are likely to meet has little to do with Anthony Bolton’s success – the City rewards the ruthless and the unpleasant just as readily as the charming and well-mannered – but it has certainly made chronicling the fact an agreeable and instructive undertaking.

Jonathan Davis
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1

Daring to be different

Three decades as a contrarian investor
by Anthony Bolton

How it all began

The year that Margaret Thatcher was first elected Prime Minister in the UK, 1979, was one of the key years in my life. Looking back, I realise that I did what I think stress consultants advise most strongly against – which is getting married, moving house and moving jobs all in a relatively short period of time. I got married in February 1979, having moved house a few weeks before, and then changed job to join Fidelity in December. I had met my wife Sarah while we both worked at Schlesinger Investment Management, a South African owned investment company which also had interests in banking and property. She was an assistant to one of the investment directors and I was, at first, an investment assistant and later a fund manager. In the summer of that year one of the two managing directors, Richard Timberlake, left Schlesingers to start a new fund management business for Fidelity in the UK. He let it be known that he was looking for two investment managers to join his nascent organisation.

I hesitated whether to contact him as I was told he had agreed not to try and actively recruit his ex-colleagues for a period of time. I also knew little or nothing about Fidelity. Two things changed my mind. The first was making contact with a personal friend who worked as an investment manager at M&G, the company that had introduced the first unit trust in England back in the 1930s. He told me that Fidelity was "the best US manager in the business". The second was my wife Sarah, who could see the potential and significance of the new company, and persuaded me to give Richard Timberlake a call. I was then aged 29, rather shy and somewhat hesitant about ringing up. "What have you got to lose?" she repeatedly asked me, until I made the call. It turned out to be one of the most important calls that I have ever made.

After a meeting with Richard, he asked me to have an interview with Bill Byrnes. Bill had worked at Fidelity's headquarters in Boston for many years and was very close to Ned Johnson, who is the President of Fidelity as well as the son of the company's founder. If Ned Johnson is entitled to the credit for Fidelity's phenomenal success in the US in the 1980s and 1990s, then Bill Byrnes is the man who deserves the credit for starting Fidelity's international business. This was at a time when most US investment businesses were purely focused on their domestic market in North America. As one of the market leaders in the US mutual fund business, Fidelity was well ahead of the times in seeing the potential for taking its investment business into the global market. I remember that the news was deemed sufficiently important by the Financial Times to be given front page treatment, though I don't think many other papers took much notice.

I went for my interview with Bill with some trepidation. I had after all only run money for a year or two at Schlesingers. I was hardly the most experienced fund manager in the UK. The last question I was asked was: "Well Anthony, do you think you can run money successfully at Fidelity and beat the competition?" I can't remember my answer, but something must have persuaded him I could do it because shortly afterwards I was offered the job. Bill is one of the most charming Americans one can meet and a great Anglophile. He has been a constant source of encouragement to me over the years. He still calls into our London office once or twice a year.

So it was that I joined Fidelity on 17th December 1979, the day that the company launched its first four unit trusts for British investors. As well as my fund, the Fidelity Special Situations Trust, there was an American Trust (not surprisingly, given Fidelity's parentage), a Fixed Interest Trust and a Growth and Income Trust run by the other investment manager that Richard recruited. His name was James Wellings. He had previously worked for a stockbroker and he ran money in a very different style to mine. He bought low risk, higher yielding shares with a very quantitative approach that involved regularly taking profits on companies that had outperformed the stock market as a whole.

We shared an office for the first few years in Fidelity's then City office in Queen Street. James was a lovely individual, very much of the old school, a traditionalist, as I suppose I am. We got on very well. The only exception was during a couple of weeks in the early months that we worked together. When I was interviewed by Richard Timberlake, I had made it a condition of joining that I wanted to be a director; one of my personal ambitions was to become a director before I was thirty years old. James hadn't asked for the same condition and, although he was also made a director later, my appointment predated his by a few months. Being equally ambitious, he was very upset that I had beaten him to the post. This made sharing a small office awkward for a while, but he soon forgot about it and thereafter we got on brilliantly.[1]

[1] James left Fidelity some time later to pursue other interests.

Youthful recruit: Fidelity's youngest UK director

The Fidelity experience

When I first joined Fidelity, I think that there were about twelve of us in the Queen Street office, consisting of Richard Timberlake's initial team, plus three or four people whom Fidelity already had in London to help run their offshore funds. Several of these funds, based in Bermuda, had been going for some years before the launch of the UK unit trust company in 1979. They were Fidelity's first offerings to international investors. It seems amazing now that 27 years later Fidelity employs more than 4,290 people (as of the 30 June 2006) in the UK. This includes an investment team with 39 portfolio managers and 51 analysts, based in our office at 25 Cannon Street. This office, which we designed, built and own ourselves, looks out over St Paul's Cathedral. It is the fourth office Fidelity has had in the City. A growing investment management business is generally short of office space and managing one's property needs is an important but difficult administrative task.

