

Reprinted from BARRON'S

July 7, 1997

© 1997 Dow Jones & Company, Inc. All Rights Reserved.

OTHER VOICES

VIEWS FROM BEYOND THE BARRON'S STAFF

Kids Today

They're managing money, frets a Wall Street old timer

BY DOUGLAS A. KASS • In a backdrop of unbridled optimism and ever-rising stock prices there are lessons, as always, to be learned from history. The wisdom of Scarsdale Fats (a/k/a Bob Brimberg) and the words of Adam Smith provide important messages that apply to the current state of the stock market — a market that increasingly looks as though it's losing its moorings.

The first lesson is to be learned from a friend, Bob Brimberg, who died four years ago this month. Bob headed Brimberg & Co., a small securities business by Wall Street standards. But by any measures Bob was a "Big Man," who hailed from Scarsdale, a tony suburb north of New York City. His moniker, Scarsdale Fats, was given to him by author Adam Smith, who, somewhere between chapters on Mr. Johnson (of Fidelity fame) and the Gnome of Zurich, immortalized Bob in his 1967 best seller, *The Money Game*.

In the 1960s, as in the 1990s, money managers with billions under management were welcome anywhere. But mostly they gathered at Bob's spartan room down on Broad Street, where corned-beef sandwiches were the *plat du jour*. No house silver, no perfectly groomed waiters, just metal folding chairs, paper napkins and a big bowl of pickles and sour tomatoes were the standard offering.

Why were Bob's lunches the meal to be invited to? As Erich Heinemann recalled: "The price of admission was that you had something to say. Bob ran the only true salon, in the 17th century meaning, for the investment community."

Bob put it this way: "I had to compete. What have I got? Nothing. Those

hot young research analysts at Donaldson Lufkin can write hundred-page reports. Bache can field a thousand salesmen. The White Shoe firms can fly the Old Street WASP flags. So I thought: Who has the money? The funds. Be nice. Ask them to lunch." And that's how Bob Brimberg became the Perle Mesta of Wall Street.

Ultimately, Bob moved uptown to a corner table at Harmonie Club. It was in that setting in 1977 that I first met Scarsdale Fats when he invited me to my first lunch. I was a wet-behind-the-ears 27-year-old portfolio manager, and Bob exposed me to the best and the brightest on Wall Street.

Scarsdale Fats' pointed questions and sometimes brusque manner cut through the pretense, and the poker-game aspect stimulated even the most knowledgeable of us to prepare for the lunch. And everybody came to be with the Yalie who was as comfortable talking about Kierkegaard as Keynes.

The Dow Jones Industrials stood as low as about 800 back in 1977, and we have been in a bull market ever since.

I, and many other people, owe a lot to Bob, and, since his death and during my visits back to the Harmonie Club for lunch (now as a member), I find myself gazing back at Scarsdale's corner table. I still remember those spirited lunches vividly, and how very much we all profited from the conversation.

You see, Bob brought the sensibilities of

a world-class bridge player — which he was — to our understanding of the markets. Above all, he taught investment humility; that if you do not know who you are, Wall Street is an expensive place to find out.

Which gets me to the subject at hand. The market. For, as Bob put it to me one day in 1987, "Doug, genius is a rising market."

And the market today gets back to Adam Smith's Money Game (which chronicled Scarsdale's tales), in which the author recalls a character named the Great Winfield, who employed a bunch of kids to manage his money. Like Billy the Kid, "who was in Leasco Data Processing, Financial General, and Randolph Computer, and a couple of others I can't remember, except that they all had data processing or computers in the title. When asked why the computer leasing stocks were so good, he responded, 'Leasing has proved the only way to sell them and computer companies themselves don't have the capital. Therefore, earnings will be up 100% this year, and will double next year and will double again the year after. The surface has barely been scratched. The risk has barely begun.'"

I am awash in nostalgia. As in the 1960s, today's investors are similarly obsessed with the market's momentum, the future of technology (IBM, Microsoft, Dell and Gateway achieved all-time highs last month), and, for that matter,

(over please)

DOUGLAS A. KASS is general partner of Kass Perkins Partners, a hedge fund.

THE PUBLISHER'S SALE OF THIS REPRINT DOES NOT CONSTITUTE OR IMPLY ANY ENDORSEMENT OR SPONSORSHIP OF ANY PRODUCT, SERVICE, COMPANY OR ORGANIZATION.
JournalReprints (609)520-4328 P.O. Box 300 Princeton, N.J. 08543-0300. DO NOT EDIT OR ALTER REPRINTS • REPRODUCTIONS NOT PERMITTED

DOW JONES

the top tier of industrial equities like Coca-Cola and General Electric, to name a few sectors sporting Snapplesque valuations. Like the period 30 years ago, the real action in the 1990s is in a relatively narrow grouping of equities.

