***"Look at John Wooden, the greatest basketball coach ever: his record improved later in life when he got a great idea: be less egalitarian. Of 12 players on his team, the bottom five didn't play – they were just sparring partners. Instead, he concentrated experience in his top players."* – Charlie Munger, Berkshire Hathaway**

March 15, 2018

To Our Clients and Prospective Clients,

Early last year, I shared with our investors the advantages to investing with smaller boutique firms versus elephantine financial conglomerates. Advantages that have unveiled themselves in spades. The historical research and evidence is compelling around the performance advantage of smaller firms versus larger firms across most asset classes. (*See:* 2017 Memo to Clients). Many skilled investment teams and money managers fled the larger institutions and sought the autonomy and creativity that boutiques afforded. The wave began in the late 1970s and early 1980s, soared during the hedge fund boom, reaccelerated following the financial crisis, and continues today.

A key ingredient that frequently allows smaller firms to outperform is less pressure to conform and more incentive to dedicate attention toward outperformance. The evidence from empirical studies overwhelmingly supports this claim. Larger firms are correctly concerned with risk avoidance; hence the rise of the "closet indexers" to ensure that performance does not deviate too significantly from the market. The products are "model" portfolios that are overdiversified with securities, exchange traded funds (ETFs), mutual funds, fund of funds, etc. which can be expensive and unlikely to deliver meaningful outperformance after fees and taxes, leaving many investors unsure what they truly own and how to measure results.

The boutique approach typically is a higher conviction portfolio defined as approximately 30 holdings or less. The results are well documented and supports the trade-off between diversification and returns according to *Diversification versus Concentration…and the Winner is?* (Yeung et al. 2012). The studies illustrate that concentrated portfolios outperform diversified funds, and the more concentrated the portfolio becomes the more the outperformance increases over time. The studies show that the outperformance is sustained not only over time but is consistent across both value and growth investing styles. And that is precisely, our firm's goal-- **to deliver good to great performance every year for our clients through high conviction, value-based investing.**

Unfortunately, I believe the industry and large firms with greater perceived "business risk" have over emphasized the benefits of diversification. Famed investor Peter Lynch coined this "diworstification" to describe this approach which helped contribute to a proliferation of ETFs and rise of index funds. Retail brokers, once considered stock jockeys now define themselves as tactical asset allocators using commodity products in a wrap fee format to move in and out of markets. Of course, some diversification across asset classes is good since it mitigates concentration and event risk, but on the other hand if a portfolio has too many underlying positions, none can significantly impact performance. I believe this type of portfolio construction is more pronounced at larger institutions that want to diversify the "business risk" as much as the investment risk, leaving clients with mediocre results.

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For investment boutiques that stand for something, managers should be motivated to deviate from the consensus. At Queens Oak Advisors, we fully recognize that asset management is a very idiosyncratic art form, and the best outcomes for clients come when you have an independent culture not encumbered by bureaucracy. A culture that is in fiduciary alignment with their clients and shared incentives with their owners. We are proud to report investment results that have been "best in class," and client service that is truly client-centric. All of which, I believe is a testament to the advantages of investing with a specialized boutique. The famed Swiss-American psychiatrist, Elizabeth Kubler-Ross, who was an expert on death and dying, said when she spoke to folks near the end of their lives, their biggest regrets were their lack of risk taking. They should have left the umbrellas at home and eaten more chocolate. In other words, from the investment perspective, they should have had a bit less diversification and a bit more concentration.

To that end, we thank you for your on-going interest and support of our firm and look forward to helping our investors achieve their economic and investment goals in the uncertain environment that lies ahead with the highest degree of creativity and conviction.

Sincerely,

Eric M. Teal
Managing Partner
Chief Investment Officer

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