INVEST IN PERFORMANCE Peregrine Capital™

Avoid the Landmines!

By Alan Yates, Head of Distribution at Peregrine Capital

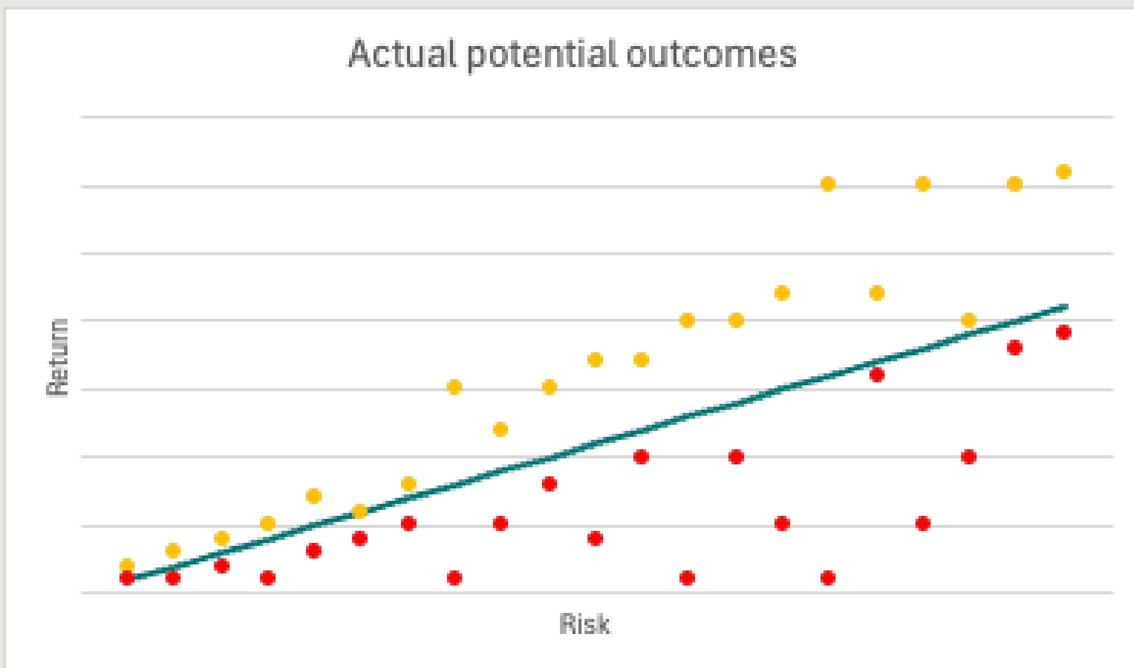
Our founder, David Fraser, has an oft used saying; "If you avoid the landmines, you start the year up 6%". This is a very simple way of expressing a powerful tenant of active investing.

Finance textbooks will invariably trot out the below graph as a central principle of the investment management function:

It is the idea that the relationship between risk and return is linear and that to achieve a higher return, one has to assume higher levels of risk. But inherent in the relationship is the suggestion that by assuming higher levels of risk, you will also achieve higher levels of return. And therein lies the rub, because anyone who has put money in harm's way, will tell you that while the relationship might apply broadly over a very long-time frame, it is not helpful when considering potential opportunities in a portfolio.

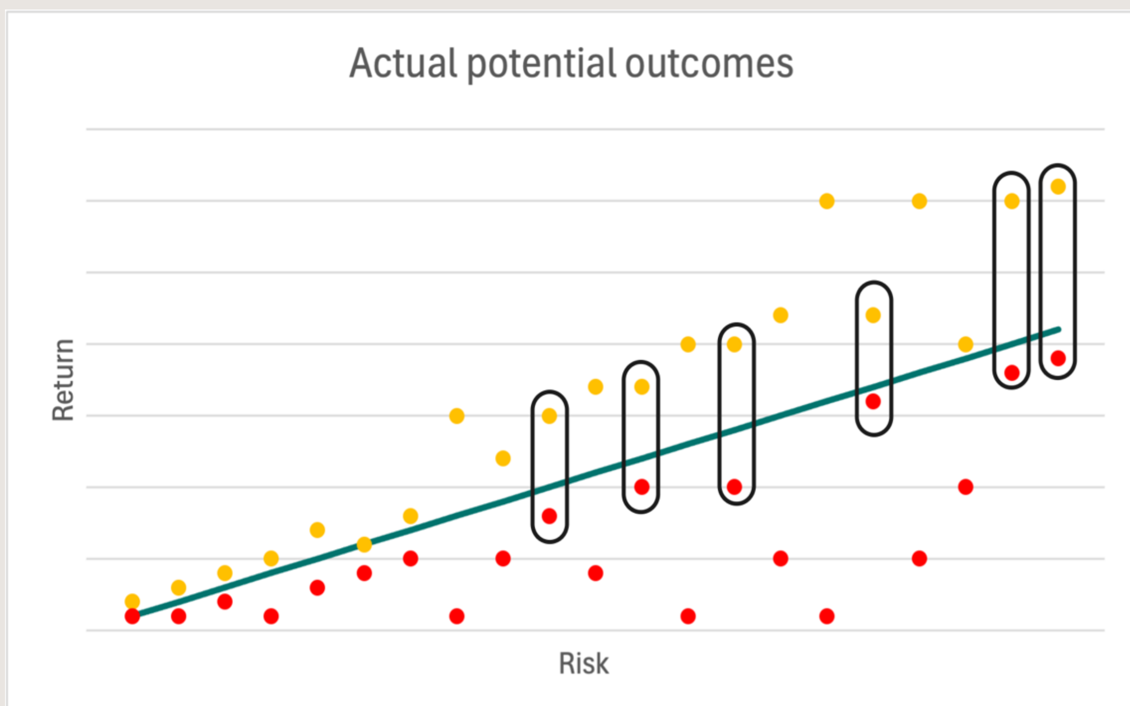
When choosing which opportunities to invest in, the outcomes are much more of a range than a single point. After all, if the theory above was really the case, risky investments would not be riskier, they would be a sure bet. Investments that assume risk (essentially everything that can give you a return), have a potential range of outcomes. The relationship should suggest that as you take more risk, the expected return increases, as per the original theory. But the range of possible outcomes gets wider, and the bad possibilities get worse. And that range can be very wide, which means you might get a great return, but you also might step on a landmine and loose a limb along the way.

