Kintbury Capital's Long/Short European Equity Strategy - With Chris Dale

Simon Brewer

Chris Ailman, CIO of the $300 billion Californian State Teachers' Retirement System, made the point in an interview here on the Money Maze podcast that hedge funds should not be described as an asset class, even though investors often refer to them in that way. There's a growing recognition that in fact, they represent a variety of approaches to access investment opportunities. Global macro, for example, or merger arbitrage has nothing in common with equity long short. Here at the Money Maze Podcast, we think a better way of viewing them is through the lens of how a proven manager or style can help deliver a different and less correlated set of returns.

Simon Brewer

In this Curated Money Maze Podcast edition, we're going to examine the investment approach of a European long/short equity fund, Kintbury Capital, founded and managed by Chris Dale, a seasoned investor in this space with an impressive long-term track record. In today's conversation, I hope we can discuss how Kintbury's approach offers an exposure to a universe of listed UK and European companies without necessarily having the market risk or beta, and how and why their analysis of shorting is so central to what they do. Before we dig in, and for full disclosure, I'm personally invested in the Kintbury fund, have been since inception, and remain so. Chris, welcome to the Money Maze Podcast.

Chris Dale

Thank you very much.

Simon Brewer

Now, I have to say this is a little bit unusual because we have something in common, which is that we each have a child who was born deaf, and I do remember at that very dark period in our life, my wife was able to call your wife because she'd already undertaken into this process and it was a beacon of hope at that dark time and we're forever grateful. I know that, in fact, courtesy of the technology around cochlear implants and all of the therapy, that we're both very lucky and we've had very joyous outcomes, but it is an unusual situation. You graduated with a degree in philosophy from Cambridge, yet you started as a mathematician. What happened?

Chris Dale

Well, I suppose at school, my real gift, if I had one, was that I was a very good mathematician and I got into read maths at Cambridge. And I was potentially going to go to Cambridge at a very young age and graduate at 20, so I decided I'd take a year off and travel a bit, and I started reading a lot of philosophy books. And when I arrived at Cambridge, I started doing maths and realized that actually I should switch, and I switched to philosophy. And philosophy and maths have very similar attributes in many respects in terms of the application of logic and how you feed through an equation is not dissimilar to how you should think through various arguments. And completely unexpectedly, it's proven to be quite an interesting skill to have, because most people when they give arguments think that they're providing an incredibly logical argument. But what normally happens is there's huge assumptions made, embedded assumptions with that. So that could be in financial discussions, pre-GFC, the housing market never goes down, or that PE will always outperform public markets or the passive will always outperform active, whatever it might be. And one of the skills that you learn by studying philosophy is that you get to see

what the major assumptions are. You read arguments differently, and actually, it's the assumptions that have made the real point of difference and that are interesting to debate. And so that I think ended up being quite a good skill. And obviously, being mathematical is not unhelpful in terms of financial markets, but that wasn't necessarily what I was thinking at the time.

Simon Brewer

That is interesting. I'm not sure I've met many people who've studied philosophy, who ended up in the investment management business. We actually had Nicolai Tangen from the Norwegian Sovereign Wealth Fund as a guest, and he had gone back later in life to train in social psychology, which he said was a must-have. So maybe the optimal combination is math, psychology, and philosophy, in which case I fail on all three counts. You start life at Warburgs. Just paint the picture of why and what you ended up doing.

Chris Dale

So my family had no background in financial services whatsoever, but I was from a mathematical background and my father was very keen on horse racing. He loved going horse racing. And so the understanding of markets was something that I came embedded in from a young age. I remember vividly being at one bookmaker at a point-to-point, and my dad was about to put a bet on, and the bookmaker made a mistake. He'd put the odds wrong. So if you bet it on all of them, you'd have a positive outcome. I remember, I said, "You should back them all." He said, "Well, I'm not going to do that. I don't know anything about it, but I think you should get involved in financial services," and it was a random comment that sort of stuck with me. So I joined Warburgs in 1993 and my first role there was in corporate finance, which probably wasn't best suited to in terms of my skillset, but it was great training, a lot about modeling. But what I realized very quickly was that what I was really interested was in actual financial markets, what moved markets, what moved stocks. And I was fortunate in that two years later I then moved into the European equities division, and it was a bit of a heyday for the company at the time. It eventually got bought by UBS, but Warburgs at the time was number one a research firm. And I just learned a huge amount when I worked there, and I think about that very much as the area that I learned how to analyze stocks and constitute what I thought was a good or bad company and then how to value them, and so it ended up being amazing training. And by other happenstance, quite a lot of my clients were forming the early days of hedge funds, some of whom have moved on, but some are still present like Marshall Wace for example. And it was just an amazing situation to have access to both probably the best research in the market and speaking to some of the smartest people, and I just learned a huge amount doing that. And towards the end of my time there, I did a number of things relating to research. I teamed up with a research colleague and then we ended up running some money at UBS prop.