I am often asked how I have stuck it out for nearly 30 years at the same company and what it is that has kept me at Fidelity. Obviously there are a number of factors. The first has been the excitement and satisfaction of having been part of the team that has built up what in my view is the number one investment management institution in the UK. I have been lucky to have been intimately involved in setting up and shaping the investment team. Secondly, it has given me the opportunity to work with some of the brightest, most talented and nicest people in the business. This last attribute is particularly important to me. I have had a number of approaches over the years to join other companies, although the headhunters have stopped ringing me in recent years as they all know it's a waste of time trying to persuade me to move.

I remember one approach in the 1980s from what was then one of the most successful global hedge fund businesses of the time. This was a second attempt as I had met the proprietor a few years earlier. This time I met the head of international investment and I must say that I thought he was a particularly unpleasant person. He ended our meeting by saying something along the lines that he couldn't understand why British people didn't think getting rich was the most important aim in life and were motivated by other things besides money.

The great thing about Fidelity is that we have a superb group of people with a mutual shared interest: every senior person has either been involved in running money personally or, if they haven't, knows that doing this well is the one activity that guides everything else that Fidelity does. The quality of the people has been the key to keeping me here and the special environment this creates is also, I think, why we have been able to retain so many of our good investment personnel. Obviously reward and incentives are very important as well, but they are not everything. I also think it is a big advantage working for a privately owned business in which it is possible to make decisions for the long term. One investment manager at a competitor firm whom I met told me that they had been through three reorganisations of their investment management side in the last four years. This was the result of other investment organisations being brought into the group by acquisition; each reorganisation involved a number of people leaving and the chief investment officer changing. Fidelity's growth has all been organic and it's been our key philosophy to build our own team rather than go out and buy other firms. I am convinced that this is the best way to motivate and keep key staff. It's interesting – and probably no coincidence – that another of the largest and most successful global investment businesses, Capital Research, is also privately owned and has grown organically.

The Special Situations fund

Why did I start a Special Situations Trust and what does this term really mean? Richard Timberlake knew at the outset that he wanted me to start a fund that was primarily focused on capital growth, to complement the more defensive qualities of the Growth and Income Trust. As one of the funds I had helped to run at Schlesingers was the Schlesinger Special Situations Trust, and as it was also the fund I enjoyed managing the most, it was natural for me to suggest to Richard that this is what we should launch. He agreed, and so the fund was born. If you had told me then that the fund would one day grow to more than £6 billion in assets, and become the best performing unit trust of the next 26 years, I would have been amazed. We started in a much more modest way, with the simple idea of seeing how well we could do and taking it from there.

The first definition of what constitutes a 'special situation' was set out in the prospectus of the unit trust when it was launched. Over the years I have refined and modified the way I describe my approach, but the basic concept – searching for capital growth opportunities in an aggressive and contrarian way – remains exactly the same as at the outset. In the prospectus for Fidelity Special Values Plc, the investment trust that I also run on the same lines as the unit trust, but launched a few years later, the description runs as follows:

"The Manager regards as a 'Special Situation' a company attractively valued in relation to net assets, dividend yield or future earnings per share, but which, in its view, has additionally some other specific features that could have a positive influence on its share price." The types of companies which may fall within the definition of 'special situation', it went on, include:

- Companies with recovery potential
- Companies with strong growth potential
- Companies with assets whose value has not generally been recognised
- Companies with a special product which has a particular market niche and therefore good earnings potential
- Companies which are possible takeover candidates
- Companies subject to restructuring and/or changes in management
- Companies which are not widely researched by the brokerage community