Adam Smith's fictional character, the Great Winfield, continues: "The strength of my kids is that they are too young to remember anything bad, and they are making so much money they feel invincible. Now you know and I know that one day the orchestra will stop playing and the wind will rattle through the broken window panes, and the anticipation of this freezes us. All of these kids but one will be broke, and that one will be the Arthur Rock of the new generation."

Bob, some things never change — this is still a kid's market.

The 1990s even has the incarnation of Adam Smith's Great Winfield. He is alive and well, running an investment partnership in Connecticut. Winfield II is an acquaintance of mine who justifiably abhors publicity, instead letting his remarkable trading record speak for itself (Cooperman and Robertson would be envious). He, like the Great Winfield before him, has a bunch of kids trading money for him. His most profitable kids, like Winfield's, have not passed their 29th birthdays. The most successful of his kids, Adam the Kid, is all of 26 and owes his success to buying every dip of Microsoft, Gateway, Coca-Cola and General Electric.

The newer, Connecticut-based version of the Great Winfield's 1966 organization is not the only one employing kids who trade stocks regardless of value and, in turn, serve to influence others' market actions (as described in Soros's theory of reflexivity). There are an astonishing number of pockets of kid-sized trading organizations among us today. Every investment professional on the sell side knows who they are; they are responsible for the generation of massive commission's business. They live to trade.

I am certain that only a few of these types will survive a full market cycle. A good deal of money will be lost by the hordes of trading rings that unprofitably "buy the dips" during a pronounced market drop.

Recently a potential investor in our hedge fund said to us, "I would like to become an investor — your analysis of companies you short is thorough, detailed and rarely, if ever, wrong. But you are 48 years old, and that's too old for this market." To add insult to injury, this investor gave his \$1 million to a 25-year-old (I have neckties older than this fellow) who has

"No one even knows for sure that the market's party will end at all. One never knows what's enough until one knows what's more than enough. What we do know is that bear markets are born out of the same type of heady environment that is viewed as existing today."

been in the investment business for less than three years. But his investment record for that period compounded at triple digits. Short selling was obviously not in his investment lexicon.

As mentioned, with so much money flowing into the coffers of money managers, the risk of short-term underperformance has become magnified. And with the major indexes compounding at nearly twice the rate of the long-term growth in equities, value investors (unable to buy momentum, preferring to wait for their pitches to be in the "happy zone" before swinging) and dedicated short sellers (who eye fundamental negative developments before they swing) have nearly disappeared.

As the kids, and others acting like kids, gleefully dance their trading tango in Wall Street trading rooms, the crevices of hedge funds and the offices of old-line mutual funds, the old-timers, like us, grumble about being bearish in a market advance that shows no signs of slowing down. In *The Alchemy of Finance*, George Soros wrote about the asymmetrical nature of a boom/bust scenario — the way it slowly accelerates and then culminates in a catastrophic reversal. Time will tell whether we are tracing this sequence.

I am equally certain that the 1990s version of Winfield, the one in Connecticut, will be the sole survivor, or one of the survivors, of this increasingly dominant class of investors "when the market's orchestra stops playing." Like the Great Winfield before him, Winfield II has traded profitably from the short side as well as the long. He will teach his Sheldon the Kid, Billy the Kid and Adam the Kid how to short 'em. He will be the Arthur Rock of his generation's trader. Increasingly, the demands of performance (now measured and judged on a weekly basis) — as well as the meaningful rewards of that performance — are serving to transform otherwise sound-minded money managers into kids. This, in turn, has led to a bifurcated market — a market of haves and have-nots in which investors/traders stock up on the

same securities — further serving to elevate share prices and accentuating the discrepancy between market participants' perception of reality and the actual state of affairs. At the time of an eventual decline in prices, this, along with other obvious factors, will likely serve to exacerbate the market's distress.

Being over 40 years old has been a liability in the bull market of the 1990s. But it's hard to forget that it took more than 17 years (1982) to eclipse the high in the averages established in the mid-'Sixties, in the last "kids' market."

I want to be like Sheldon the Kid and the rest of the kids in the 1960s and 1990s — trading in and out, relentlessly buying all dips, paying 15 times revenues for high tech, disregarding value and common sense — but I can't.

Indeed, no one even knows for sure that the market's party will end at all. As it is said, one never knows what's enough until one knows what's more than enough.

What we do know is that bear markets are born out of the same type of heady environment that is viewed as existing today. (By contrast, bull markets are born out of distress — the only distress these days represents that of short sellers.) It is something that market participants currently describe as a "Goldilocks" economy — not too cold, not too hot, just right.

We also know that outsized investment returns have become the expected form of investors who continue to throw an unprecedented amount of savings into mutual funds.

For us, taking Warren Buffett's advice that investors "should be fearful when others are greedy, and greedy when others are fearful" seems to be an appropriate course of investment action.

One day the Goldilocks script might be uncovered for what it is, a children's fairy tale. For as Adam Smith related in "Visions of the Apocalypse," his final chapter of *The Money Game*, it can all come tumbling down.

I know, this is an old guy talking, blinded by a sense of history. ■