So reality looks much more like this:

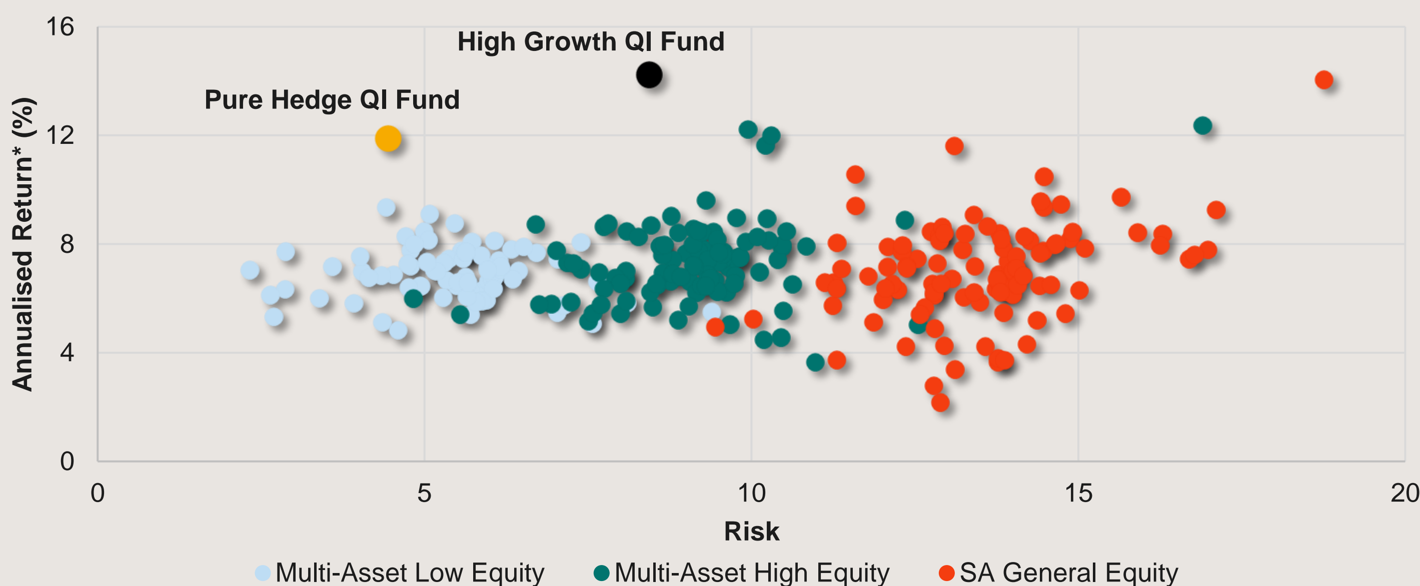


There are clearly various ways to manage a portfolio of assets. Some managers will be willing to take on the landmines in the hope of spectacular returns, but you must accept that if you are going to swing for the fence every year, you are going to have many terrible years as well.

We would rather start by "avoiding the landmines". Our experience is that the best foundation for exceptional long-term performance is an absence of material losers. Being an active manager means you get to choose what you invest in, and what you don't. Being benchmark agnostic means we don't ever need to hold something just because it is in the benchmark. Put another way, we don't need to invest in all the opportunities in the graph above, and that allows us to look for the opportunities that have asymmetric positive payoff profiles.



Being conscious of downside risk allows us to consistently generate alpha. And that is what alpha really is - the ability to enter the market of opportunities and access the upside potential of that market, while limiting the downside risk to your portfolio. Where you have this focus on asymmetric returns, you are able to have more confidence in your outcomes, which means you can take meaningful positions in these opportunities as the bedrock of your portfolio, while still producing overall returns that are more than commensurate for the risk taken. And that is exactly what we aim to do at Peregrine Capital. We are not looking to be the manager who generates an exceptional return in any one year, followed by a horrible one the next. Rather, we aim to offer the best possible return for the risk taken. By doing this consistently, we reduce volatility and avoid losses that might be fatal to our investors, which produces industry leading risk-adjusted returns over the medium term.



Returns are to 31 December 2023 | Source: Peregrine Capital, Morningstar.
*See Full Disclosures below.

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Full Disclosures