Photography The traveller and the lens p46

Society Revenge of the typewriters p50

WeekendFin

www.afr.com | 26-27 July 2014

Edited by Shelley Gare: sgare@afr.com.au

THE ROAD FROM OMAHA

The world's greatest investors were putting on their shows – from Nebraska to Las Vegas. **Jonathan Shapiro** went along to extract their secrets.

Night has just fallen at the Bellagio hotel pool and I'm sipping a strawberry martini alongside "Mr Black Swan", Nassim Nicholas Taleb. As if that wasn't surreal enough, a harlequin on a pogo stick comes bouncing through the crowd of cocktail waitresses and chinos-clad men.

Most don't see the springing interloper; their eyes are fixed on a platform where a half-naked violinist in high heels and angel wings is scratching out a tune between two fire-breathing acrobats.

I have landed in Las Vegas for a three-day hedge fund extravaganza of pool parties, rock concerts and investment ideas but now it looks as if my mission has taken an indulgent turn for the worse.

The brief was a simple one; to find the secret to making money from the best investors in the world. America is a land that celebrates capitalism. Money, and the men and women who make lots of it, are idolised. And those men and women are also shadowed and analysed so that others can try to capture what they've managed to achieve.

It's a nation built by titanic captains of industry. Rockefeller, Carnegie, Ford and Jobs had the vision to build business empires as technology changed the world. But I wasn't after the builders and creators. My quest was about the investors and traders: those who have accumulated vast fortunes by moving capital around and making profits as its value changed.

For more than a century, the lubricant of America's industrial might has been its financial markets. They have taken capital from businesses and projects where it's not needed and directed it to sectors, businesses and securities where the returns are higher.

The nation's investment capital converges on Wall Street, a short stretch of concrete in downtown Manhattan that has come to embody power, wealth and its influence. But Wall Street is on the wane. A technological arms race has made a pit, a floor, or any location where people physically gather to trade, redundant.

The great financial crisis of 2008, which eroded the public's trust – and engendered new rules to prevent a repeat – has stripped the Wall Street banks of their role in allocating capital in the economy.

In today's post-crisis world, it is the great investors and hedge funds that have emerged as the kingmakers in the capital markets. Their hot money means they have a growing role in shaping not just the financial markets, but the economy, society, politics and culture.

Top investors and hedge funds are the new kings of the markets, drawing pilgrims determined to win riches for themselves. PHOTOS: GETTY, BLOOMBERG

The ruling elite of the investment world are an eclectic bunch. There's the grey-bearded sovereign debt raider, Paul Singer, a New Jersey native who brazenly confiscated an Argentinian navy ship in an African port as he took the South American nation to court to demand payment on his bonds. There's Bill Ackman, a wealthy New York investor who has pursued Herbalife, the 30-year-old nutrition products maker, claiming it's a pyramid scheme and betting against its shares. As other hedge funds have taken him on, he has created a battleground based on morality, class, ego and profit. There's David Einhorn, the 45-year-old New Yorker who helped topple shaky financial firms such as Lehman Brothers with undermining slide shows. And Dan Loeb, a Californian known for penning vicious letters to the management of companies – and for the prominent arches on the balcony of his penthouse at that enclave of New York's new rich, 15 Central Park West.

Then there are the greatest investors of all: Warren Buffett and Charlie Munger. The evergreen duo have invested studiously and confidently in the long-term prosperity of America in a way that seems too simple, to the point where young kids, pensioners and citizens of the world flock to hear him address his Berkshire Hathaway shareholders at the company's annual meeting.

All these successful investors have varied qualities but all are ultimately admired for their investment returns. And what are the qualities that make them great investors? Well, if you ask, they might just tell you.

"The great thing about this business is everyone is trying to help you," Seth Klarman, founder of the $US15 billion ($16 billion) Boston-based hedge fund, Baupost, told an audience of students in New York last year.

"Warren Buffett tells you how to invest; he does it generously."

Klarman is considered one of the greats himself, a wonkier, more reclusive version of Warren Buffett. With his words ringing in my head, I set off across the United States to hear from as many of the country's great investors as my travel budget and relatively privileged access will allow.

The journey begins right in the heart of America, in Omaha, Nebraska.

The town may be in the middle of a great prairie but its wealth is visible. Sleek, modest office towers make up the small central business district although the second tallest, the "Woodmen of the World" building, is still a reminder that, while this may be a modern town, it's an agrarian one.

