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Portfolio Strategy

Investment success: How much is down to luck, or hard work?

In the third, and final part of the series, Didier Saint-Georges, managing director and member of the investment committee at Carmignac, takes a closer look at what makes a successful manager

Didier Saint-Georges

Luck often gets a bad rap, and it is true that it is not something you can count on. But even the most successful people owe their good fortune at least in part to luck.

Sergey Brin's and Larry Page's extraordinary success at the head of Google is rightfully seen as the result of their visionary genius. But just a year after founding their company, they tried to sell it for $1m – and failed because they could not find a buyer.

Luck is probably the most underrated factor in investment performance (except among those who like to blame their poor performance on bad luck). And that leads to three key recommendations for risk managers.

Good and bad luck tend to cancel each other out over time, so that a fund's long-term return reflects the actual talent of the manager. Even the best fund managers have bad years, and even the worst have good years. The truth only comes out with time

1. Performance should be judged only over the long term

Luck can artificially boost returns for a few months, or even a few years, making even the most irresponsible fund manager look like a mastermind.

However, good and bad luck tend to cancel each other out over time, so that a fund's long-term return reflects the actual talent of the manager. Even the best fund managers have bad years, and even the worst have good years. The truth only comes out with time.

An average chess player could beat the world champion once or twice if the latter were distracted. But he or she would have no chance of beating the champion over an average of 20 games.

2. Focus on how sound your reasoning is, and don't settle for the first few signs of confirmation

Digging deep into the underpinnings of your reasoning is what will help you form solid convictions. And those solid convictions are what will enable you to hold a position long enough against market consensus until events show you were right, and the markets adjust accordingly.

In October 2015, the MSCI World index shot up after a summer correction triggered by disappointing economic data from the US, a slowdown in China along with the ensuing depreciation of the yuan, and the Federal Reserve's first rate hike since 2008.

But despite the rebound in the index, a bearish outlook on equities would have been perfectly justified given that China's economy was getting worse, US monetary policy was weighing on growth and oil prices were in free fall. However, it took considerable courage to stand by that conviction.

Finally in November, equity investors saw reason and the index changed course; it dropped 15% between November 2015 and February 2016, the month when the Chinese government finally announced a new stimulus programme to halt the slide in its economy (the same strategy it deployed in 2009).

What is often seen as "courage" in risk management is nothing more than a focus on well-founded convictions that enable you to patiently withstand pressure and stay on your guard against causal and confirmation biases.

3. Use your awareness of these biases to avoid overconfidence like the plague

The trouble with focusing on short-term success, rather than on how well-founded your reasoning is, is it will encourage you to plough ahead, extrapolate from "what worked", follow your hunches and place more and more trust in your intuition.

Hordes of investors have ridden the wave of asset price bubbles, only to be left in ruins when those bubbles burst.

By the same token, if you managed to avoid heavy losses when the markets crashed in late 2008 because you had been convinced for years that Western economies were doomed to implode under the weight of excessive debt piles, then you finally got "lucky".

But those gains probably made it impossible for you to reposition your portfolio for a rebound in March.