Lessons from the Tour de France

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A Race For Madmen

The Tour de France has been in the news a lot this year with a Brit winning the Tour for the first time and Lance Armstrong being stripped of his record seven titles for alleged doping.

What's this got to go with investment?

Imagine the peleton is like the mass of index-hugging funds. In each stage (quarter or year) it produces a winner, but the leadership continually changes. In the mountain stages, the climbers are those defensive funds that outperform in adverse market conditions, but don't do so well in rampant bull markets. The sprinters are the High Frequency Traders built for speed. Gearing and derivatives are the investment equivalent of EPO and steroids-they can boost performance but at a cost, and added risk

You can take at least one vital lesson for successful investment from the Tour. It will be run for the hundredth time next year and in all those years it has never been won by a rider who won all the stages, and it never will.

Why? Because the Tour has three distinct types of stage. In the most familiar stages, the flat stages, the riders ride in the peloton. They get an advantage by slipstreaming the riders in front of and around them. This can save about a third of the effort of riding on your own. Each team carries its sprinter, such as Mark Cavendish, within the peloton hoping to unleash them within a few hundred yards of the finish line to win the sprint finish.

In the time trial stages, the riders ride on bikes which have tri bars, handlebars named after triathlons, on which they place their arms so that their posture is more aerodynamic. Often the bikes have solid rear wheels and wide carbon rims for the same reason. The riders wear close fitting skinsuits and aerodynamic helmets because they cannot obtain any aerodynamic assistance from any other rider since they are set off individually at intervals. The result is a pure test of riding ability.

Similarly, the search for an investment strategy or fund manager which can outperform the market in all reporting periods and varying market conditions is as pointless as trying to find a rider who can win every stage of the Tour. Yet as investors we persist in doing just that-examining our funds' performance in every reporting period, as frequently as every quarter, and sometimes exiting when our manager underperforms.

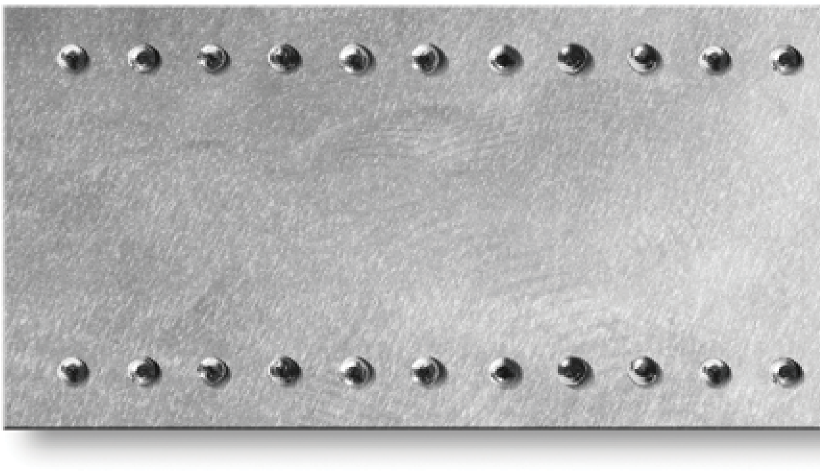
An element of this is clearly sensible-investment performance has to be measured over some time period, and some funds are persistent "dogs" in almost all market conditions and reporting periods and should be exited (see the BestInvest annual "Spot the dog" report for examples).

But a quarter is too short a period to judge performance reasonably, and even a year is in fact the time it takes the Earth to go around the Sun. It is not a natural time period over which to measure the performance of any business or investment unless it is linked to the Earth's orbit by the agricultural cycle. To assess an investment strategy or a fund you really need to see its results across a full economic and investment cycle with both Bull and Bear markets.

And there is a lot of evidence which suggests that where investors are switching between funds and changing investment strategies, their timing is almost invariably wrong. This does not only apply to retail investors. Professional investors in the form of trustees of endowments and pension funds have a clear track record in ditching managers after a streak of poor performance only to find that the mangers they have jettisoned recover their touch and those they have chosen start to underperform. Even worse are any strategies which rely upon a element of market timing: the ability to time entry and exit points in markets. There are only two types of people: those who can't market time, and those who don't know they can't market time.

Investment is a lot like the Tour de France. It's a test of endurance, and the winner over the long term is likely to be the investor who finds a good strategy or fund and then sticks with it.

"A Race For Madmen: A History of the Tour de France" by Chris Sidwells



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