Omaha has its charm but, were it not for College World Series baseball, a catchy song from Counting Crows and Warren Buffett, it would share the obscurity of nearby towns such as Lincoln and Des Moines.

Buffett's wealth has grown to a staggering $US65 billion through the power of the compounding returns he has generated for shareholders of Berkshire Hathaway.

The Buffett brand transcends investment circles because, as well as his enormous riches, there's his folksy wit and humble lifestyle. At a time when Americans are growing increasingly resentful towards the wealthiest "one per cent", the man who represents the smallest fraction is cherished by most as a wholesome symbol of the ultimate American dream.

Over 49 years, Berkshire Hathaway's annual general meeting has grown from a corporate formality, to a cult-like gathering of 1500 at the city's Orpheum Theatre, to a major international tourist attraction.

Today, 40,000 shareholders line up at the crack of dawn. The media – arriving from Tel Aviv, Tokyo and everywhere in between – are seated high up in the skybox with a view of the entire arena. That makes for a great vantage to observe the running of the bulls: middle-aged men holding their glasses on their noses as they charge for the best seats.

The show begins as it always does with a shareholder video, a plea from Buffett for it not to be recorded and a collection of skits. Last year, Buffett sold peanut brittle to Walter White of *Breaking Bad*, This year he angles for a major role in the *Entourage* movie. After that come the questions and answers. Buffett and Munger are as sharp as ever, deflecting the most prickly about governance and their performance with trademark wit. By the time it's finished, more than four hours later, the essence of Berkshire Hathaway's success has emerged.

Buffett and Munger have the ability to find businesses that make money and they know how to direct that cash within their own vast empire of businesses, from candy makers to railroad operators.

They are pulling the strings in their own carefully assembled economy.

Why do people travel from around the world just to hear two octogenarians pontificate for four hours on intrinsic value and corporate governance?

One shareholder says it best: "It's like going to church. You know what the message is going to be, but you still need to hear it regularly."

The message of "value investing" is a hard one to define. Generally, it describes buying something for less than it's worth and then profiting as the market realises its true value – or "buying $1 for 50¢". Buffett learnt how to find undervalued companies from the father of value investing, British-born Benjamin Graham (1894-1976). Thousands have since tried to emulate both men.

In Omaha, a cottage industry of conferences and seminars has sprouted up to capitalise on the influx of investment enthusiasts ahead of the AGM. There's a sense that the Buffett pilgrims consider themselves to be a "chosen people" – they have grasped the simple philosophy of value investing that will lead them on to a path to prosperity.

Could it be that easy?

"I applaud everyone for coming here and studying 'The Genius of Warren Buffett'," says Jane Siebels, founder of Bahamas-based hedge fund Green Cay. "But the thing you need to do with the great investors is figure out their essence – and then do things your own way."

Siebels grew up not far from Buffett in neighbouring state, Iowa. Her rural upbringing meant she could fly a plane before she could drive a car. She found herself managing money alongside two of the greatest investors of all time – Sir John Templeton and Julian Robertson. If she has any advice, it would be that investing is not something that can be perfectly replicated.

It's like going to church. You know what the message is going to be, but you still need to hear it regularly.

Superstar investor Warren Buffett's Berkshire Hathaway annual meetings, top, have grown from small, cult gatherings to mass media events. Jonathan Shapiro, above, on his quest.

"If you are going to do things like everyone else, you are going to perform like everyone else," she says.

She describes a private talk given to a group of fund managers by Todd Combs – one of the two mortals anointed by Buffett to manage Berkshire's multibillion-dollar stock portfolio. "I won't give out any secrets," Siebels says. "He was looking at stocks that we all know … but he was looking at them differently. He was using different value metrics and things of that nature. If they looked at stocks in the same way as everyone else, they wouldn't find anything."

The concept of buying undervalued companies – and then profiting – will resonate with amateur investors. But the ability to assign value to businesses in the first place is a skill that few possess.

Omaha has turned many investors, including Australian pilgrims, into successful ones. But as the circus rolls out of town, it is time for me to follow the money back to New York, where the city's warring princes are jostling to succeed Buffett as the world's greatest investor.

