What are the implications of portfolio size?

It has almost become an investment truism that the majority of investors underperform. They not only underperform relative to the broad market indices, but also relative to their own investments, by chasing performance; i.e., buying more of the assets that are rising in value. There are many reasons for this. In this commentary, we'll address one aspect of this very broad topic: the size bias.

Over and over again, empirical studies have demonstrated that large portfolios, i.e., typically portfolios with many billions under management, suffer a performance hit. There are numerous reasons for this to happen, including liquidity premium paid on trades, the performance impact of individual positions and diminishing opportunity sets. Seeing this performance degradation, institutions with a conscience should close their funds. But conscience is in short supply in the investment business. Not being any wiser, investors continue to favor large institutions, and large portfolios over their smaller counterparts. Emotionally, investors feel comfortable following the herd and placing their funds with large fund companies which manage over-allocated portfolios. However, comfort and investment performance are inversely related.

For the purposes of this commentary, I decided to compare IMI Blue Chip Long Only Fund to Berkshire Hathaway, an industrial conglomerate managed by Warren Buffet. This is a trophy holding for most investors. Further, since Berkshire Hathaway is a diversified conglomerate with a large investment portfolio, using this company rather than a mutual fund is not as farfetched as it seems. In addition, Warren Buffet's investment acumen is legendary and his historical record is enviable.

Table I. IMI Long Fund vs. Berkshire Hathaway Total Performance

	IMI Blue Chip Long Only Fund		**Berkshire Hathaway**	
	Annual Return	Cumulative Return	Annual Return	Cumulative Return
2003	29.81	29.81	15.81	15.81
2004	21.25	55.39	4.33	20.82
2005	12.64	77.29	0.82	21.81
2006	10.43	95.78	24.11	51.19
2007	8.89	113.19	28.56	94.36
2008	-33.73	41.28	-29.56	36.91
2009	36.97	93.51	-0.40	36.36
2010	20.83	133.82	21.42	65.57
2011	2.80	140.36	-4.7	57.74
2012	12.98	**171.56**	16.82	**84.27**

As the table clearly demonstrates, IMI Blue Chip Long Only Fund beat Berkshire Hathaway by a factor of two over the time period under consideration. In other words, even one of the most talented investors of all time, Warren Buffet, has trailed IMI returns. This statement in no way implies that I am a better investor than Warren Buffet. But it does signify that even a legendary investor such Warren Buffet cannot overcome the diseconomies of scale associated with managing a $200B entity, and generate sufficient returns to beat an agile minnow such as IMI. In view of this fact, how likely is an over-invested portfolio manager with skills that don't come close to Buffet's, to deliver index beating results?

PO Box 791020, Paia, HI 96779 (808) 572-1040 www.iminvestments.com