



# Stewart's Gateway to Huston's Future

*What the greatest investors in history  
did that so few ever do*



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The world hates rest. Comfort. Most of all, it hates wealth, which is the accumulation of both. Once any living thing acquires even the most modest surplus, powerful forces are already at work seeking to destroy it. This isn't just biological (competition between living things). It's physics (entropy). Even metaphysics. There's a reason the ancients' believed there was no such thing progress in human life, just an endless repetition of cycles.

Despite these conditions, some investors manage to defy the gods. These investors not only retain their wealth but compound it at incredible rates. The financial world tends to focus on the investment strategies of the day. What gets far less attention are the strategies that have withstood the only judge there is: time. To us, there's only one question in investing that matters, and it's this:

What, if anything, has worked in investing across the ages? Are there any enduring principles? Or is investing like time or war in that what's worked in past eventually succumbs to entropy or the changing tactics of a thinking opponent?

To answer this, we did something we don't believe has ever been done before. Instead of mining historical data for patterns as quants do, we took a quantitative approach to a subject that's inherently non-quantitative, a subject that we think reflects a deeper reality than a numbers-only approach. What we did was create a database of the greatest investors in history. Then we studied their investments, their strategies and their philosophies for overlap.

We think this represents the next frontier of quant—because it involves the systematic study of things no computer will ever understand. We also think this is a far higher-percentage way to learn from history because we aren't studying theoretical outcomes, we're studying what actually happened.



We defined great investors as those who achieved at least 2.5% outperformance over at least a 20-year period. Next we looked for similarities across time and geography. For example, is what worked in the 1950s for a US investor the same as what worked in the 1990s for a Spanish investor?

The results of this study changed our lives as investors. The truth is great investors are far more similar than not. Below we present our findings (underlying data is in the end tables).

## 1. Payoffs

The #1 difference between a great investor and a mediocre one is payoffs. Great investors made large, concentrated bets with massive potential upside: at least 50-100% upside or 15-20% IRRs. By contrast, even top mutual funds typically target things with at best 30% upside. Meanwhile they're so diversified and closet-indexed that, after fees, only luck can deliver any outperformance at all.

But tepid payoffs make underperformance structural. Why? Because we live in a world subject to vicious, almost awe-inspiring randomness. We're constantly buffeted by forces that dwarf us: pandemics, recessions, the mass beliefs of others. As a result, loss and hardship are certain. They're the price of admission. To offset this, when you win, you have to win big. And that's exactly what the greats did. They went for the whale.

There's no better example of this than Charlie Munger throwing aside his love of compounders to buy Tenneco, a middling over-leveraged company in a dreary industry: automotive components. He bought during the 2001 recession after Tenneco's EBITDA crashed from \$500 million to \$250 million and the shares collapsed from \$50 to \$1.5-\$2. The market cap was just \$80 million, and there was net debt of \$1.5 billion, giving the company an enterprise value of \$1.6 billion.

Munger felt that eventually the recession would end and Americans would want new cars again. In that case, Tenneco's EBITDA would go back to \$400 million. Meanwhile if it traded at 6.5x EBITDA, an undemanding multiple, the equity would be worth not \$80 million but \$1.1 billion. Munger held the shares until 2007, withstanding an earnings restatement and a dilutive equity raise. Most investors, at that point, would have sold and praised themselves for having the humility to recognize a mistake. But he held on and made \$80 million, 15x his original investment, a 57% IRR. He then gave it to Li Lu, who invested the money in China and turned it into \$450 million.



In both cases, Munger did something that isn't a central part of the Munger canon. He went to where the payoffs were. When the payoffs were in mean reversion for an utterly average business, he pushed his chips there. When the payoffs were in the reemergence of a once-great empire, he pivoted there.

This leads to the next question: how does Munger—or any investor—know what the payoffs actually are? After all, every bankrupt Twitter trader, every Wall Street Bets plunger, claims the payoffs for their schemes are extraordinary. Why are their payoffs illusory and Munger's real?

