Somebody Has to Fund It

The last note ended on Howard Marks: to beat the market, a position has to be non-consensus, and it has to be right. Non-consensus and wrong is what funds somebody else's outperformance.

That sentence has a second half nobody says out loud. For some investors to beat the index, others have to lose to it. That is arithmetic. The people who trail are not a flaw in the market. They are where the winnings come from.

Nobody calls themselves the losing side. They call themselves careful. Read enough fund material and the same words come back. High quality. Disciplined. Long term. Risk-adjusted. Every one of them describes how the money was (apparently) managed. None of them is a result. But there is only one test. Did the client end up with more than they would have by holding the index? Good marketing survives a decade of failing that test. The arithmetic does not.

Why a fund or an individual underperforms does not matter here. What matters is that they exist. They are the opportunity. Somebody has to fund it.

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References

Marks, H. (2006). Dare to Be Great. *Oaktree Capital Management memo*.

Sharpe, W. F. (1991). The Arithmetic of Active Management. *Financial Analysts Journal, 47*(1), 7-9.