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best of the
boutiques

Fuller & Thaler
Asset Management

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Small but perfectly formed

After a decade in which scale ruled the asset management industry, small is beautiful again. *James Rutter* charts the rise of the boutique. Eleven of the best boutiques in the business outline their recipes for success.

FULLER & THALER

ASSET MANAGEMENT

IN THE BUSINESS management course that Professor Richard Thaler teaches at the University of Chicago, he lists 26 of what he calls: *Thaler's Rules for Good Decision Making*. Rule number four is that streaks happen. "Before you infer that a string of successes is due to skill, ask whether it might be a run of luck."

Thaler laughs when I enquire whether he has asked himself that very question about the investment record of Fuller & Thaler Asset Management, given that the firm's four main investment strategies have all outstripped their respective benchmarks with ease since inception.

"Although the firm has been around for 10 years, for the first six my role was as an informal consultant," he says by way of an answer. "Then in 1998, I spent six months out on the west coast trying to raid Russ [Fuller's] wine cellar and talking about increasing my involvement. I turned to him one day and said that his job for the day was to convince me that the excess returns he'd enjoyed were a matter of skill and not luck. Rule four was driving that conversation." Thaler adds that he'd be happy to go through his 26 rules one-by-one and show how they have each been applied to the Fuller & Thaler business.

That business has now accumulated \$1.5 billion in assets under management on the basis of a simple and unique investment philosophy: that outperformance can be captured by taking advantage of the behavioural biases exhibited by investors. The firm has just launched a series of three large cap funds (core, value and growth) to add to its five existing strategies investing in US small and mid-cap stocks. It has also hired

Joseph Leung, previously chief investment officer of AXA Rosenberg in London, to spearhead its move into international markets.

But for a long time success was far from assured. Russ Fuller says that for the first five years of its existence the firm gathered virtually no assets with its Earnings Heuristics fund, that looked to take advantage of investors' underreaction to good news on corporate earnings. "I couldn't understand it," he recalls, "which shows you that I don't know anything about marketing."

One day a friend of Fuller's, who was also an investment consultant, pulled him aside and pointed out that the big problem was the fund's name: not only was it incomprehensible but it also didn't fit into any common style box. As a result, the Earnings Heuristics fund was re-named the small-cap growth fund and as Fuller says: "It was amazing what happened to sales after that."

The growing acceptance of behavioural finance as a discipline has also helped, although Thaler emphasizes that the purity of Fuller & Thaler's approach sets it apart from imitators.

"Although the concepts can now be read in the popular press, as far as we know there are still very few money managers using behavioural finance to develop their investment strategies," he suggests. "What many are doing is taking an investment strategy that has had an alpha and using behavioural factors to explain after the fact why it has worked. Our philosophy is to start with a behavioural bias and ask: where does that lead us?" *JR*