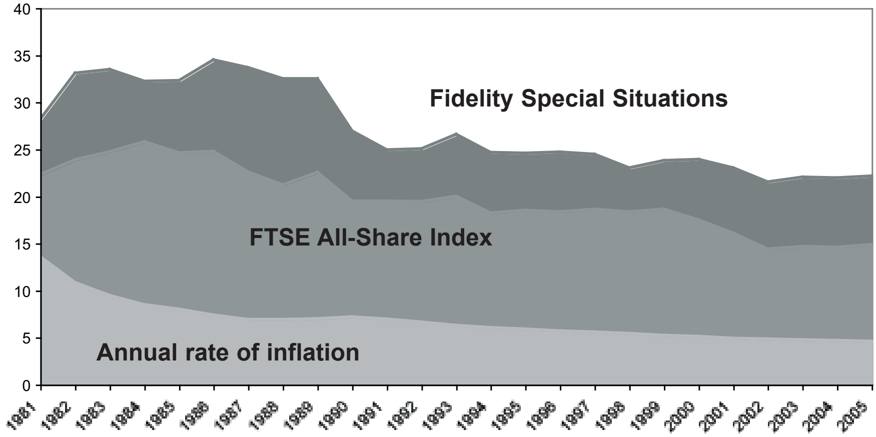
The fund manager, we said, "is likely to concentrate on companies which it considers to be out of favour with investors or undervalued in relation to generally accepted valuation measures, but where it believes investor sentiment is likely to improve in the medium term". That would lead us to focus on shares in companies outside the market leaders. We would adopt a 'bottom-up' stockpicking approach, selecting investments "primarily on the basis of specific criteria relevant to the company in question and not on the basis of general macro-economic considerations". Noting the importance of doing our own research, we added: "As well as the analysis of the company's financial position and their relative valuations, the manager meets the management of a significant number of such companies. It aims thereby to build an information advantage which previous experience has indicated can be utilised to exploit the market inefficiencies and hidden values in under-researched companies. After investment in a company, the manager will follow it closely and, generally, maintain contact with the management in order to identify at an early stage any change in its situation or prospects."

This still very well encapsulates my approach. It is important that the definition of what constitutes a special situation has always been pretty wide, which means that many different types of situation can be included. If your objective is the aggressive pursuit of capital growth, as mine has always been, it makes no sense to exclude potential moneymaking opportunities by being too restrictive about what kind of shares you can buy. Another key phrase in the prospectus definition is "…..which it considers to be out of favour with investors or undervalued". My investment style has always been at heart a 'value' approach.

Of the two most important investment styles – growth and value – why did I choose value? I think there are several reasons. Firstly, I have always liked reading books on investment that are written about, or by, the great investment gurus. In my opinion the weight of the evidence of these supports the idea that value is more likely than growth to deliver superior returns over the long term. This does not mean that I dismiss growth as a valid way to produce above average returns. It is merely that over the long term the odds are slightly more in one's favour with a value approach. Another factor that influenced me at the beginning was the fact that one of the most popular unit trusts at the time was the M&G Recovery Fund. It was run with a broadly value style that involved buying companies that had done poorly. I very much identified with its policy of buying out of favour companies.

Finally, I believe that investment managers should find a style and mode of operation that works for them personally and then stick to that style. For some reason I have always felt happier going against the crowd and generally feel uncomfortable doing what everyone else is doing. So many pressures in the investment business encourage one to do the opposite and go with the crowd. Unless you are temperamentally happy with acting on your own, this approach is unlikely to do you much good. People have asked me if my general approach to life is also contrarian, but I don't think it is. Generally in my personal life I will follow what I like, which sometimes may be fashionable and sometimes not. What I have found is that my contrarian stock market style is particularly helpful at market turning points when the natural tendency is often to do completely the wrong thing. Experience, I believe, counts for a great deal in investment. As Mark Twain said, "History never repeats itself, but it sometimes rhymes." I think these eight words should be burned into every fund manager's desk.

THE FUND, THE MARKET AND INFLATION
Cumulative average of returns 1979-2006



Ignoring the benchmark

John Maynard Keynes, who was a successful investor as well as an outstandingly original economist, said in regard to the stock market that picking shares was like a beauty contest where "it is important to choose not who you think is the prettiest girl, but who the judges will think is the prettiest girl". Another way to put this, to borrow a phrase from Ben Graham, is that the stock market is more of a voting machine than a weighing machine, at least in the short term. I have always started my search amongst the stocks that investors don't think are the prettiest, so that if they change – and I'm really using my skills to find ones that have the factors that might lead to a change – there will be lots of new buyers for the shares as they become more attractive. (In life, as opposed to the stock market, however, I recommend you pick the girl that you think is the prettiest. I certainly did.)

One of the most important features of the Fidelity Special Situations Fund, which flows directly from my contrarian philosophy, is that I have always run it on an unbenchmarked basis. That is to say, I pay little attention to how what I own compares with the makeup of the FTSE All-Share Index. The All-Share Index is the measure, or benchmark, against which my performance is judged: and the objective of the fund is to do better than the index. But, unlike many fund managers with the same objective, I do not spend time worrying whether I have say 10% in oil company shares at a time when the index has 15%, or whether I do or do not own the biggest component companies in the index.

This indifference to the benchmark's weightings by definition means that over time my fund produces more 'lumpy' returns than the market averages. I have inevitably had bad patches during my years in charge of the Special Situations fund. However, at the heart of my approach is the view encapsulated by Warren Buffett when he said that he and his partner Charlie Munger "would much rather earn a lumpy 15% [per annum] over time than a smooth 12%". My objective is to provide the highest average annual return that I can in the long term, even though this return will fluctuate more in the short term. It is the opposite of a benchmarked fund which attempts to provide a modest amount of relative performance on a consistent quarter by quarter basis, building up over time to a smoother, but lower, long term return.

