Investment Monitor

PERITUS

ACTIVE MANAGEMENT
Challenges and Lessons Learned

How have investment managers evolved over time to stay relevant? What have been the greatest challenges over the past decade and what can we learn for the future?

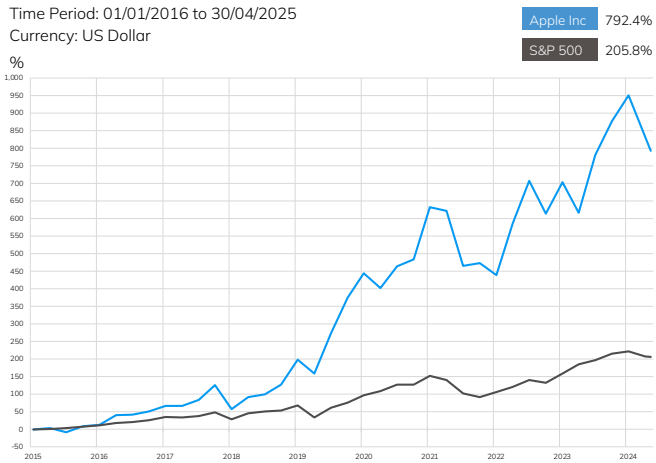
The Reality Check

'I think Apple still has room to move north.'[1]

Investment markets have taught harsh lessons over the past decade. This quote from a telling scene from the TV show Billions: An analyst at a fictitious hedge fund suggests that there is further potential from an investment in Apple, only to be dismissed by their team head because it is too obvious, as it was the world's second largest company by market cap at the time.

Since the episode came out in in 2016, Apple's stock had grown almost eightfold.. The series is fictional but the situation described is very real and pertinent to similar discussions taking place at investment management firms.

Apple Outperformance vs US equities, 2016-2025



The first lesson learned is that avoiding well-known companies simply to appear different can blind managers to exceptional opportunities.

However, the search for unique investment ideas is a common theme in investing. As Investment legend Howard Marks puts it:

'If you seek superior investment results, you have to invest in things that others haven't flocked to and caused to be fully valued.'

In other words, you have to do something different.[2] However, Marks also notes that it is not enough to be different; one also needs to be correct. This is not easy as the crowd is often right.

Selecting esoteric investments just for the sake of being different is not a viable strategy. If a manager makes investments that diverge from the index or peers, it should be because of their process leading to such unique selections, rather than deciding from the outset that they need to buy lesser-known companies.

Why have Traditional Approaches not Succeeded?

'Many shall be restored that now are fallen and many shall fall that now are in honour.'[3]

The foundation of value investing, championed by Warren Buffett's mentor Benjamin Graham, relied on mean reversion - the idea that fallen stocks would rise again and high-flying stocks would eventually fall.

This approach was successful for decades until 2017. Since then, many traditional value investors have either closed their funds after years of underperformance or

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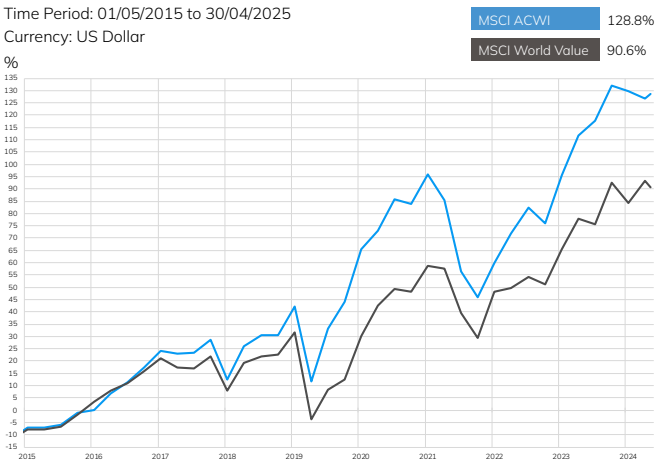
adapted by being willing to pay a higher price for higher-quality companies than what Graham's traditional value approach would have advocated.

One reason traditional value investing has not worked is the increased accessibility of data. Simply buying stocks with low price-to-earnings or price-to-book value ratios is unlikely to lead to outperformance when every investor can easily access the same information.

Performance Simple Value Metrics, 2015 – 2025



Traditional valuation multiples have also been distorted by the increasing importance of intangible assets, such as proprietary technology or brands.[4] The accounting treatment for these non-physical assets differs from physical items such as property, plant and equipment.

Therefore, the second lesson learned is that the investment world becomes ever more complex and simple metrics such as price-to-earnings ratios no longer tell the complete story.

Can Trees Grow to the Sky?