Simon Brewer

And then you go to Millennium, and for those who don't know, Millennium is of course one of the world's best-known hedge funds. The firm is known for its scattered corpses and broken investment dreams, and a quarter of its managers get fired every year. You survived nine years, which is quite remarkable, along with your partner Gavin, who I know is still invested with you in Kintbury and we'll come to that. But what was the most important lesson or two that you learned whilst managing money there?

Chris Dale

Well, Millennium was a very different place when I joined. It was a $2.5 billion fund. I think it's now $60 billion plus. When I arrived, there were 20 people in the London office and we were one of the first teams. When I left, I think there were about 500 or 600. But I think it was an interesting counterbalance to what I had learned probably at Warburgs in that Millennium has an immense risk management culture, and therefore it was probably the place that I really thought about risk in a much deeper way than I had ever done before. And the discipline of the rules that they necessarily instigated were incredibly helpful to me. And there's just various insights that come out. You got to look at a portfolio the way you look at a company through lots of different lenses to see what kind of risks you run, and also the different environments, different types of risks, are more important. And so fast-forwarding to today, for example, you can end up having a star bias that you wouldn't have looked at before. So during COVID for example, whether you're long or short, COVID winners or losers would be an inevitable thing, whereas obviously there are other things like sectors or countries or whatever. So I suppose that was probably the main training ground for that. And I vividly remember Izzy saying to me once when we were talking about risk is that the best way to reduce risk is not to add multiple layers of hedges, but to take risk off, and that was the simplest way. But I would say it was a deep understanding of how risk works was probably the main learning point that I took away from Millennium.

Simon Brewer

So then you set up Kintbury in 2015. Why create a fund with all of the attendant emotional and business complexities?

Chris Dale

I think I'd always wanted to run my own firm. And I think my motivation for doing that was that, particularly as a Millennium had grown, the idea that you could run a business with people you had chosen and a lack of politics that you get in small firms was important. I also felt that what we were doing was very different to what hedge funds were at the time and what I thought they should be, so I thought we had a differentiated moment. And in my mind when I launched it, I was going, well, if you can compound 10% or plus uncorrelated market with no beta, and at Millennium, I made money eight years out of nine, I almost had in my mind, who wouldn't want to do that? And the disadvantage of being at a firm like Millennium is that you have one investor, which is great and terrible at the same time. And then it just struck me that we could find some long-term investors who really understood the proposition that we were making and could see the value of it.

Simon Brewer

So let's talk about Kintbury today, nine years on. Just recap on size and people and then we'll go into the mission.

Chris Dale

So we have $1.4 billion under management. There are 14 people in the firm. That's an investment team of eight people and anonymous team of six.

Simon Brewer

And if you were defining the mission in a sentence?

Chris Dale

To create consistent alpha over time and to create generally positive returns in all environments. So I think of the fund as an all-weather fund. Obviously, our stats show that we make money in both up and down months in the market over time, which is one of the attributes that I thought hedge funds should have, and that also that you should create alpha on both the long and the short side. So I just felt our mission, as it were, if it was, is to replicate that through cycles. We particularly will stand out in more difficult environments because obviously most hedge funds have beta to the market and don't do very well when markets do poorly, so our performance really stands out in that kind of environment.

Simon Brewer

Now, you are also a little unusual because you are UK and Europe only, which I think is good because sticking to knitting is not something that our industry is known for. Why was your lens so resolutely focused on those two geographies?

Chris Dale

I think it's just really in terms of background. So my background is having basically looked at European equities for 30 years. That's an area that I know extremely well. An investor in an alpha manager shouldn't really worry from a pure geographical perspective. Just go, "Is the opportunity set there and has the manager got skill?" Now to my mind, investing in something in an area that I've looked at for 30 years makes a lot more sense than saying, "I'm so smart that I'm now going to be able to invest in US equities, where I have no background and where lots of other people obviously look at it incredibly closely."

Simon Brewer

Now, as I have dissected your materials, and obviously I've known you for a long time, you make an interesting comment, which is companies need to make money and you need to get the cashflows back. It couldn't be more obvious, but of course we know this business is much more complicated in practice. What do you really mean by that?

Chris Dale

Good companies either are making positive cash flows or are on the path to doing so. The companies that we generally like have higher margins, higher returns on capital employed, and will generate cash. The benefit of companies that have higher return on capital employed is that they might give cash back to you, but they might then also reinvest in the business, and that gives a competitive advantage to those that have lower costs of capital. We've obviously had an extraordinary period, and when I say that, I mean 20 or 30-year period of consistently falling rates, but in the last five, 10 years, almost zero rates. And so the penalty for companies that don't generate cash has been almost minimal, and it's allowed businesses that are not even on a path to make money to survive. And it's also helped zombie companies that probably shouldn't have done so well to go through. So I think in essence, companies need to generate cash to be able to either give it back to you or to invest in a business that's going to be extremely profitable. And over a 30-year view, the best performing strategies from a quant perspective would be EPS-driven, so companies that upgrades versus downgrades. But from a valuation perspective, those companies that are cheap on free cash flow yield compared to those that are expensive is one of the great strategies. And what's been interesting during a zero interest environment since 2016 is that strategy hasn't worked particularly well and hasn't really created any performance. But during that period, those companies have actually generated a lot of cash for earnings growth, and therefore the cheap companies on high free cash yield are cheaper versus the expensive ones than they've ever been.