In the early days of Fidelity I also ran some money for pension fund clients such as Tate & Lyle and Rank Xerox. However, my heart has always been primarily on the unit trust side. One of the reasons is the very wide freedom that one has to manage a unit trust in comparison to a pension fund, where there is the constant burden of trustees questioning your actions after the event. In those days, it seemed to me, pension fund trustees always wanted to spend the most time talking about the investment decisions that hadn't gone right, or at least had not gone right at the moment of reporting.

Yet investment is an odds game. No-one gets it right all the time; we are all trying to make fewer mistakes than our competitors. In fact, the key to success in this business is as much to avoid losers as it is to pick winners. On the other hand, running money with a style that is so defensive that it avoids all losers is also, I believe, counterproductive to superior returns. Having a calm temperament is another very important factor. One should learn from one's losers but not get too upset about them. Conversely it is unwise to overcelebrate the winners; overconfidence can be just as bad. It is always worth remembering that some of your best performing stocks could have been picked just as easily with a pin!

In the mid 1980s I took on the added responsibility of managing Fidelity's European Trust when this was launched. Europe particularly interested me as, from an investment point of view, the markets were very underdeveloped compared to the UK and therefore the opportunities for finding mispriced shares were abundant. It was a very rewarding environment for a stockpicker such as myself. As our team grew, I was able to give up my institutional accounts to focus solely on these two funds. In 1990 I also took on management of our Luxembourg-based fund European Growth Fund which became Fidelity International's largest fund. It started as a fund that invested only in continental Europe, with no UK exposure, but later became a Pan-European fund that included UK shares as well.

In the early 1990s we launched two closed-end investment trusts, Fidelity European Values Plc in 1991 and Fidelity Special Values in 1994. Both of these I ran with similar portfolios to their sister unit trusts. The investment trusts provide investors with alternative ways to invest in my stockpicking abilities and can also, unlike the unit trusts, use gearing (borrowing) to enhance returns. At times when the investment trusts sell at a significant discount to their net asset value, they can be particularly attractive alternatives to the open-ended funds.

Three and a half years ago I gave up my European funds to focus on just Special Situations Fund and Special Values Plc, which together (as of mid 2006) have assets of about £6.4bn. Running four funds, including Fidelity's three largest ones, had become extremely demanding, involving monitoring 400 individual shareholdings and doing three or more company meetings every day; I had come to a stage in my life when I wanted to cut down my responsibilities. This effectively meant giving up either the UK or continental Europe, and I decided to do the latter and return to where I had started.

Drama in the markets

During the last 26 years four events particularly stick in my mind. They are the stock market crash of 1987, the invasion of Kuwait in 1991, the technology bubble in 1999/2000 and the terrorist attack on New York in September 2001, now commonly known as 9/11. About a week before the 1987 crash, our youngest child Ben was born at Queen Charlotte's Hospital in London. To be near my wife Sarah, I was staying with my parents who lived in Holland Park in London rather than our home in Hampshire where my mother-in-law was looking after our elder two children, Emma and Oliver. On the Thursday night, there was the great storm which wrought havoc across Southern England. Even in London, I found it hard to sleep, being kept awake by the wind.

The next day when I made my way to work by tube from Holland Park station, the streets were covered with a thick, green carpet of leaves and small branches from the trees along Holland Park Avenue, creating a rather surreal effect. It had been our intention to return to our home in the country that weekend when Sarah and Ben came out of hospital, but the storm put a stop to that. There was no electricity at our house and a tree had fallen on my car, making it a write off. Sensibly my mother-in-law had decided to take our two elder children, our mother's help and our golden retriever 'Kingston' back to her home in Devon, which was much less badly affected. So Sarah and Ben came to join me at my parents' house, and that is where we were the following Monday when the crash hit Wall Street. I felt very disorientated, firstly not being at home as I expected, and then having to live through the most extraordinary few days in the stock market that I have ever experienced.

Professional opinion after the crash was polarised. I remember one experienced investment manager telling me: "If the world's largest market can fall by more than 22% in a day, investing will never be the same again." There were plenty of commentators who predicted that the crash would bring about a huge recession, or even a depression. I remember going to a lunch with the Australian entrepreneur, Alan Bond, who was definitely in this pessimistic camp. Whether it was my optimistic nature, or my contrarian investment approach, I didn't see it that way. I remember arguing that markets would recover and the crash had therefore created a significant buying opportunity. I even sent around a note internally at Fidelity to this effect, which is something that I have not done very often. At the heart of my argument was the feeling that it was very unlikely that the scale of the stock market fall would be matched by a similar deterioration in the economy.

