Market Commentary

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Mentorship and The Smartest Man
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There will be no essay on The Smartest Man in Europe this year. My good friend and mentor Edgar de Picciotto, Chairman of Union Bancaire Privée in Geneva, has passed away; he was 86. I met him during the 1980s when I was at Morgan Stanley and he was a regular attendee at our global client conference at Lyford Cay in the Bahamas. I came to know him well when we were both Supervisory Directors of Soros Fund Management and met for several days twice a year in Europe (Soros was an offshore fund.) When I started writing about him in 2002, I chose not to reveal his name to protect his privacy. I did, however, have a shirt made with the legend “Smartest Man in Europe” and gave it to him, but he told me he only wore it around his swimming pool.

Over the years I learned that he didn’t think like other investors, and I wondered about the formative events in his background. He was descended from a mercantile family whose roots stretch back hundreds of years to the days when they operated canteens along the Silk Route, providing food and weather protection to travelers moving to and from China and India. Born in Lebanon and educated in Europe, he came to the United States for training in finance. Sensing great opportunity as Europe recovered from World War II, he settled in Geneva and began managing the wealth that was accumulating on the continent. He was an early investor in hedge funds and his reputation as a person who could identify secular change, talent and undervalued assets ahead of others grew over the years.

He lived well. His homes in and near Geneva contained paintings by artists ranging from Canaletto to Kandinsky. He bought one of the few private homes designed by Oscar Niemeyer (the architect of Brasília). It had fallen into a derelict state, but it was on an incomparable spit of land in St. Jean Cap Ferrat in the south of France and Edgar restored it impeccably. At its entrance he installed a fuchsia Jeff Koons balloon dog, twenty-five feet tall, which was brought in by crane.

While he took pleasure in his material possessions, it was discussing and reading about ideas that really aroused his enthusiasm. He was one of the first people to identify the investment potential of Japan in the 1980s and then sold his positions before the sharp decline in that market. Before the Berlin Wall came down and Russia began to dismantle its command economy, he saw the changes brewing there and the potential available to domestic and overseas investors. He was an early investor in the emerging markets and he sold his positions there in a timely way as well. He did the same with gold and technology. After September 11, 2001, he was an aggressive buyer of U.S. stocks, but by the middle of the decade, he cooled, sensing a pending recession.

He pressed upon me the importance of understanding the macro environment. “Many people describe themselves as stock pickers,” he would say, “but you have to consider the economic, social and political context in which the stocks are being picked.” He encouraged me to meet as many people of influence as I could. For him, networking never stopped. He would test his ideas on those he respected, and if he ran into a strong opposing opinion, he would reflect on it seriously and sometimes change his position. While he never lacked conviction about his ideas, he was open-minded and flexible. “Nobody owns the truth,” he would tell me.

As I look back on the titles of my essays about him over the last 15 years, they provide a chronicle of the market’s glory days and pitfalls. In my first essay about him in June 2002, nine months after the attacks on the World Trade Center, he was “upbeat.” He believed that although terrorism was a continuing threat to investors and an incident could destabilize markets for a period of time, the world economy was huge and had plenty of momentum, so he was very positive.

Some of what he said in 2002 rings especially true today. “All the portfolio managers I know in America are complaining about how hard it is to make money. No powerful themes are emerging that they can put big money into. The only way to perform is to trade, but the friction costs are great. Portfolio managers in New York still don’t understand the importance of global interdependence.” So when many investors were still cautious, he said, “I see an opportunity to make some serious money here: I bought gold on leverage, sold the dollar short, put money in European hedge funds and invested heavily in Russia. I am excited and very busy and I expect to make a killing.” And he did.

In 2003 he talked about the opportunities in China “which is on its way to becoming the manufacturer of everything the world wants, but, as it moves up the technology scale, it will seek political influence. The U.S. is abdicating its political and economic leadership position. You Americans think of yourselves as the brains of the world. You cannot provide jobs for your 300 million people as a service organization. Nine-tenths of your population simply cannot find gainful employment cutting the grass, doing the laundry and cleaning the houses of the one-tenth that the world holds in awe.”

In 2004 Edgar was down on Europe and the United States, but bullish on Asia where he saw an expanding middle class. At that time he was beginning to understand the importance of monetary policy in determining the future course of stock and bond prices. He suspected that even though the Fed was likely to be accommodative, inflation was going to stay low, despite the theories of Milton Friedman of the University of Chicago.

In 2005 he was bullish on bonds because of the build-up in liquidity around the world. Few people expected interest rates on U.S. government paper to decline as much as he did. He thought U.S. stocks would do well as a result. He was, however, worried about the debt accumulation taking place at the government, corporate and individual levels. In 2006 he was focused on the migration of economic opportunity from Europe and the United States to Asia, and the prospect of stagflation in the mature developed countries, but he was still bullish on the United States. He sensed a movement to the left in America (he should have lived to see Bernie Sanders), but he didn't think it would undermine the capitalist spirit of the country. He was positive on India and concerned about the rise of Islam. He was buying gold.

By 2007 he was growing cautious. The title of my essay that year was "The Smartest Man Is Wearing Rain Gear." The title in 2008 was "Overcoat Time for The Smartest Man." He was nervous about the debt incurred by marginal borrowers to buy assets that he considered overvalued. As a result, he pulled out of all the hedge funds where he was locked up beyond one year. By 2008 he was recommending cleansing the U.S. economic system through bankruptcies and a devaluation of the dollar to revive manufacturing, but said that America was not ready to go through a period of severe pain. In any case, he expected the standard of living to remain flat in the West and rise in Asia. He was beginning to cool on globalization.