Because the greats' payoffs were grounded in the concept of intrinsic value. Intrinsic value is a mealy-mouthed, slippery, often-abused concept that can mean whatever a money manager needs it to mean. On most lips, it's essentially an ownership stake in a gold mine that doesn't exist—and never will. Nonetheless it's the only ground on which an investor can stand. Everything else is just pure belief, just an endless series of abstractions and things people say with no touchpoint in anything real. Which is to say, in anything enduring.

A striking fact: almost all of the greats relied on the concept of intrinsic value. To make the concept less airy, a better term might be “forever value.” If you bought an asset and had to hold it forever, at what price would it allow you to earn the market average of 7-10% a year? That price is its intrinsic value.

Ed Wachenheim, who returned 19% a year gross for 29 years, would value businesses at 16x earnings, the long-term average for the S&P 500. Historically the average S&P 500 firm grows its earnings 6% a year. So Wachenheim would adjust that 16x multiple up or down based on whether he thought the company's earnings would grow more or less than 6% a year.

Flipping that around, and using yield instead of multiples, we were shocked by how many of the greats, including Munger, Buffett and Glenn Greenberg, used the following equation to determine forever value:

Free cash flow yield + growth rate = return.

Generally they were looking for companies where free cash flow yield + growth rate equaled 20% or more. In other words, they were looking for returns double the market average, which is exactly what all of them achieved over their long careers.

Across the board, the greats harnessed a principle that's applicable not just to markets but to life as well: If you're going to play, play for stakes. The truth is everything you do



takes effort, even low value things, so you may as well focus on what offers large rewards. Janitors work just as hard as entrepreneurs. Only payoffs distinguish their paths.

At its core, though, the concept of payoffs is tied to the concept of what's truly worthwhile. There's a reason why one good friend is worth more than a hundred acquaintances. Why a good spouse means more than wealth or fame. The upside to these things is just so great. Life is going to be full of hardship and disappointment. Only finding things that are truly worthwhile will allow a person to rise above the forces forever weighing him down.

## 2. Sameness

In the movie *Chinatown*, Jack Nicholson's character asks John Huston why he's murdered and stolen to acquire even more wealth than he already has. Huston's answer is chilling:

*"The future, Mr. Gittes. The future."*

As investors, we're all doing the same thing: competing for a piece of the future. The greats have something important to say on the matter. Their strategies reveal that the key to the future doesn't lie in grand theories or embracing new fashions earlier than others. The key to the future lies in the past.

According to current theory, what makes capitalism great is its ability to both push and respond to change. Great investors, however, generally sought the opposite. While everyone else was fixated on the new thing, great investors were overwhelmingly betting on sameness.

Markets extrapolate wildly from minor fluctuations in quarterly earnings. The average stock's 52-week high is 100% higher than its 52-week low. Think about what that means. The average public company's valuation doubles or halves in any given year. But this price volatility isn't matched by changes in the underlying business. That isn't to say businesses don't change. They're always changing, always on a trajectory toward some half-known destiny. But when you look at a company's economics over time, you almost always find a bounded, if not a fixed, character. Like people, it's impossible for companies to defy their character on a long enough timeline.

What's so striking about the greats is that most of them bet on that historical character above all else. It was their north star. 63% ran strategies where they were betting heavily



on sameness, i.e. the persistence of history. And 76% ran strategies where they were betting at least modestly on sameness.

Examples:

- The Chandler brothers bought Japanese banks at 2x normalized earnings during the 2001 recession. The banks were priced for bankruptcy, but the Chandlers bet on Japan's historical stability and earned a 4x return and a 46% IRR.
- Warren Buffett put 40% of his fund in Amex after the salad oil scandal cratered the stock. Within four years, Buffett's investment went up 250% for a 26-30% IRR.
- Jim Rogers bought Lockheed Martin stock in bankruptcy during the 1970s and was mocked for doing so at an idea dinner with famous investors. Rogers, a self-described trend investor, would seem to be the opposite of an investor betting on sameness. But Rogers is an ardent student of financial history and a believer in recurrence, the idea that the past repeats in the future. He believed Lockheed's historical importance to the US would persist, even grow. Lockheed's stock eventually went up 100x.