And the valuation discrepancies in the market are as wide as they were in 2000 within Europe, which provides an amazing opportunity set as a starting point.

Simon Brewer

So some of your comments echo Terry Smith, who founded Fundsmith, who's just been a guest on the show. And let's just pause on this idea of reinvestment, because bond yields are backed up and said bonds compete with stocks, and yet there is something that I don't think until I was talking to Terry Smith that I had perhaps processed as much as I should have done. Let's just explain why to you that compounding is so important.

Chris Dale

So you can have companies that maybe don't have great reinvestment opportunities and they just give you the return back. And if those cash flow yields are high enough and they're double-digit plus, if you are just getting that, that's good enough return. But if a company has the ability to reinvest that cash at high rates, then you are just getting a much better return on that cash than you would do others. So if a company has return on capital than you would do others. So if a company has return on capital employed of 20%, 30%, you realistically want them to invest at that rate of return as much as possible and over any period of time that's worth looking at, then that will be a great return. What becomes interesting is when companies have generated very high cash returns and those start to deteriorate or they can't reinvest it in cash and you often see that and companies often end up making acquisitions and their return on capital employed can fall quite significantly and that has quite an interesting signal in its own right. So it's important not to just think about the return that you are getting, but the money that they're investing, are they going to be able to consistently generate very high returns from that cash.

Simon Brewer

Got it. Very clear. Thank you. Let's talk about the idea generation and how you have organized it.

Chris Dale

So within the team, we have sector specialists across a range of sectors. We cover the portfolio across all sectors apart from insurance, and then additionally we have a forensic accounting overlay. I suppose the source of idea generation will come from the sector specialists and in terms of things that they think are interesting in the sector and particularly things that are changing when industries change, that's often quite an interesting moment. And there'll be an interplay in terms of what's going on at individual companies. Of the probably 450 companies that we have in Europe that fit our criteria of market cap over $3 billion, we probably detailed analysis on about 220 and invest in about 70, 30 longs, 40 shorts. And so, things will come up and that you then investigate. And additionally, the accounting stuff that we do, we have a flag system, we have 19 different underlying flags that we look at that feed into 7 categories. And when we scream for those, they often trigger signs that something might be occurring at the underlying company, and then we'll do a deep dive investigation of that. It really works incredibly well when you see something that's quite unusual going on in the accounting, and then by looking at the industry level, you can understand why that is happening. So pure accounting on its own is interesting, but it's very interesting when you go, the reason why they're pulling these levers is because there's some sort of difficulty going on at either the company or at the industry level.

Simon Brewer

So I want to talk about the short side in a minute, but let's start with the long side and I think again, so helpful for investors even though I'm reminded by the late Charlie Munger's comment that loss of memory is highest in the investment management industry because we always forget the stocks that haven't worked. But maybe just give us a illustration either of a current or past name that you've earned on the long side and it's been an important contributor and why it was such an important element of a portfolio, whether it's today or past.

Chris Dale

If I give a couple of examples, one would be a company that I have probably invested on and off for 20 years, which is incredibly known. Biggest company in Europe is Novo Nordisk. And when I was at Millennium, we probably owned it throughout that period because it was great business. They're the global leader in terms of diabetes treatment. Diabetes, unfortunately, the number of people who have diabetes grows by about 6, 7% a year and they were in a fantastic position to take advantage of that. There was an interesting moment in 2016 where there was suddenly an insulin price war, which was their primary product at the time. And consequently, the growth absolutely collapsed and earnings fell. And that was a moment where we chose to completely go to zero in terms of opposition. We didn't short it, we probably should have done. And three or four years later, the company transformed because instead of insulin being the most important product, GLP-1s once became the next generation of diabetic treatment. The growth rate in that has been absolutely phenomenal and they and Eli Lilly have ended up being a duopoly in that market. As a better product, only 20% of US patients who are diabetic are taking this and that's growing incredibly quickly, but the growth rate has really accelerated, and then there's been a compounding effect of what's happened in terms of the weight loss drugs which have been launched in last year, which got a lot of publicity, which has ended up being a launch that's been much better than expected. So this has been an amazing company on a 20-year view, but there were definitely moments that you didn't want to own it. And then, it's the realization in terms of the analysis of going the market is missing the... in 2018, '19, the market was missing the GLP-1 opportunity, and in the last couple of years the analysts have generally now investigated the weight-loss potential and it's now going to be an enormous market. And even though it's done incredibly well, I think it's gone up tenfold relative to the market during that 20-year period I'm describing. It's still an amazing, amazing investment. Something that can be much more opportunistic would be something that was probably our best contributor last year was a company called Colruyt, which I suspect not many people will know.

Simon Brewer

Belgian retail.