In 2009 he was bullish again because of the sharp sell-off in world markets. He did caution correctly that growth would only be 2%. While he was positive on the U.S. and Europe, he thought there would be stronger growth in Brazil, Russia, India and China. In 2010 he was worried that the debt in the U.K. and the U.S. had reached a point where the problem could only be cured by fiscal discipline or inflation or a combination of the two. He thought warning signals would be higher interest rates and inflation, but so far we had not seen either. He was cautious in 2011 and his only investments were in Swiss francs and gold. He was still talking about the high level of government debt everywhere, the possible decline of the dollar and the uncertain stability of the European Union. He continued to be positive on China and India.

Edgar suggested a title for the 2012 essay: "Dancing Around the Fire of Hell." I paraphrased it, but his view that year was that the debt problems were still there, even though various governments had figured out a way to postpone their consequences. He complained that too many investors think "incrementally," without looking at the broad range of problems facing the markets. He was troubled about Greece, but thought its problems were indicative of flawed financial planning everywhere. He anticipated higher interest rates and inflation. He owned a few stocks like Apple and IBM, and had some gold and energy investments.

In 2013 he was bullish on Europe, which was a very contrarian idea at the time. He was impressed with the operating efficiencies that had been put in place by European companies. He had sold his gold and was cool on emerging markets. He was concerned about the Middle East and the confused policy approach of the United States in that region. He was buying Yahoo and Google because of the possibility of open-ended earnings. By 2014 he was totally committed to innovation stocks, believing they represented a new industrial revolution; that theme continued in 2015. He did not expect the markets in Europe and the United States to do much, but he continued to believe technology offered opportunity. He thought governments around the world had proven ineffective at problem solving. His conclusion in 2015 was that there were more risks than opportunities, but you could still make money in technology and biotechnology.

My purpose in reviewing Edgar's thinking over the past 15 years is to show how he consistently tried to integrate his world view into the investment environment. That was his imperative. He wasn't always right, but he was always questioning himself and he remained flexible. When he lost money, it tended to cause minimal pain in relation to his overall assets, and when one of his maverick ideas worked, he made what he called "serious money."

Edgar was a mentor for me. Over the years I've learned that mentors fall into two categories. There are those you work with every day who are continuously guiding you to improved performance. The late Barton Biggs, my colleague at Morgan Stanley, falls into that category. He developed the concept of impressionistic strategy, writing his essays in the first person as though he was in a conversation with investors rather than in a totally objective style similar to an academic paper. He was totally devoted to his work and he never wasted time. He would take an hour out of each day to exercise, and he loved sports like tennis, golf and touch football, but when he wasn't exercising, he was reading and writing, and his output included essays and two books with a third in process when he passed away.

The second type of mentor is one whom you see intermittently. These individuals provide guidance because of who they are and what they do. Edgar fell into that category and I am forever grateful to him for what he taught me. He was fond of breaking rules. Suspicious of diversification as the hiding ground for those without conviction, he believed in concentration: If he liked a country, a sector or an asset class he was willing to put considerable money into it and exclude representation in other areas more popular with institutional investors. He sought high rewards and was willing to tolerate high risk in the process, once buying an office building in Iraq and selling it a short time later after it had doubled. He was not a trader, but he knew that a good investment had three phases: the period when you are waiting for an offbeat, but promising, idea to work; the period when everyone agrees with you and the stock or asset performs well; and the final period when the asset may still be appreciating but it is time to look for something else because the additional gains will be small. It can be dangerous to overstay a position. I still have not learned this lesson. He was particularly skillful at selling his mistakes quickly. Happily, I have learned that lesson.

But he taught me much more. He took great pleasure from knowing smart people and exchanging ideas with them. In the Morgan Stanley days when Steve Roach, our head economist, and I would come to Geneva, he would organize a dinner for us at his home and invite a dozen of the leaders of the Swiss financial community to discuss the important issues of the day with us. The Benchmark lunches that I put together in the Hamptons each summer are an outgrowth of this. He taught me to look at houses and objects of art as permanent possessions, not items to be sold at some point. I should buy them because they would enrich my life and I should not sell them because they had appreciated in value, because then I would be parting unnecessarily with something I loved and there would be emptiness as a result. My heirs could do the selling.

He taught me the value of trust and the joy of friendship and the futility of envy. He was proud of his own success but also an admirer of the success of others who were his friends. He never talked about missed opportunities except when he was criticizing himself. He was his own toughest critic and he encouraged me to be the same. Even if you are an intelligent risk taker, you will make many mistakes. Recognize them early, but never stop taking risks, because that is where the real opportunities are and your life will be more stimulating as a result.

Edgar enjoyed his cigars and his 1982 Bordeaux collection and his circle of influential people. He worked at the bank until the end because that was the way he could enjoy each day as much as possible. My life is better as a result of having known him and I will always be grateful for that. He wrote a book about his life and called me one day to ask me to write the foreword to it, which I did. Afterward he wrote me a thank you note that I quote here.

"I am grateful for what you have written. I do not deserve your nice words as my professional life has been directed to give the best of my capabilities."

"It was nice that you accepted to write and realize the friendship and feelings you have towards me. I do value your qualities and feel proud of having you as a friend." He was modest and generous to the end. Every mentor should follow his lead.

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