Like Jim Rogers, many of the greats were obsessed with financial history. Actually there's probably no one else *more* obsessed with financial history than they are. Why does the past interest them so much? Because they believed it was destined to repeat. It's this belief in "recurrence" that allowed the greats to think and feel outside the present moment. It's this that made the greats seem like visionaries when others lacked the context to see the opportunities in front of them. Their success tells us something about our world, even about our lives. Namely the past is never over. It isn't even really past.

The greats weren't, however, just betting blindly on sameness for every and any asset. Often they were expressly targeting businesses characterized by a high degree of sameness. Warren Buffett has termed these companies "inevitables." Inevitables aren't higher growth or higher margin companies. Instead they're higher-percentage in terms of survival and longevity. And that in turn means they support higher-percentage predictions.

The investor who really brought this idea home for us was Bill Stewart, who outperformed the S&P 500 by 4.3% net for 40 years. Stewart was more obsessed with earnings "predictability" than any other investor we've ever come across. In interviews, it was half of what he talked about. And eventually it sunk in what he—and most other top



investors—were doing. So much of the world is in flux. In response, top investors were attempting to find gateways where the future would resemble the past. Pockets of sameness.

Whether this took the form of the cyclicality that Jim Rogers sought or the clockwork repeatability that captivated Warren Buffett and Bill Stewart, top investors succeeded because they discovered connections between the past and the future that an investing public, locked in the present, simply couldn't fathom. But it was these gateways that allowed the greats to bridge the past and the future as so few ever do. Their example is so powerful it stands for something that transcends money and markets.

Jeff Bezos famously said, "It's the things that don't change that you can build great businesses around." But the truth is far larger than that. The truth is you can't build anything meaningful—a family, a culture, much less a business—around something unstable, characterless and forever-changing. This's why the greats sought sameness: it's the only thing real in all the senseless randomness. It's the only land in an endless ocean of change.

## **Intermission**

At this point, we've left behind 99% of the mutual fund universe and most hedge funds. We've also left behind most growth investors and most value investors.

Why?

Because most growth investors are invested in glamor stocks that are (a) speculative, lower-percentage businesses and (b) low-payoff situations due to their chronic overvaluation. Interestingly most value investors fail for the exact same reason. Most value funds owns stocks that are only tepid bargains, priced slightly below the market average. Meanwhile those chasing steep, fire-sale bargains often fail because they're pursuing weak, low-percentage firms, whose futures are totally random and thus impossible to predict.

What's so striking is how many of the greats and how many from seemingly opposite disciplines paired the concept of payoffs with the concept of sameness. Bill Stewart, for instance, was a growth investor. His returns came entirely from each portfolio company's earnings growth. He, like Buffett, only wanted firms whose growth was assured to the point of being inevitable. Then at the other end of the spectrum, you have a deep value investor like Donald Smith whose returns came not from earnings growth but from expansion of a company's valuation multiple. But he was betting on the exact same



“predictability” that Stewart was. He was betting that a firm’s past value—as captured in its book value, retained earnings, past earnings power—would persist into the future.

What’s also striking is how many of the greats who put up the highest returns married the concepts of payoffs and sameness to the most extreme degree. Dan Cloud, for instance, was able to buy the top businesses in a volatile, transitioning Russia at pennies on the dollar, first in 1994 and then again in 1998. His fund returned 95x before fees, a 38% IRR over 14 years, betting that these companies would eventually trade at a somewhat normal valuation eventually. And that’s exactly what they did.

Meanwhile the Chandler brothers made 37% a year from 1986 to 2006 buying countries’ crown jewel assets at 1-2x earnings, often after those countries’ stock markets had experienced utter collapse. But once again the thesis didn’t require a paradigm shift or a clever prediction, just a mundane return to historical precedent.