Chris Dale

Of course, you know. And this is really every day low-price model, has 32% market share of the Belgian food market. But there was a price war and there was a price war during 2021 to '22 that resulted in margins going from 4%, 5% down to about 1%. Obviously, multiple stocks derated. But what was interesting, what we identified a year and a half ago was that it's effectively a family-owned business that they'd also been investing in a number of wind projects. And at the absolute nadir of the margin in the Belgian food retail market, we identified through some of the work we'd be doing in terms of the win market that their assets were probably worth €1 billion euros and the market cap at the time was 3 billion. So we thought that was a great opportunity. Share price was around €20. And then, the company has actually subsequently have sold some of those assets. So that is cash that's coming back to shareholders. And incrementally, our work was showing that we thought the price war that our holder were doing would then would diminish. And consequently in the last year or so, margins had gone back

up to four and a half. The shares are more than doubled. So it's one of those examples where we knew the company incredibly well. They had a difficult period. We were able to identify an asset that no one else was talking about and also that there would be an upswing. And so, that was really a great example of when you find something that nobody really is looking at. Everyone's looking at Novo, but not many people are looking at Colruyt.

Simon Brewer

Got it. Well, I'm going to give a quick plug for the fact we just interviewed Mike Milken. And in that interview, he discloses that the highest incidence of diabetes in the world today is China and it is the country that has the least treatment available for its population. Let's talk about the short side. A lot of the competition has withered, disappeared, abandoned the fact that it is just very difficult. Tell me first of all why you want to be in that space given the asymmetry of returns that we know exists, the stock you can own forever on the long side can go and go in a shop, probably can only go to zero. Tell me a little bit about why it's important to what you do.

Chris Dale

So it's just right at the heart of what we're doing. In terms of if you are trying to create a return that's uncorrelated market, then you have to have longs and you have to have shorts, and to have that low net construct. Now, the majority of people who do this often might use index or moves hundreds of short names and consequently they choose very little short alpha. And it is a different skill set to the picking of longs, not just in terms of the analysis of those, but in terms of sizing and timing is much more important on the short side and you tend to own your shorts for a shorter period of time than you would do for your long. So our average holding period for our shorts is 12 to 18 months, whereas our longs are about 2 to 3 years. So it is an important part of that. But the other way I think about the fund is if you think about the composition of return, you've got our cash because we've got net cash, which obviously hasn't been making any money in the last 5, 10 years, but will increasingly do so going forward. And you have your alpha of your longs and your shorts. And if you have the skill to generate alpha on both sides, then you want to maximize that. And that's why we run almost entirely single stop shorts.

Simon Brewer

Got it. So I want to talk about one of them because I noted as an investor that you very quietly for some time were short Wirecard. You actually only wrote about it I would say very modestly later on. What was the red flag or red flags? So just tell us a little bit about how that became, how your conviction grew.

Chris Dale

So Wirecard was probably our most successful short ever. Wirecard is an interesting test case for a number of different reasons. So there were lots of early signs that there was a problem with Wirecard. The company grew at an unbelievable rate, particularly in Germany and you couldn't necessarily correlate their revenue growth with what you could see in the underlying data if you looked at industry data. They did some very strange acquisitions, one in India, for example, in 2015 and as early as 2008, people were a bit concerned. So Wirecard originally was, sorry, is a payments company and part of the element of where their core business came from gambling and pornographic sites. And so, there were an element of them that was created that they had a higher margin. The company was incredibly promotional in terms of how they disclosed themselves. And for a company that was supposedly generating lots of cash, the gross debt kept rising. So there was some various accounting issues that looked a bit strange. I remember my colleague turning to me when we launched finally in 2015, again,

