Don't be left hanging with the In-Crowd

Key points

- Know what in-crowd investing looks like
- Be able to spot the warning signs
- Recognise how in-crowd investing hurts long-term manager performance

Understanding the In-Crowd

In-Crowd investment takes many forms. Typically, it begins with relentless hype about a sector or theme. Total addressable market (or TAM) stocks with little in earnings but high revenue growth are a recent example. Supported by continuing expectations of near zero bond rates, promoters believed these stocks would lead sharemarkets higher, seemingly in perpetuity. While these stocks had been strong performers, from both absolute and relative valuation perspectives better opportunities were presenting in out-of-favour cyclical segments of the market.

The in-crowd usually buy into a theme too late. Or sell too early. Often, they extrapolate the past too far into the future. They base investment decisions on past company returns and share-price performance, even though the market always looks forward. They become seduced by investment hype and stop thinking for themselves. They overestimate their investment skill.

Danger signs

Overhyped fund-manager commentaries, research reports and media 'noise' are tell-tale signs of the investment in-crowd. When funds emerge with catchy names or products based on the latest theme, care is needed. When fund managers with a limited performance record appear every day in the media, be sceptical.

When seemingly every research report has a buy recommendation on a stock, it's usually time to sell. When research reports promote the 'consensus' view on a stock as a reason to buy, run for cover. You'll never make money following the consensus, which is often wrong. PM Capital's best ideas often come from taking a strong position against the consensus view.

How In-Crowd investing affects manager performance

Fund managers need to attract investors and 'net funds flow' (more money coming into a fund than going out). The best way to attract funds is through return outperformance (the fund achieves a better return than its benchmark index, such as the S&P/ASX 200). For some fund managers, the easiest way to achieve return outperformance is by hanging with the in-crowd.

In fund-manager terms, we call this 'momentum investing'. Funds allocate more of their portfolio to companies with strong share-price momentum. In the past decade, the big momentum play was 'growth stocks', at the expense of 'value stocks'. Short-term performance can be great because of underlying momentum in share prices, but eventually fades.

The star manager from one decade is rarely the star manager in the next decade. Fund managers who invest with the in-crowd rarely last.

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1.. The PM Capital Enhanced Yield Fund was named Money Magazine's 2020 Winner for Best Income Fund – High Yield and Credit.

2. Pro forma Fund performance has been calculated based on the new fee structure (implemented 1 December 2018), assuming it had applied from the Fund's inception. These returns do not represent the actual net Fund performance and are included for illustrative purposes only.