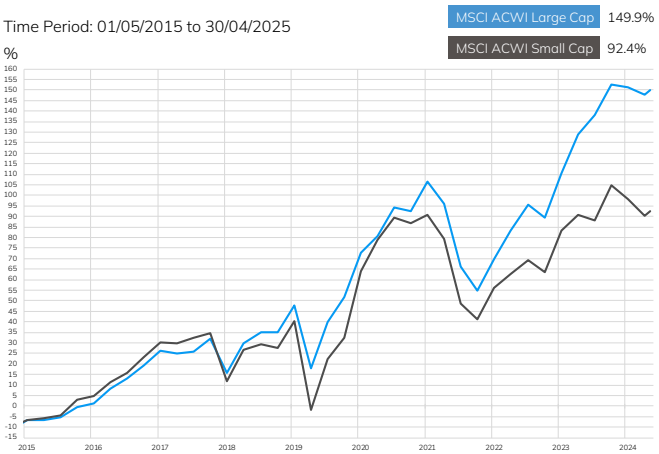
Historical results suggests that smaller companies outperform larger ones,[5,6] but this has not held true over the past decade.

Research from Mauboussin and Callahan[7] showed that the trend has reversed as the very largest companies continued to outperform. They demonstrated that active managers tend to struggle during periods when large caps outperform small companies, as has been the case during the past ten years.

This may be because it has become easier for smaller businesses to receive funding in private markets and as a result more value creation happens before companies are listed.

The third lesson learned is that what has worked in the past is not guaranteed to continue in the future.

Global Small Cap Equities Underperformance 2015 – 2025

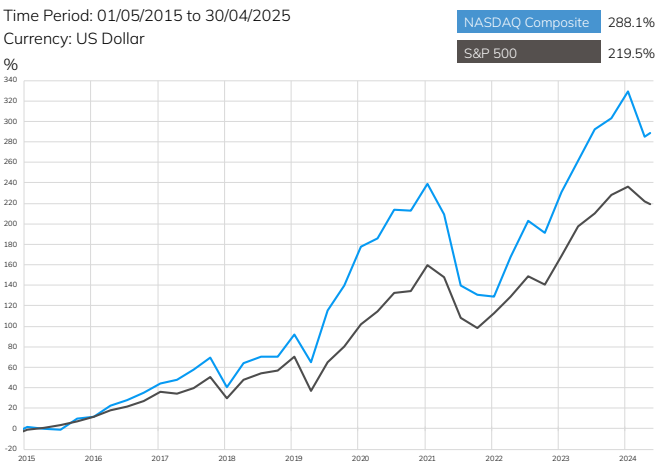


Understanding Modern Growth

Many of the largest technology companies have grown beyond what market leaders have done historically. There are many reasons, for example software-based models can grow without proportional cost increases and network effects create self-reinforcing growth cycles. In addition, strong cash flows enable continuous innovations in new areas alongside strategic acquisitions.

The fourth lesson learned is that modern business models can allow growth to continue beyond what the largest companies have historically achieved, challenging conventional wisdom about market saturation.

Nasdaq Composite – Technology biased, 2015 – 2025



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The Passive Revolution

The rise of passive investing has not created the opportunities active managers expected. Instead, it appears to have changed market dynamics.

Investment strategist and portfolio manager Mike Green argued that capital flows now influence stock prices more than company fundamentals.[8] In the past, if a stock became undervalued relative to its fundamentals, investors would invest and this would close the gap to its intrinsic value.

One the other hand, some believed that active management would become increasingly difficult with more passive investing. Mauboussin discussed the "paradox of skill"[9] in which only the best active investors are left to compete amongst themselves as less skilled investors are the ones more likely to switch to passive funds. Although the absolute level of investment skill has increased, it becomes harder to outperform the more skilful competition.

The fifth lesson learned is that market structure changes require strategy adaptation. Price dislocations can still provide excellent opportunities for fundamental investors, but the impact of passive flows mean investors may need even longer time horizons for prices to converge with their fair values.

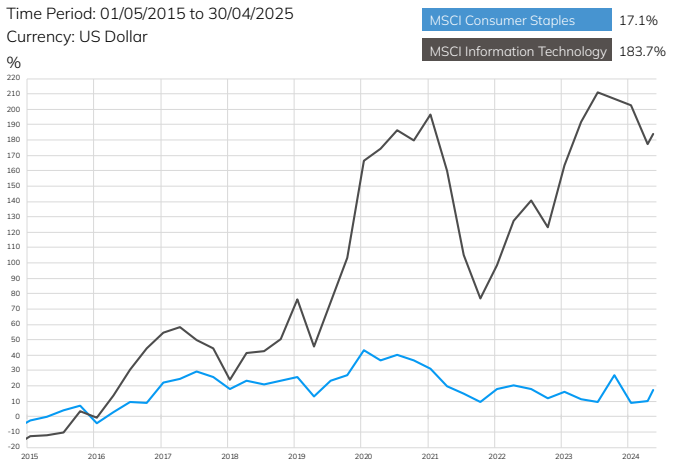
Successful Adaptation

One reason why some investment managers have not invested in leading technology-related companies is the difficulty in predicting their long-term prospects. Managers with long time horizons often prefer to invest in companies they are confident will still exist in ten years or more.