there's something seriously wrong here and I think it probably is a fraud. And the key about frauds and the payoff on frauds is very different. First of all, frauds are very rare. So there's been about three European frauds during the time that we've had the fund, Wirecard, Steinhoff, and NMC Health. We got two of them in the fund, the third one, NMC, we've done all the work and we're late in it. Anyway, the point about frauds is that once a company has decided they're going to lie and cheat and create false invoices, they don't profit warn. So a normal company, when you're short, you're waiting for the profit warning or the disaster to strike. But if a company's lying, they won't have a profit warn. So it is a grave error to be early on frauds. You have to wait for the bomb to go off as it were. And just in case anyone, it's quite interesting how frauds are found because it's never the accountants. There's a study that shows that 5% of frauds have come from accountants and 5% have also come from accidents. So a company that says that its unqualified accounts means nothing really in this respect. So the thing that triggered that was Dan McCrum's article in the FT in January 2019, where a whistleblower in Asia had flagged him that there was something going on there. And for a newspaper like the FT or the Wall Street Journal to write an article like this is pretty extreme and they will not have done it without a huge amount of due diligence in terms of that. So we thought that was the smoking gun that was going to start the whole affair and it would all be over in two or three months, so we shorted the stock. Of course, what the German regulators decided to do was instead of investigating the company, they investigated the FT and short sellers and there was a short selling ban from a period of time. And then, there was an amazing drama that lasted about 18 months. And there were times SoftBank got involved but didn't get involved. There was a very bizarre transaction. There were various questions from some of the accounts. I had a meeting with Markus Braun who was the CEO and company meetings were a big part of what we do. My colleague came when I came back and said, "What did you learn? What did you learn?" I was like, "I don't think I learned anything except for the fact that nothing he said made sense. There were no numbers and that he's obviously a liar." And getting the sense of that was quite important. Anyway, we got to an end point in 2020 where EY had to sign off on the accounts and it was delayed multiple times and we felt that that was a tipping point in terms of what they were going to find. Now, we couldn't have known and we didn't know that the 1.9 billion of cash that they had didn't exist. But that's what came through in terms of the accounts. And what we did do is realizing that it was a major event and it was very binary with asymmetric outcome, thus we bought a number of put options on the stock as well. One of the reasons we didn't talk about Wirecard in our letters is Wirecard were incredibly aggressive in terms of hacking people, bothering people. There's a whole thing in terms of Dan McCrum's Netflix film showing that. We just chose that it was better for us to be just not quite disclosed in that respect. So we chose not to write about it. It touches on an interesting point about what kind of short seller you are. So I know you've interviewed Carson Block, for example, who's an activist short seller. He puts short position and will write an inflammatory article and then look for that to be the catalyst. We've chosen not to that. We feel that at times that has elements of market manipulation and it's just an area that we would choose not to go down.

Simon Brewer

Let's just say, more generally, and as your team is scouring for opportunities on the short side, we're staying with the short side here, what are the things that will particularly get your attention? And the team will say, "Right, more work is needed to be done."

Chris Dale

So in terms of shorts, we would... And there's certain characteristics of shorts that we would have. Normally, companies will have weaker margins, lower returns on capital where they're deteriorating rapidly, poor cashflow conversion. Often, those companies have higher levels of debt. But if we look at it

in terms of categorizing shorts, I would probably put them into four buckets. So one would be booms that go bust, where there's a huge growth that then implodes. So an example of that might be food delivery companies, which, obviously, had an amazing pandemic. And then have absolutely collapsed in terms of demand. Or demand for swimming pools during the pandemic went up materially, while we were sitting at home and thinking we needed a swimming pool. Another, mining CapEx cycles would be not dissimilar to that. You would also probably identify fads, where there is a single product that is incredibly popular and the market then extrapolates that. And the best example I can think of that would be a Polish company called CD Projekt, which had a thing called Cyberpunk 2077, which I'm sure you've played lots of times. But it was going to be the best game since Grand Theft Auto. And they had problems with release. But, anyway, they were one-hit wonders. And those are relatively rare. Then you have what I would describe as structurally challenged businesses. Those are often where you have very high levels of market share and you overcharge for the product. And that you're going to basically have competition that will undercut you and you lose market share. A good example of that might be Hargreaves Lansdown, which has got a million customers in the UK. And charges way more than its competitors. And it's not growing customers, but profitability is going to collapse. And then the last one is accounting. And accounting is just giving you insights into what's necessarily going on underneath the surface. And, often, they might also have elements of business that go bust, or challenge models and that they overlap. So there'd be the four basic categories of shorts that we would have.

Simon Brewer

And behind this, of course, is the question of research. I think some of the data I've seen suggests that the sell side, the investment banks, et cetera, have an astonishingly tiny proportion of their research to which a sell recommendation is attached. We had Steve Clapham on the show, who was talking about the juniorization of research. From an industry standpoint, having been in it for a long time, is it clear to you that, without wanting to be unfair to the sell side, the quality of research, or a lot of investment talent, has migrated from sell side to buy side?

Chris Dale

I think there's an element of that. And just the ratio, in case you were wondering, is 3:1 in buys to sell.

Simon Brewer

Okay, thank you.

Chris Dale

And we did an average in that, cost brokers, 50% of recommendations are buys within that ratio. I think there is an element there, obviously, regulation has meant that research is not as profitable as it was 20-plus years ago. And, therefore, there's financial pressures. You have fewer analysts, possibly more junior analysts covering more stocks. And, therefore, the level of work that they're able to do is probably diminished as well. You also have the growth in the platforms, like my old firm, who are very focused on short-term trends and data, rather than deep underlying analysis. So I think their clients are also pushing them for a different type of analysis than the ones that we look at and how we try and do that. So I think there are other factors as well as just that they're younger people. But, clearly, we do have a number of sell side contacts who are excellent, and give great industry knowledge that we then will do our own work around.

Simon Brewer

If we back up to the fund as a whole. You described your fund as an all-weather fund, although, it's notable that it has performed very well in more bearish periods. How do you think about an environment where the headwinds become the tailwinds and there's a... Nobody will ever believe there is money going to be net-net coming into Europe because everybody's given up on Europe. But should the backdrop become more positive, how do you think about beta and where you would be comfortable taking your unhedged exposure?