### **3. Value**

Our database is comprised of 83 investors. Of that number, 54—or 65%—were value investors. Value has become a buzzword, a cosmetic veneer used to appeal to certain allocators. But Li Lu, who’s in the database, is likely correct when he says that only 5% of assets are managed by true value investors. In view of this, it’s staggering that a tiny minority—just 5% of the market—would compromise a full 66% of investing’s hall of fame.

We think value works because, far more than any other approach, it exists at the intersection of payoffs and sameness. Value is all about investing in situations with large upside in the event the underlying asset reverts back to long-term character.

### **4. Deep value**

Historically the average stock in the S&P 500 has traded at 16x earnings. Anything below that would typically be defined as a value stock. Deep value stocks, on the other hand, are even cheaper, and we define them as stocks trading at less than 7-10x earnings. These stocks tend to belong to deeply out-of-favor companies, many of which even value investors don’t want to own. Buying them means taking a humiliation risk—because you’re buying something whose faults are obvious to all.

Nonetheless an astonishing 34% of the investors in our database were deep value investors. When Warren Buffett returned 29% a year from 1957 to 1969 versus 10% for



the market, he was one of the most deep value investor we've ever come across. What's interesting, though, is that despite deep value's long track record across both time and geography, there are very few true-blue deep value funds. We estimate less than 2% of assets are managed this way, so it's incredible that 33% of the greats come from this particular, unloved corner of value investing.

### **Eternal Recurrence**

The things about history is we never know what point in history we're at. All we know is that we're in its stream.

As a result, we think the highest-percentage strategies are those which harness what's worked in the past. If, for example, a money manager explains that his strategy is to buy hyper-growth firms trading at 10x revenue because they're on the right side of technological change, it's good to know how such companies have fared in the past. In this case, the historical record for such companies is disastrous. As a result, the burden is on the manager to prove this time is different. Unfortunately for him, as the experience of great investors shows, it usually isn't. In fact the principles that allow an investor to succeed are far more universal and eternal than not.



Table #1: The Greats (returns in parenthesis, alpha where indicated)