I had redemptions to deal with in my funds, with several investors deciding to sell their units in the fund in the wake of the market crash. As a result I had to sell shares that the fund owned in order to meet the redemptions. In times of panic such as the 1987 crash, I find it helpful to concentrate my portfolio. I focus in on the stocks I like the most and force myself to identify those about which I have the strongest convictions. I have found I have a tendency to allow the number of holdings in the fund to rise as a bull market progresses. Market downturns are therefore also a good opportunity to weed out some of the smaller holdings that have accumulated in the portfolio.

Fortunately, by the end of 1987, despite the dramatic falls in the market during the month of October, I still ended the year with the fund up 28.0%, with the market up 7.3%. However, just before the crash the fund was up an exceptional 97.4% since the start of the year, in a period when the market had risen 45.6%. I guess I should have seen the magnitude of these moves as a warning sign, but at least overall my fund was not too badly affected.

For Fidelity International as a business, the crash had much deeper effects. In the years leading up to it we had been through a phase of strong growth and staff numbers had risen rapidly. We had some management meetings in Paris during November 1987 to coincide with the launch of our French business (in retrospect, it was not the most auspicious timing for a launch). At these meetings, our Chief Executive showed some graphs on the performance of Fidelity's business. These showed a worrying picture of a rising expense line meeting a falling revenue line. As a result we had to carry out a major restructuring of the business over the next year or so, including some layoffs. There is an unwritten rule at Fidelity that during downturns the investment team should be excluded from any redundancies. By protecting the lifeblood of the business, which is its investment expertise, we were able to maintain intact the team which was subsequently responsible for Fidelity's success in the 1990s.

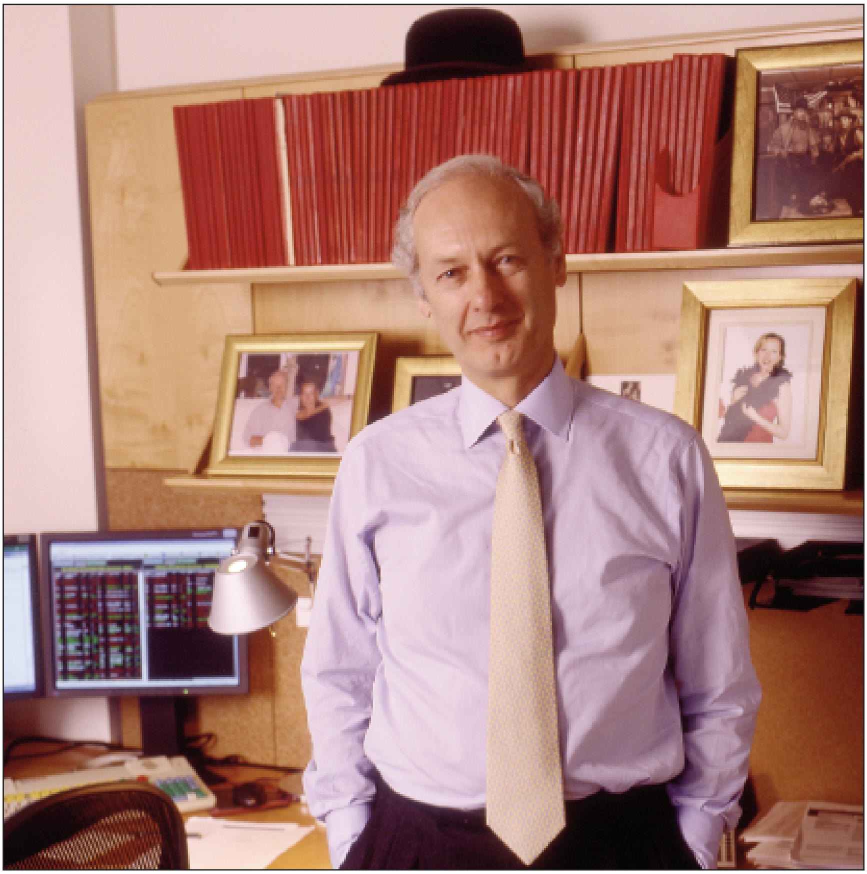
At the time of the invasion of Kuwait three years later, I was on holiday in Portugal. For several summers in a row we had rented houses on the Algarve for two weeks in August. In the days before mobile phones, I always insisted on any house we rented having a telephone in case I needed to make contact with the office. Having been promised that our villa outside Albufeira had a phone, when we got there we found it, of course, out of order! Every day for a week I contacted both the villa company and the telephone exchange to try and get it repaired, but with no effect. After the invasion of Kuwait, I ended up having to drive into Albufeira at least once every day to hear what the redemptions were and to give instructions regarding which securities to sell. Although I delegate trading to one of our traders who works with me on my purchases and sales, I will hardly ever delegate the decision of what to buy and sell (unless there is an emergency and I can't be contacted). Over the years, I have found it pretty rare that I have had to spend a lot of a holiday on the telephone to the office – but 1991 was the exception.

