When Warren Buffet placed a bet (and won)!

NIYATI KHANNA
CFP® Professional, CA, MBA [Finance & Strategy] representative of Alman Partners Pty Ltd, Australian Financial Services Licence No: 222107

AlmanPartners
True wealth

This story goes back a few years but is a timely reminder in these times of volatile market returns. 2017 saw the 10-year bet between Warren Buffet (one of the world's foremost investors), chairman of Berkshire Hathaway Inc. and Ted Seides, a New York hedge fund consultant.

Buffet had issued a public challenge stating the benefits of low-cost passive investment vehicles.

Seides responded to this challenge, and it was agreed that they would both follow their respective investment strategies for a period of 10 years from 1st January 2008 to Dec 2017. At the conclusion of the period, the owner of the underperforming portfolio would donate $1mn to the charity chosen by the winner.

Buffett's strategy was to invest in the S&P 500 Index, while Seides selected five hedge funds.

The cash amount was revised midway by converting the sum invested in bonds to Berkshire Hathaway shares, so the final amount is reported to be in excess of $2.2 million.

The 10-year period included years of dramatic decline for the S&P 500 Index (–37.0% in 2008) as well as above-average gains (+32.4% in 2013), in short, there was ample scope for clever fund managers to try and return better than the market, utilising timing as a strategy.

For the nine years from January 1, 2008, through December 31, 2016, the average of the five funds achieved a total return of 22.0% compared to 85.5% for the S&P 500 Index.

With such significant underperformance by the hedge funds, Seides graciously conceded defeat in mid-2017.

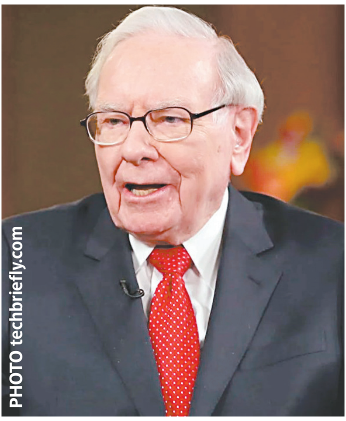

PHOTO techbriefly.com

While this shows how difficult it is to outperform the market even by professionals, Seides made a very relevant observation about what happened during this time.

In the first 14 months of the bet, the S&P 500 Index declined roughly 50% (2008 GFC) while his basket of hedge funds declined less than half as much. At this time following the decline, he commented that many investors exited the S&P 500 index and were then too fearful to enter again in order to participate in the recovery that followed.

In other words, Buffett benefited by being a disciplined investor and remaining invested in the face of volatility which is not what most retail investors would have done and to that extent, the hedge funds would have performed better than their individual investment experience.

The key takeaway - long-run returns don't matter if the strategy is abandoned along the way.

It is important before you make an investment decision that you are aware of the unpredictability of the capital markets and make asset allocation decisions wisely considering your individual circumstances.