This philosophy makes it challenging to invest in rapidly changing industries, where companies tend to be younger and outcomes uncertain. This can lead active managers to gravitate toward companies with long heritages and predictable business models in industries less prone to disruption.

That said, some thoughtful managers have adapted. For example, one investment manager with a flexible mandate we identified in our research balances the portfolio with high growth technology companies that have significant upside but a broad range of outcomes, alongside more predictable businesses such as consumer staples, which offer modest potential but a higher degree of long-term stability. This balanced approach has led to strong results across varied market environments, as opposed to managers that limit their focus to specific types of companies.

Information Technology and Consumer Staples Sector Divergence, 2015 – 2025



Warren Buffet has evolved his approach in a similar fashion. Berkshire Hathaway reached new highs in 2025, in large part because of its substantial position in Apple, while also maintaining a part of the portfolio in stable businesses such as Coca Cola. When Buffett, who started his career as a conventional value investor, changes the way he views technology stocks, it signals a fundamental shift in how value can be found in modern markets.

The New Balance

There are many ways to be successful in investment management. Some specialised managers have developed deep expertise in niche areas. However, our research shows this approach can lead to extended periods of underperformance if the chosen sector falls out of favour.

We support very long-term investing, but this requires that the managers' structure is designed to withstand multi-year periods of being out of sync with markets and that it has clients who will remain loyal with the firm through these difficult periods that can last many years.

What is the Main Objective?

The evolution of active management isn't slowing down. At Peritus we emphasise that managers shouldn't become closet indexers—if the goal is minimising

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benchmark deviation, passive funds are more appropriate than paying active management fees.[10]

Instead, investment managers should seek to maximise long-term returns through deliberate, well-researched positions, instead of trying to be different for the sake of it. In other words, **"there are no extra points for being eclectic or going off the beaten path."** This quote came from a thoughtful fund manager, who expressed near embarrassment at buying leading technology companies during the COVID selloff in March of 2020.

Holding esoteric names must be driven by a thoughtful process that identifies the companies as undervalued, not a deliberate strategy to be unconventional. Similarly, low portfolio turnover or high concentration should result from a high conviction, long-term investment approach but not explicit targets.

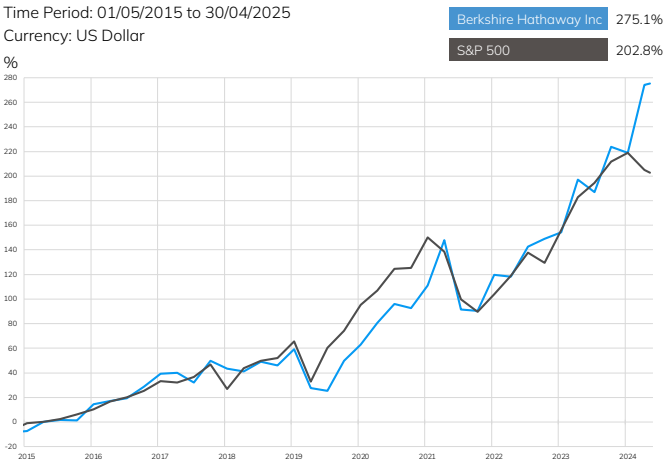
Conclusion

The evolution of active management is not about abandoning fundamental principles but continuously learning and applying them in new ways. Investment consultants should evaluate managers based on their philosophy and decision-making processes and whether these align with a higher probability of long-term success.

An important lesson is that investment managers need to continually adapt and learn. While style drift is often criticised, evolving one's approach is necessary as strategies that worked ten or twenty years ago are unlikely to be as successful in the future.

Berkshire Hathaway's recent success shows that even investors with more than half a century of experience can adapt successfully. Buffett was often ridiculed for missing out on great opportunities in technology companies over the years, however the investment in Apple proves that it is never too late to adapt. His story, along with others in our research, indicate that evolution in investment management is not only possible, but essential for long-term success.

Warren Buffett's Berkshire Hathaway vs US equities, 2015 – 2025



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