The internet bubble

The technology bubble in 1999-2000 was one of the most extraordinary periods in the stock market that I have witnessed. I am often asked how I can justify being a picker of stocks in a period when the investment markets have become so professional. They say things like: "Isn't the market efficient and over-researched? Haven't most of the investment anomalies already been exploited?" All I need to do in reply is point to this period, which presented some of the biggest opportunities in the shares of 'old economy' companies that I have ever experienced. How did it ever come about? Well at its heart must be the herd-like nature of most investment institutions, the intellectual challenge of a new paradigm ("the internet will change everything") and the cult at the time of momentum investing.

My general impression is that the market today frequently fails to see the wood for the trees; it's so busy arbitraging out the small inefficiencies between the trees, it misses that the wood itself is inefficiently priced. For example, I remember great debate at the time about which of Logica or Sage was the more attractive IT stock to own in the Information Technology sector. The answer was they were both wildly overvalued. I gave an internal talk in 2000 to our portfolio managers and analysts about bubbles – their nature, historical examples and how they burst. There were a few events that really drove it home to me that we were in cloud-cuckoo land.

One was the valuations of many companies in the TMT sectors. A software company called Kewill Systems particularly sticks in my mind. I had followed Kewill since its IPO (initial public offering) in the mid 1980s and also visited the original head office in Walton-on-Thames in the early days. The company was involved in the exciting areas of supply chain & e-commerce software. Between June 1999 and March 2000, its market capitalisation rose more than



At work today: the bowler hat is now redundant

ten times to over £2 billion, at which point the shares traded at more than 60 times its sales. The share price subsequently fell from £31 at its high to 7.5p at one stage in 2002. What was surprising was that this pattern of excess valuation was repeated again and again: I even recall one Swiss software company that was called Fantastic Corporation – sadly it was fantastic for a short while only!

A second, rather different indicator was the fate of Tony Dye at PFDM, one of the City's largest pension fund management firms. Tony Dye must be considered as one of the leading proponents in London of value investing. He and PDFM parted company in February 2000, two weeks before the NASDAQ index peaked on 10th March. At the same time PDFM announced that it was reviewing whether it should stick with its longstanding value style of investment. To any contrarian, this was a classic signal that the market was approaching a turning point, as of course it proved to be.

Lastly there was an event that particularly sticks in my memory. A long-standing corporate finance contact of mine telephoned me with a proposition. He was floating an internet incubator fund via a placing of shares. [Incubator funds were a popular fad of the time, designed to invest in a range of start-up internet companies and in theory help them grow]. I think he had been allowed to approach eight institutions. The conversation went something like this: "Hello Anthony, I want to tell you about a very interesting new company I am listing." "Great," I said "when can we meet the management?" "I'm afraid we are doing it on an accelerated basis and that won't be possible. In fact, I need to know your interest by this evening. Anthony, you should know that every institution that I have contacted so far not only wants shares, but says they would be happy to take many more than we are offering them."

We then went through the figures on the company. The fund owned a mixture of listed and unlisted companies related to the internet. I worked out that if one valued the listed investments at market prices, one was paying five or six times book value for the unlisted ones – a very, very high valuation in my opinion. "Thanks", I said "it's not for us", "I beg your pardon, Anthony", he replied. "Thanks, but it's not for us", I repeated. "But Anthony," came the reply "you'll be the only institution to have turned this down." "Fidelity is happy to let this one pass", I replied. This was only a few weeks from the top of the TMT bubble and the writing was clearly on the wall. I didn't follow what happened to this company in the end, but I very much doubt that it survived. The incredulity of my corporate finance contact tells its own story about what happens during bubbles of this kind.

On the day of 9/11, I was having lunch with a contact who runs a small specialist broking firm. He is an expert on general (i.e. non-life) insurance. We talked mainly about the insurance industry over lunch and by the end he had convinced me, or we had convinced each other, that the outlook appeared pretty good. I suppose it was ironic that just as we were drinking our coffee, the worst insurance event in recorded history should be taking place on the other side of the Atlantic. I know it may sound callous, but my experience suggested that over the months following that terrible event (and

I can't think of a more horrendous one) a very important buying opportunity would occur in the companies that had been worst affected by the fallout from the terrorist attack. I later significantly increased my holdings in insurance, hotel and travel related companies, and made some good returns as the shares recovered. In the investment business one has to be hard-nosed at times, unfortunately, but it is part of what being a contrarian involves.