Chris Dale

So the unhedged beta is very easy to work out. It's we aim to have a zero beta in the market and, therefore, we're not interested in the beta play of Europe being particularly cheap versus the US. I do think it's fair to say though that if no one's bothering to invest in Europe, and the discounts of some of the great companies are huge compared to their US peers, when the lens flips towards Europe, then international investors will probably be more likely to be our buyers on our longs than our shorts. And so I think that would be, on balance, beneficial. I do describe it as an all-weather fund because I've pretty much done this for 20 years now, and made money 18 years of those, and in very different market conditions. And so while our performance will stand out in more difficult environments, that won't necessarily be the case. The opportunity, I think, right now, is amazing because the discrepancy between good and bad companies is incredibly wide within Europe. The valuation spread is incredibly wide, as I described. It's at peak levels, even on a sector neutral basis. This is not just that certain sectors are particularly cheap versus others. Even with intra-sector, the spreads are extremely wide. You described earlier that people have given up on shorting. And there are moments, the last time I remember this was really Feb '21, during the Game stock bonanza, which did have a feed into Europe as all the US funds closed their European shorts. But the short interest in Europe, as of today, according to Morgan Stanley, is the lowest it's been in a decade. And, therefore, one of the things that is difficult will be if you have these short squeeze episodes. But if no one's short, then the element of short squeezes is diminished. So I think you are entering a period where margins have gone up over the last couple of years, partly because companies have been able to raise prices. We're at peak margin. I think that's probably going to fade, even if there isn't a recession. You have interest costs that are going to rise, as companies have to refinance their debt because that comes with a lag. And one of the amazing things during the period of time that interest rates have gone up is that weak balance sheet companies haven't underperformed, which is something that you wouldn't necessarily expect. And I think that that valuation band, that elastic band, is extremely stretched. And what would catalyze that to really work, I think, would be either a slightly tougher economic environment or those interest rates really starting to hurt.

Simon Brewer

So you're clearly very excited about the landscape. I'd like to understand who you think this approach and strategy works for best? We've got lots of allocators who will be listening. And so just tell me how you would answer that?

Chris Dale

Well, we could argue whether if the beta rush that we've had for the last 10, 15 years is diminishing, then the natural tendencies for people to buy what's worked. And, inevitably, people are very long in PE and very long the market and the Magnificent Seven. But not withstanding that, if I think about the people who do give us money and how they think about us, so you inevitably, if you're an organization, will have your beta. You'll have your market exposure. And then you will have an element of what you would describe as uncorrelated returns. And those could be lots of different asset classes, some of which

I know you've had on the show. And we fit neatly into that bucket in terms of pure alpha, a return that will be uncorrelated with market. Now, you could argue whether your uncorrelated returns bucket should be higher when markets are at peak. And you are more cautious on the market. But within that bucket, the thing that really stands out for our investors is that Europe has become a lonely place, in many respects, in terms of European long short. And when they look through their hedge funds and see what the underlying holdings will be, if you have a load of US funds, you might find an element of crowding. One of our biggest investors did this exercise. And their simple observation was, "You're trafficking in an area that no one else is." And, therefore, your alpha return stream is likely to not just be uncorrelated market, but potentially uncorrelated with some of the other stuff that we have.

Simon Brewer

And it's worth just pausing for a second on the type of clients who have been with you and have grown with you. Just give us a flavor of that?

Chris Dale

Our longest standing investor is a US endowment. And our largest investor is a very large pension plan in the North America area.

Simon Brewer

Right. And I'm intrigued, because I've noticed that the US investor base is quite important. What is it that they might see that you think others have been less focused on?

Chris Dale

That's a really difficult question. There's a lot of money in the US, and about 70%, 80% of our money is in the US. And we have got interests from other areas of the world. Middle East for example, is somewhere that people are looking at. We've generally done well in that endowment foundation area within the US. In Europe, it's more been in pensions and family offices. And I think it's just an appetite and an interest in trying to diversify. We're talking about, even within those investors, it's not unusual to go to the US and someone say, "I have 20 hedge funds." "How many in Europe?" "One." Would not be an unusual conversation. So we've done well with a particular group of investors. I think they can see that Europe is maybe a bit less crowded and that it maybe less efficient. And I think European markets are incredibly inefficient at the moment. And that provides an opportunity for them. And that our returns will be uncorrelated with the other stuff that they've got.

Simon Brewer

And I do note, from some data, actually, that Will Campion sent me, is the average life of a hedge fund now is only five years. So the attrition is extraordinary. You're standing, and that in itself is an important attribute. And I also note that your fund has been up at nearly 70% of quarters since inception. How should one interpret that?

Chris Dale

So the stats are that we are up 55% in days, 60% in months, and close to 70% of quarters. And I described it to my children the other day as a bit like having a coin that's clearly weighted. It's that, inherently, if you have those probabilities in your favor, then that's something you should keep pressing on. There will be moments, obviously, when it doesn't work. And there are particular types of environments don't work. But I think that shows a consistency of returns. And I think a quarter is not an

unreasonable period to look at. Particularly monthly volatility, particularly, actually, in the last three or four years has gone up a lot. Not just by the market but also by factors. But it just shows, particularly as ours is a more long-term investing strategy, I think that's a reasonable measure to look at.