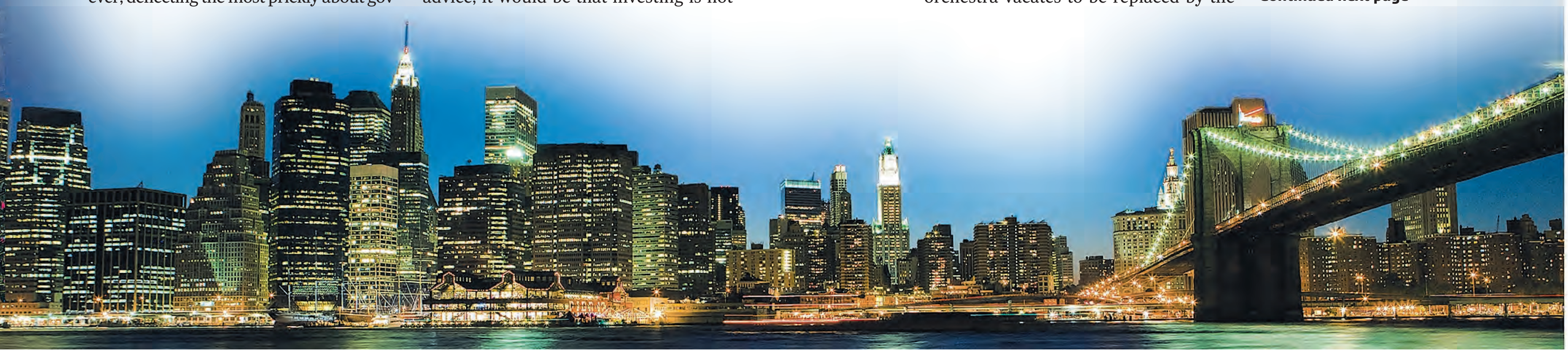
The magnificent Avery Hall in the Lincoln Centre, with its grand halls, squares and staircases, on the Upper West Side of Manhattan, is the destination. Once a year, on a May afternoon, the city's philharmonic orchestra vacates to be replaced by the brashest of hedge fund managers.

These high-profile investors front the vast, 2600-seater hall to pitch their best trade ideas, and all in the name of charity. This is the Sohn Investment Conference, a high octane, market-moving showcase for master traders.

Before the presentations get under way, Evan Sohn gathers the press together to speak about his kid brother, Ira, who died of cancer as he was beginning his career on Wall Street. Ira wasn't particularly talented but he was a "mensch", and so his friends have kept his legacy alive by putting together an investment conference that has become one of the most prestigious gigs around.

For the hedge fund industry, Sohn is highly anticipated and, for $US5000 a ticket, the audience wants a show. The city's financial media have their twitchy fingers on the tweet trigger, ready to broadcast every stock tip – and to move markets towards the presenter's position. The result is investing fireworks. Jeff Gundlach, the eccentric west-coast bond investor, is one of the star acts. When his art collection was stolen in late 2012, Gundlach helped the FBI find the thieves by suggesting they track Google searches of the artists. His Sohn pitch, which includes intermittent homages to '50s pop artist Jim Flora, dismisses the widely held view that the US housing market is on the path to recovery. Americans, he argues, are

Continued next page



Lenny Kravitz belts out his hits to an audience of men wearing lanyards and earplugs.

From previous page

The road from Omaha

falling out of love with home ownership and for that reason it is time to bet against home-builders.

Activist Bill Ackman appears, to stick up for hedge funds, and Fortress's macro trader Mike Novogratz, a former army helicopter pilot who campaigned to restore wrestling to the Olympics, tells investors to buy Brazil.

The Sohn Conference also lures out the once brash but now reclusive southerner, Paul Tudor Jones. He's another cult hero, partly for his starring role in an outrageous 1980s TV documentary, *Trader*, that captured him hysterically screaming orders down a clunky telephone and living it up on the ski-slopes of the Swiss Alps. Copies are rare; Tudor Jones apparently employed a squad of lawyers to try to buy up or shut down any that might surface on the internet.

This is an older, wiser Tudor Jones though, who laments, in his distinct drawl, how depressing a typical week in his life is now, in a time of "low volatility". When the market isn't moving, there are few ways for traders to make money, especially when they're paying and playing for the big move.

The show-stealer at Sohn is the closing act, David Einhorn, who has the audience rolling in the long wide aisles. His target is the spruiky and hyperactive Jonathan Bush, chief executive of Athena Health – captured in a video montage reciting every imaginable buzz-word to sell his stock. By the time the crowd gather in the early evening sunshine for cocktails and jazz, Athena's stock has tanked more than 10 per cent.

This is investing as a performing art.

A few days later, a far more humble gathering is put on by the New York Society of Security Analysts. The young student organiser says he made the event in honour of the 120th birthday of Benjamin Graham to get some big names along. It has worked.