The changing investment scene

From its earliest days, Fidelity's investment approach has been based on conducting its own research, using in-house analysts and having regular meetings with the companies it invests in. This was an approach with which I readily identified. My first job in 1971 was in the investment department of Keyser Ullmann, a small merchant bank which mainly managed investment trusts, including one called the Throgmorton Trust. Its focus was on smaller companies (a bias that I have kept ever since) and doing one's own research (though in those days that nearly always meant visiting the companies at their own offices; few companies came to the City and when they did, it wasn't to visit investors). The analyst team at Keyser Ullmann included, as well as fundamental analysts, one technical analyst. Since then I have always used charts as an input into my approach – something that I found was also Fidelity's philosophy. My background was therefore well suited to Fidelity, which may be something that Bill Byrnes had spotted.

In the early days the investment department was very small and it was only in the mid 1980s that we started to build up our own team of in-house analysts. We did some individual company meetings in those days, but it was more normal to attend group meetings at broker offices, where a number of institutions met with the management of a company at the same time. I do remember a meeting that James Wellings and I had in the early years with a company in our office at Queen Street. I can't remember the name of the company, but I do remember the name of its Chief Executive, which was Ron Shuck. Later he was involved in a major fraud case.

From the mid 1980s onwards, more and more of the meetings were one-to-one meetings with companies in our own offices. From the late 1980s I started to keep my notes of meetings in hard backed notebooks which I keep in my office. I have a different set of books for each European country. I am now up to my 48th book of notes on UK company meetings. These notes are invaluable when I re-meet companies. When I also ran the European funds, I used to do three or four company meetings a day. I now do one or two a day on average. My record, I think, is six company meetings in one day, which I don't recommend as one is rushing from one to the next and one feels pretty washed out at the end of the day.

Our meetings are normally with the Chief Executive (CEO) and/or the Finance Director. In bigger companies it may be just with an investor relations officer. Meetings normally last one to one and a half hours and we like to meet or have contact with companies at least once a quarter if we have significant holdings. We also use conference calls where we know the company well. The meetings are run by the appropriate analyst, not by the fund managers. Each of our analysts specialise in different industries and produce an agenda and financial model before each meeting. The fund managers also chip in with questions from time to time.

The way we run our meetings has not changed significantly over time. One thing I definitely notice, however, is that while I used to be younger than most of the chief executives, today the opposite is definitely the case. At the end of a company meeting there is often a debriefing session where the investment managers discuss the key conclusions and cross-examine the analyst on the assumptions in their financial models.

I remember going to a dinner in the early 1990s that had been arranged by a broker where several senior representatives of companies and institutional investors were present. One of the subjects discussed was what sort of contact institutions want with companies. I explained our approach and said I thought it was going to become the norm for many larger institutions. I remember one of the chief executives taking issue with me. He said, "how am I going to have any time to run my company if I'm going to have to spend a lot of my time with shareholders and prospective shareholders?" I would estimate that today investor relations activities are something that most CEOs spend a significant amount of their time on. Often ones that have historically done less of this (Shell and M&S are two examples that come to mind) have suffered as a result of their introspective culture.

George Wimpey. 6/9/02

H1 relates alot to orders taken post 11/9.
Post Xmas pick up. Prices very strong Feb–April.
Av. selling 19% 1% was yr²↑. 18% ½ mix, ½ inflation.

Av selling in order book Aug. £153/- vs £127/-
→ Infl. 9/10% → 15–17%. = SE. Single figs, E Ang/Mid/NW >20%

Slowed sharply June but Jan–Apr, Sept–Nov key periods
Visitor traffic & reservation pick up Aug.
July, Aug. +30% on '01
but not translated to prices yet. Much infl now <10%
More customers have no chain, moved into rental temporarily.
→ Cancellation rate low.
→ Broad stability future view.
Risks: higher outskirts in London areas ↑ alot (eg Deptford)

Strategy still balanced by region
Landbank. Had long North, shorter Mid & South want to even out.
Key is to have good locations, want to be in best quality locations.

Av yr² +1%

Problem of Wimpey landbank was margin & land bank.
In 2000 with no infl. bought 8% margin land.

* What margin with infl @ 3/4% to make free cash flow ~15%* (eg. Persimmon level.) (after alloc of central o/head)
Achieved in last six months.
1700 more sites last 6 months not
(Av plot 34/-, new plots 46/- cost.
Assume price infl. balances build cost infl.

All meetings with companies are noted and filed away. This is an extract from a two page note on George Wimpey, the house builder.