Simon Brewer

Right. Now, I think you and I would probably agree, and we're not going to spend time on the macro, that the tailwinds have inverted and that there are headwinds in all sorts of directions. And that's before we talk about geopolitics. And that that could lend itself for a more propitious environment for Kintbury to perform. How would you judge success five years hence?

Chris Dale

I would just judge success, in the end, if you run money, the only thing that you would judge success on is performance. And that's the only thing, really, that matters. It's very important to me that we do well in different types of environments. It would be pleasing to me if we had a more challenging economic environment, in the sense that it would be good for the fund. And it would really highlight the skill that we are exhibiting over time, which might be missed by other investors. That could be masked when people look at underlying performance when markets go up a lot. And other asset classes, they often, when you judge managers, you should definitely think about the alpha component. In a more challenging environment, where markets maybe don't go up quite so much, or maybe where that cash component actually outperforms the beta that other managers might have, that would mean that our returns would be, on average, better. So I would view success as consistent high levels of return and doing that through cycle.

Simon Brewer

Do you conduct postmortems when things have not worked? And if so, what are the important lessons you've taken away when the investments haven't worked out, as happens to all of us?

Chris Dale

Totally. So I suppose lessons I would think about, I'd categorize, I think about different types of lessons. So there's one type of mistake, which would be an analytical mistake, where you've got the numbers wrong, where you thought something would happen and it didn't happen. And where you thought something would happen and it didn't happen. And we obviously do have circumstances of that, but that is relatively rare. I would say that the mistake we probably make sometimes is that we might hold onto some of those positions too long. You have a thesis which, and you need to be continually reassessing. So that's probably one of the key things. And we've done some analysis of our alpha contribution since the day that we put the positions on and it's very clear looking at that, that the alpha, safer on longs, actually grows over time, has its steepest quotient in the first 12 months. Our short performance is slightly different. Similarly, the first 12 months are very good and that can often tail off. So recycling of positions is something that is important and that's not just because they've necessarily gone to your price target and we have clear discipline in our price targets, but also things change, the environment changes, something might be a good company but the environment around it changes that makes life very different. So there's an analytical mistake. There are different things, and I get much less worried about what I would describe as share price mistakes. So if you get the earnings right, but the share price goes against you, that can sometimes be a mean reverting thing. But where you're making a mistake there would be if there's a narrative around the company that you underestimate. So there was an example I can give you is Umicore, which we were short of, which had a period of time where it was

viewed as one of the great plays on electric vehicles and it didn't really matter that the business wasn't doing very well. That's what drove the share price. And therefore, there's a pragmatism around stock prices. You go, "I might be right about the fundamentals but this just isn't going to work right now." And so the ability to be able to just step away, the market's always there, you can always go back, that's a great thing about liquid markets. So I would say that is something that we have to ask ourselves. Are we getting the fundamentals right? And is the stock market going to look at things the way that we look at it? I think the biggest mistakes or learnings or changes is probably more on the risk management side. So if I think back, I don't know, two years I described that we lost money, our worst mistake was in 2016. We didn't think that Brexit would occur and we underestimated the stock price, individual stock price impacts that would occur. And that was a major contributor to that year. The other thing we learned from that year was about earnings, sorry, about price momentum. And historically, I've always measured price momentum with the portfolio. I'd measure it in a way of looking back, how much price momentum, how much money would we lose if the share prices go back to where there were three, six, 12 months ago? And I used to always look at that relative to the earnings. So if the earnings drove the prices, I tended not to worry. But price momentum, while over long term is a positive alpha factor, can be extremely volatile, particularly at those turning points in markets. Now generally speaking, when markets go down, our higher quality better balance sheet companies hold up very well. So that tends not a problem, but those inflections positively can be a problem. And so what we decided post 2016 is that we would effectively halve the maximum exposure we'd have to price momentum. So we'd take profits in a more disciplined fashion, even if we thought there was more to go for in some of the shares in order that we didn't have one of those turning points. If you think about those turning points, the really big ones are quite rare. So I'm really thinking about 2009, which is very obvious, out of the GFC, 2016 was actually a similar year triggered possibly by Chinese stimulus, and so the vaccine news in November, 2020, would be another period.

Simon Brewer

So Chris, before we conclude, I read one of your most recent reports where you were very obviously concerned about luxury stocks, valuations, underlying trends. I even sent it to the head of a very large financial institution because you made the point about how price increases had moved disproportionately relative to costs. Everybody's interest in luxury at one level. But what have you concluded and where do you stand?