Warren Buffett (20% 60 years)	Donald Smith (7% alpha, 30 yrs)	S. Druckenmiller (30%, 30 yrs)
Chandler bros. (37% 20 years)	Peter Cundill (2.4%, 35 yrs)	Louis Bacon (18%, 30 yrs)
Bill Ruane (4% alpha, 37 yrs)	Carl Icahn (12% alpha, 20 years)	Bruce Kovner (4.5% alpha, 25 yrs)
John Neff (3% alpha, 31 yrs)	Francisco Parames (8% alpha, 20 yrs)	Paul Tudor Jones (24% net, 26 yrs)
Jeffrey Ubben (20%, 18 yrs)	Marty Whitman (3% alpha, 22 yrs)	George Steinhardt (24%, 33 yrs)
Armor Capital (8% alpha, 21 yrs)	Bruce Karsh (23% gross, 23 yrs)	Lee Ainslie (3% alpha, 21 yrs)
Leucadia (18%, 40 yrs)	Max Heine (20%, 20 yrs)	George Soros (32%, 31 yrs)
Lou Simpson (7% alpha, 24 yrs)	Seth Klarman (16.5% net, 25 yrs)	Jim Simons (66% gross, 30 yrs)
Bill Stewart (4% alpha, 38 yrs)	John Templeton (4% alpha, 35 yrs)	Jim Rogers (45% net, 10 yrs)
Francis Rochon (6% alpha, 23 yrs)	Dan Cloud (38% gross, 14 yrs)	Jeffrey Gates (5% alpha, 24 yrs)
Charlie Munger (16% net, 60 yrs)	Philip Carret (5% alpha, 55 yrs)	L. Cooperman (3% alpha, 27 yrs)
Nomad (12% alpha, 14 yrs)	Laurence Tisch (9% alpha, 40 yrs)	Joel Tillinghast (4% alpha, 25 yrs)
Glenn Greenberg (18%, 25 yrs)	David Abrams (15% net, 15 yrs)	Leon Levy (11% alpha, 15 yrs)
Li Lu (16%, 21 yrs)	Robert Olstein (2.5%, 17 yrs)	David Iben (3% alpha, 20 yrs)
Allan Mecham (17% net, 17 yrs)	Tweedy Browne (9% alpha, 16 yrs)	Ed Wachenheim (19%, 29 yrs)
Howard Marks (19%, 22 yrs)	Jean Marie Eveillard (16%, 25 yrs)	David Einhorn (2.7% alpha, 24 yrs)
Tom Russo (2.8% alpha, 25 yrs)	Ben Graham (2.5% alpha, 20 yrs)	Shelby Davis (21%, 47 yrs)
Chuck Akre (6% alpha, 22 yrs)	Tom Claugus (16% net, 21 yrs)	Dan Loeb (16%, 21 yrs)
Kerr Neilson (5% alpha, 25 yrs)	Anthony Bolton (6% alpha, 29 yrs)	T Rowe Price (4% alpha, 37 yrs)
Norbert Lou	Bob Rodriguez (6% alpha, 25 yrs)	G. Vanderheiden (2.5% alpha, 19 yrs)
John Rogers (4% alpha, 30 yrs)	John M. Keynes (6% alpha, 24 yrs)	Andy Brown
Michael Price (5% alpha, 20 yrs)	C. Thomas Howard (6% alpha, 20 yrs)	John Griffin (15% net, 20 yrs)
Walter Schloss (16%, 49 yrs)	K. Stensrud (9% alpha, 20 yrs)	R. Driehaus (9% alpha, 40 yrs)
Paul Isaac (7% alpha, 17 yrs)	Prem Watsa (19%, 30 yrs)	Ralph Wanger (2.5% alpha, 28 yrs)
Arnold Schneider (2%, 20 yrs)	Julian Robertson (7.5% alpha, 20 yrs)	David Tepper (25%, 26 yrs)
James Dinan (14% net, 20 yrs)	Chesapeake (5% alpha, 24 yrs)	Chase Coleman (21% net, 20 yrs)
Ken Griffin	Steve Cohen (30%, 20 yrs)	Ed Thorp (20%, 30 yrs)
Paul Singer (14% net, 36 yrs)		



Table #2: Sameness

Bet heavily on sameness		Bet modestly on sameness	Didn't bet on sameness	Unable to categorize
Warren Buffett	Donald Smith	Jeffrey Gates	Stanley Druckenmiller	John Griffin
Chandler bros.	Peter Cundill	Leon Cooperman	Louis Bacon	R. Driehaus
Bill Ruane	Carl Icahn	Joel Tillinghast	Bruce Kovner	Ralph Wanger
John Neff	Paul Singer	Leon Levy	Paul Tudor Jones	David Tepper
Jeffrey Ubben	Francisco Parames	David Iben	George Steinhardt	James Dinan
Armor Capital	Marty Whitman	Ed Wachenheim	Lee Ainslie	Ken Griffin
Leucadia	Bruce Karsh	David Einhorn	George Soros	Julian Robertson
Lou Simpson	Max Heine	Shelby Davis	Jim Simons	Chesapeake
Bill Stewart	Seth Klarman	Dan Loeb	Jim Rogers	Ed Thorp
Francis Rochon	John Templeton	T Rowe Price	Chase Coleman	
Charlie Munger	Dan Cloud	George Vanderheiden	Steve Cohen	
Nomad	Philip Carret			
Glenn Greenberg	Laurence Tisch			
Li Lu	David Abrams			
Allan Mecham	Robert Olstein			
Howard Marks	Tweedy Browne			
Tom Russo	Jean Marie Eveillard			
Chuck Akre	Tweedy Browne			
Kerr Neilson	Ben Graham			
Norbert Lou	Tom Claugus			
John Rogers (Ariel)	Anthony Bolton			
Michael Price	Bob Rodriguez			
Walter Schloss	John Maynard Keynes			
Paul Isaac	C. Thomas Howard			
Arnold Schneider	Kristopher Stensrud			
Paul Singer	Prem Watsa			
Andy Brown				