There may be only about 60 people in the classroom high up in a mid-town skyscraper but the speakers are impressive. Headlining is Howard Marks, the billionaire founder of Los Angeles-based distressed debt fund, Oaktree Capital.

Marks is one of the pioneers of distressed debt investing. He has lately become known for his truisms on the art of investing. His message this drizzly Manhattan morning is we should think more deeply about what is "normal" – a concept often shaped by our experiences and those of our parents.

Marks's parents lived through the Great Depression so he grew up with catch-phrases such as "eggs in one basket" and "saving for a rainy day". He tells his audience, "The young investors of today don't have this. Most [of their] parents have lived through eerily optimistic times ... investors have made a ton of money."

The comments reflect the thoughts of temperamental bond king Bill Gross. Gross runs PIMCO, a multitrillion-dollar bond fund but his web posts – dubbed "Insights" – cover all sorts of issues. In his April 2013 note, "A Man in the Mirror", he wondered whether he or other great investors of his generation were really that good ... or had they been helped by a 40-year "epoch" of credit expansion, where those who took risk – but were protected by the advantageous times – rose to the top.

"The problem with the Buffetts ... the Granthams, the Marks ... and the Grosses of the world is that they'll likely never find out," wrote Gross. "Epochs can and likely will outlast them. But then one never knows what time has in store for each of us ..."

Marks made his name from embracing the asset class most shunned: junk bonds and the debt of companies in distress and facing bankruptcy.

Distressed debt funds are sometimes called "vulture funds" and, while Marks commands respect, distressed debt investors, along with short sellers and corporate raiders, are still seen by some as pariahs, scavengers and manipulators.

The reality is often the opposite. These are misunderstood catalysts of value. The distressed debt funds can be financiers of last resort to troubled companies. The short sellers actually work like shadow regulators because they smoke out fraudulent companies that they've bet against.

Meanwhile, activist raiders, who target poorly run businesses, can end up enforcing better governance and improve returns to shareholders.

Today, the modern-day corporate raiders or activists are enjoying a golden age. A new generation – and some survivors from the "greed is good" 1980s – are shaking down corporate boards, raiding cash boxes, breaking up companies and firing CEOs as a way to squeeze more juice out of a stock market that is tearing away. "Value investors on steroids" is how one activist described it.

A compelling case for activist investing is made by Pershing Square's Paul Hilal, telling the story of the remarkable fight for Canadian Pacific, one of Canada's oldest companies. It began with a tip from disgruntled investors, turned into a fierce and public corporate power struggle and ended with a near tripling of the stock price as the railroad's profit margins were lifted.

It doesn't always end that well. Activism can turn the investment process into open combat between boards and shareholders, with increasingly sophisticated weapons.

But with cheap and easy money pushing every stock or bond towards a high-water mark, the big pension funds are gravitating towards the activist funds delivering on their promises: to shake out returns from businesses that are either mismanaged or too patient for the markets' liking.

The Sohn Investment Conference, above left, is a high octane showcase for master traders. Bill Ackman, above right, is one of new elite of the investment world. An original copy of Benjamin Graham's 1949 *The Intelligent Investor*, below, on display at the New York Society of Security Analysts conference. Graham was the inspiration for Warren Buffett. Below right, some of the scrum at the Oracle's annual show in Omaha. PHOTOS: BLOOMBERG JONATHAN SHAPIRO

Activists are the new black in the hedge fund world. But fashion changes with the weather and market conditions. Where does one go to avoid the distortion of style?

Vegas, baby, and the Bellagio, the biggest, boldest and tackiest hotel on the strip. That's the venue for the three-day SkyBridge Alternatives Conference, or SALT. It's an ostentatious gathering of hedge fund brethren peppered with politicians and A-grade celebrities. For $US7000 a ticket, this is the opportunity for mere mortals to mingle with these masters of the universe in their natural habitat: the house of risk.

The ringmaster of the SALT conference is SkyBridge's ubiquitous founder Anthony "The Mooch" Scaramucci, a salesman extraordinaire with a Harvard law degree and an unfettered desire to be stinking rich.

For this, The Mooch assembles America's biggest names in sport and entertainment – all of whom speak off the record. Basketball legend Magic Johnson talks about his sporting and business instincts over lunch, while director Francis Ford Coppola shows how much skilful negotiation it took to make his films according to his vision. Oscar winner Kevin Spacey, lead in *House of Cards*, dissects how fluid power and influence has become in politics, finance and even entertainment.