Chris Dale

So the consensus view is that luxury is an amazing business, structural growth, and people have generally positive and they've been amazing companies. They've almost been the tech of Europe in many respects. But it's quite interesting, and this is partly tied in with what's happened since COVID is the ability of companies to raise prices. And we are very interested in companies which have effectively price gouged and some company, and then on the other side somewhere that hasn't necessarily been the case where there's a scope for a margin recovery. Now in the case of luxury, it is difficult to get like for likes, but on average, prices for the products over the last three or four years have increased by 50% to 100%, which is a truly staggering number and is not the strategy that they employed during the last financial crisis. So into the last financial crisis in 2008, there was a weakening of demand, but actually they managed to increase prices to offset that. So you're at a super normal level of profitability, margins for example of LVMH have gone up by 800 basis points to about 33%. And even the weaker players within the area, like a Burberry where revenue growth during its boom period over the last 10 years has been 2% versus the sector of 8%, have been able to prove margins that. There comes a point where demand might soften because you might have already bought your bag or whatever. And there might be

an element to that. There might be a slight squeeze in terms of living where either the price is too high or you just don't have the same [inaudible 00:47:57] and you are definitely seeing very clear indications of that. You had profit warning by Burberry.

Simon Brewer

Yeah, saw that.

Chris Dale

And Burberry is an example where new designers come in, Daniel Lee's come in, they've doubled the price of bags. And the point that's difficult for companies in luxury, because brand equity is incredibly important, it's very difficult to bring that price back down. So you then either have to double down in terms of promotion, and if that doesn't work, that could be very negative for margins. Or you have to have a complete change of strategy. And so we're at the point where we think there are certain brands that are much weaker than others, but even the premier bands like LVMH we think are going to be difficult to sustain the level of growth and margins that they've had in the past.

Simon Brewer

Very interesting. And, yeah, I'm with you and you could probably add hotel prices and airlines and other stuff that has gone up at a multiple of inflation much to my dismay. I don't buy luxury bags so I've not been affected. Chris, you are also a scratch golfer. You won the President Putter when you were captain of golf of Cambridge, you won the Halford Hewitt. Can golf teach us anything about being better investors?

Chris Dale

I think there are some disciplines that are similar to golf that are good as investors. And I think this probably applies to other sports necessarily as well. So when I think about it, golf is an incredibly difficult game. You have a small ball, small bat, big field, and the margin of error is huge. And consequently it's very difficult to be super successful. Even the best player ever, Tiger Woods, won 22% of times, Jack Nicklaus, it was 12% of times, Rory McIlroy, 8% of times, far fewer than tennis players where you can dominate your opponent, where Djokovic has won close to half the Grand Slams he's played in. But the thing that, when you want to get better at golf is you need to focus on the process. So you need to focus on improving your skills and it's a multidiscipline sport, the putting is different to driving, the bunker play. And the thing that can be frustrating when you play golf is that you might feel you're working really hard on your game, but the impact doesn't necessarily come through in terms of performance. There's an element of luck in performance, but also it just takes time. And so I think to be good at any sport like this, you need to focus on following the process and not worry quite so much about performance, which is incredibly difficult to do, and then always to go, there's always the next shot, next hole, and do necessarily that, think like that.The other thing I would just throw in because..

Simon Brewer

I'm taking notes!

Chris Dale

I would just throw in, which is sort of more maybe philosophical, there are many, many people who think it's impossible to generate alpha in markets. Not just long, but particularly probably on the short side. And the analogy I would give is that I believe investing is something that there is persistent skill. Now the

difficulty for allocators is to identify that skill because, rather like I can birdie a hole and Tiger Woods can make a par, so on a one hole basis I can look like I'm better than Tiger Woods, I'm not, however good I think I might be. But the interesting thing necessarily about that analogy is that people say, "Where's your edge? Where's your information of value?" So Tiger plays the same course, the same ball, the same clubs, but it's skill.And I think the same is true for investing, is that people who are better at it and the best way to identify that is through multi-year periods rather than just, how did you last quarter, last year? That would be one of the takeaways I'd give to other people possibly. But the main thing I think from playing golf is that ability to focus on process and investing requires a huge amount of patience and resilience and, you knowing how difficult golf is, those skills are needed in that as well.

Simon Brewer

Thank you. Well that's a good place to stop, as you looked at me and saying how I know how difficult golf is, we haven't played for a long time and it's still just as difficult. I'm going to take three things away from this conversation. Number one, there is considerable opportunity sitting there in the UK, European landscape. People have given up on Europe, people have given up on the short side largely. So that creates some axia massive opportunity. We have got number two, an environment where interest rates have gone up, companies with debt are beginning to have to deal with that, consumer slow down is a reality in that environment as well. And that changes the landscape from zombie companies all the way through. Thirdly that in focusing very specifically, as you have done for your career, on the types of companies that generate cash, that can reinvest it, that have winning positions, is that if you stay with us, they can be the compounders. And to a certain extent, the market has been, I would argue, less discerning. And finally that your business and the fund is not about getting the beta or the stock market exposure, it's about finding that alpha, that outperformance that you believe is very much available on the long side and on the short side. So you are in a small group of people occupying this space and it's been really great to talk to you today. So thank you very much.

Chris Dale

Thanks, Simon.

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