I believe Fidelity's approach of in-house analysts and one-to-one company meetings has become the blueprint for many of our competitors. What was quite unusual in the early 1990s is standard practice today. It's been good to have been ahead of the crowd, but nothing stands still. One of the things I spend time thinking about today is how we can stay ahead. If we only do what everyone else is doing, it will become harder to outperform even if we are doing it on a scale and with more resources than most of our competitors. One area where we think we remain ahead is in the quality and depth of our global research, using information gleaned in one country or region to help make investments in another. Very few institutions can match our global resources.

Broking and research

Another area which has changed dramatically during my career is the brokerage community. As well as using the best internal research one can, I have always been a proponent of using the best outside research to complement it. With one's own research, one needs to know whether the conclusions differ from the consensus view, which itself is often made by the key analysts at the different stockbrokers who follow a particular company. Because of Big Bang and the spate of takeovers which followed deregulation of the stock market in 1986, most stockbrokers have changed hands (some several times) during the last 20 years.

Among the larger broking firms, the new approach of combining proprietary trading with investment banking and research means that the business model has been completely transformed from the old partnership structures that existed when I started out. Has the quality of output from broking houses changed, and do I share the view that most of the output from brokers today has little value? I don't agree with that. The nature of what analysts are able to put in writing has certainly changed. It is also true that in many cases broking research is being increasingly used for investment banking purposes. Nevertheless I believe that if you know how to use research and which analysts to talk to, it can still be very valuable. This is particularly true of those nuances an analyst may have that cannot easily be explained in writing.

In the early years the broker we were closest to was Rowe & Pitman (long ago amalgamated into what is now UBS Investment Bank). They had helped Fidelity launch its offshore funds. They gave me some excellent advice at the time. I also remember a visit from two executives at Goldman Sachs. They had no real research or involvement in the UK stock market at the time, but said if they could assist with anything to do with the US market or elsewhere, they would be only too delighted to help. (Fidelity in the US was at the time one of their biggest clients.) I did in due course find some areas where they were of help.

The secret of picking stocks

In general, my approach to picking stocks has always been based on a wide range of inputs. My philosophy is that the more ideas that find their way to me, the better. The way I like to put it is that I want a wide 'net'. The more that comes in, whether from inside Fidelity, or from smaller broking houses, industry specialists or the big integrated investment banks, the greater my chances of finding a gem. As my former colleague Peter Lynch once put it: "If you turn over ten stones, you might find one attractive investment idea but if you turn over 100 stones, you might find ten." Running large funds one needs lots of ideas. Even with a big in-house team we can't cover, or be the expert, on everything.

Trying to explain what makes me buy one stock and not another is surprisingly difficult, even after all these years. What is true is that before I buy a company I like to have considered a number of factors. First, wherever possible, I like to have met the management. The meeting will do several key things: help me get a view of the people and the strategy; help me understand the quality of the businesses and the main variables which influence their financial performance (some of these may be in management's control, others, such as currency sensitivity, largely not). I am a great believer that businesses are not created equal – some have much better franchises than others and other things being equal, I like those with the better franchises.

The meeting will also allow us to build a financial model of the company as accurate as any done by third parties. I will then want to look at a number of valuation metrics. I am always keen to look at a range of valuation measures and not focus too much on just one measure. The key ones I look at will be P/E (price-earnings) ratios, the ratio of enterprise value to gross cash flow, free cashflow ratios (I like companies that generate free cashflow) and cash flow return on capital relative to invested capital. I will also look at how the company is valued against its industry peer group on a country, region and global basis.

I will then want to look at some balance sheet ratios to see how strong the balance sheet is; one vital lesson I have learnt over the years is that when things go wrong, the companies I have lost most money on are those with weak balance sheets. I will also consider the list of shareholders and whether there is a possible 'corporate angle' to the stock. I will also look at the company from a corporate governance point of view, whether there has been director buying or selling and what technical analysts are saying about the shares. I will also consider whether the shares are over or under owned by institutional investors, whether there has been net buying or selling and what the key broker analysts who cover the shares views are.

Finally, I will consider whether there is something about the share that investors are not focused on today, but which could re-excite interest in the future. This list is not exclusive and there can also be other factors I will consider on top of these. I can't understate the importance in my approach of looking at a wide range of factors before I decide to buy the shares of a company. I observe that other investors often want to use a 'shorthand' approach to investment, just using one input as their buying or selling criterion. An extreme example of this would be buying shares on a tip, or merely looking at a share price chart in isolation. The fact that many less experienced investors seem to want an easy or (dare I say?) lazy approach to stock selection does, I believe, help to throw up opportunities for professional investors like myself, who will always be looking more deeply at an amalgam of buy and sell considerations.