The gathering seems to be a celebration of power and wealth. So it is striking to learn what the departing generation of private equity tycoons are actually doing with their billions. David Rubenstein, the 65-year-old founder of private equity firm Carlyle Group finally realised harnessing the power of leverage and carried interest to flip businesses doesn't make his mother proud. He has become a philanthropist.

"My mother never once called me when I was building Carlyle; now, when I am giving away money, she's calling me all the time. Maybe the mother test is the best one," he says.

Politicians past and present are sprinkled throughout the agenda. Karl Rove, the mastermind behind George W. Bush's campaign for the White House joins James Carville, an adviser to Bill Clinton, on a panel. Former British prime minister Tony Blair and ex-US Army General David Petraeus, who are now embracing the lucrative speaking circuit, make appearances.

Finance's brightest minds have jetted into Vegas. One is Nassim Nicholas Taleb, the outspoken author of *The Black Swan* – a seminal work in finance literature that focuses on our inability to predict things. Another is Larry Summers, the divisive economist who has just missed out on the most powerful job in finance as chairman of the Federal Reserve. Taleb barks and Summers chews and hisses in an ill-tempered debate about whether governments were right to bail out the banks – punishment and moral hazard versus capital and living wills.

It becomes clear that much of the action at the SALT extravaganza is taking place behind the scenes. But blatant political overtures show The Mooch is not hiding his ambitions. He is no longer simply a mediator between retail investors and hedge funds, but a conduit of private hedge funds wealth and the Republican Party cause.

The function on the second night of SALT is titled "American Dream". Nineties rock god Lenny Kravitz belts out his greatest hits to an audience of middle-aged men wearing lanyards and earplugs.

Vegas is one hell of a party but someone has to pay for it. My visit to Sin City leaves me with a better sense of the unholy alliance between finance and politics than it does the art of investing. As my flight takes off into the desert sky, I dare not look out the window for fear I might turn into a pillar of salt.

On my journey from Omaha to Vegas, I have seen the two faces of America's investment industry. Big, brash and loud on the one hand; sleepy, steady and patient on the other. The characters of the great investors cover the full spectrum – from the flashy to the folksy. Their success is based on merging their investment style with individual temperaments. The hyperactive trade every day to constantly pick the pocket of the market. The patient out-stalk it. You can learn much from the greats, but their DNA is different so duplicating them doesn't work. If I am going to become rich, I have to do it on my own.

My final stop is Greenwich, Connecticut, the leafy capital of the postmodern hedge fund. This wealthy town, an hour's train ride north of New York, is the optimal distance between where the action is and where perspective can be sought.

I head to the fourth-floor offices of AQR, a $US105 billion hedge fund that doubles for a financial markets think-tank. There I am to meet Cliff Asness, protégé of Eugene Fama, the Nobel Prize-winning economist who came up with the "efficient-market hypothesis". The principles of EMH are hardwired into the brains of every student who undertakes a formal education in finance.

That is, that the market price reflects all known information, therefore it's not possible to beat the market, because you cannot know more than it. Quit before you start.

Asness, a comic-book fan with a low tolerance of fools, showed otherwise. He confronted his mentor's central tenet and used his findings to form AQR – a quantitative hedge fund which trades systems that have been proven to beat the market, systems based on the assumption the market remains irrational. Investors continue to make mistakes and the anomalies that AQR identifies can be exploited.

In his impeccably neat but cosily crowded office overlooking the green expanse of Connecticut, Asness explains, "People ask me, 'Are you worried the world has suddenly gotten rational?' Over my career we've seen two of the greatest bouts of irrationality of the last century. I don't spend a lot of nights awake worried that the world won't make mistakes again." The conversation turns to Buffett. Asness has publicly criticised Buffett's view on taxes – Buffett thinks tax doesn't matter to investors – but he's a great admirer of Buffett, the investor.

AQR produced a paper, *Buffett's Alpha*, that attempted to quantify why the Oracle was able to be such a successful investor. The key to his success isn't so much his investment process but his dogmatic devotion to his principles: "One of the biggest traits is sticking with his process through ridiculously harrowing periods with no sign of putting his foot on or off the pedal."

Buffett isn't so much a super-human investor as a man who has a super-human adherence to his process.

"He lost quite frequently but less often than when he won," Asness says. "And he didn't waver. It seems like a very easy road map to become the richest man in the world. Obviously it's not." W