Table #3: Value

Value			Not value	Not able to categorize
Warren Buffett	Charlie Munger		Bill Stewart	Kristopher Stensrud
Seth Klarman	Nomad		Shelby Davis	Andy Brown
John Templeton	Jim Rogers		Stanley Druckenmiller	John Griffin
Dan Cloud	Anthony Bolton		Louis Bacon	Ian Cumming/Joseph Steinberg
Philip Carret	Bob Rodriguez		Bruce Kovner	Lou Simpson
Laurence Tisch	Glenn Greenberg		Paul Tudor Jones	
Ed Wachenheim	Li Lu		Tom Claugus	
Bill Ruane	Jeffrey Gates		Francis Rochon	
John Neff	Jean Marie Eveillard		T Rowe Price	
Walter Schloss	Leon Cooperman		George Steinhardt	
Donald Smith	Prem Watsa		Tom Russo	
Peter Cundill	Joel Tillinghast		Chuck Akre	
Carl Icahn	Leon Levy		Lee Ainslie	
Paul Singer	John Maynard Keynes		George Vanderheiden	
Armor Capital	Norbert Lou		George Soros	
Jeffrey Ubben	Allan Mecham		Jim Simons	
David Einhorn	Howard Marks		Ken Griffin	
David Abrams	John Rogers (Ariel)		Julian Robertson	
Robert Olstein	David Tepper		Dan Loeb	
Tweedy Browne	James Dinan		R. Driehaus	
Arnold Schneider	Tweedy Browne		Ralph Wanger	
C. Thomas Howard	Ben Graham		Chesapeake	
David Iben	Michael Price		Chase Coleman	
Francisco Parames	Paul Isaac		Steve Cohen	
Marty Whitman	Kerr Neilson		Ed Thorp	
Bruce Karsh	Paul Singer			
Max Heine				



Table #4: Deep value

Deep value	Sometimes deep value	Not deep value	Unable to categorize
Warren Buffett	Warren Buffett	Ian Cumming/Joseph Steinberg	Kerr Neilson
Seth Klarman	Charlie Munger	Lou Simpson	Paul Isaac
John Templeton	Nomad	Bill Stewart	Kristopher Stensrud
Dan Cloud	Jim Rogers	Shelby Davis	Andy Brown
Philip Carret	Anthony Bolton	Stanley Druckenmiller	John Griffin
Laurence Tisch	Bob Rodriguez	Louis Bacon	
Ed Wachenheim	Glenn Greenberg	Bruce Kovner	
Bill Ruane	Li Lu	Paul Tudor Jones	
John Neff	Jeffrey Gates	Tom Claugus	
Walter Schloss	Jean Marie Eveillard	Francis Rochon	
Donald Smith	Leon Cooperman	T Rowe Price	
Peter Cundill	Prem Watsa	George Steinhardt	
Carl Icahn	Joel Tillinghast	Tom Russo	
Paul Singer	Leon Levy	Chuck Akre	
Armor Capital	John Maynard Keynes	Lee Ainslie	
Jeffrey Ubben	Norbert Lou	George Vanderheiden	
David Einhorn	Allan Mecham	George Soros	
David Abrams	Howard Marks	Jim Simons	
Robert Olstein	John Rogers (Ariel)	Ken Griffin	
Tweedy Browne	David Tepper	Julian Robertson	
Arnold Schneider	James Dinan	Dan Loeb	
C. Thomas Howard	Tweedy Browne	R. Driehaus	
David Iben	Ben Graham	Ralph Wanger	
Francisco Parames	Michael Price	Chase Coleman	
Marty Whitman		Steven Cohen	
Bruce Karsh		Ed Thorp	
Max Heine			
Paul Singer			