FT Alphaville Markets volatility

Baillie Gifford has thoughts on stock selection versus natural selection

To err is human, to underperform divine

Homo Floresiensis (left) at London's Natural History Museum in 2004 © AP

Bryce Elder AUGUST 10 2022

Apologies. In Tuesday's news rush we somehow overlooked annual results from UK-listed tech fund Baillie Gifford US Growth Trust, which contain one of the more inventive excuses on public record so far for losing investors' money on modish stuff like Peloton and Vroom.

It's evolution's fault.

> It is easier to be long-term when things are going well. It is during periods of weakness that conviction is truly tested. Bear markets cause emotions to bubble to the surface which urge one to act. It can be cathartic to do something, but decision making under stress increases the chances of errors. Stress also influences our attitude towards risk and our ability to assess probabilities. Humans are prone to the affect heuristic - the tendency to take mental shortcuts when emotions are running high. Such quick decision-making conferred evolutionary advantages at earlier points in human history. But careful decision-making trumps speed when dealing with complex-adaptive systems like the stock market.

As well as blaming the persistence of hunter brain in a farmer world, BGUSGT chair Tom Burnet criticises Peloton for having "wrongly extrapolated pandemiclevel demand" and real estate portal Zillow for having "veered irreparably off track". Ride-hailer Lyft and used car dealer Vroom were heaved out of the portfolio on competition worries, in the latter case because the fund managers wanted to keep hold of Carvana instead. Yes, that Carvana.

BGUSGT was down 35.3 per cent in NAV terms for the year ended May 31 and its shares are now comfortably underperforming the S&P 500 since launch in 2018.

	Fund/benchmark	Change
Price	Baillie Gifford US Growth Trust plc (Ordinary Share)	+84.47%
NAV	Baillie Gifford US Growth Trust plc (Ordinary Share)	+119.39%

Luckily, recent research on affect heuristics in investing has shown some interesting ways to minimise the "mental shortcut" problem described above.

Christoph Merkle, Associate Professor of Finance at Aarhus University, proposes in a paper published last month that fund manager performance should be required, not expected. A hard target forces a manager to consider risk-return tradeoffs, whereas the soft approach just encourages picking whichever stocks they feel strongest about, he says.

By expecting rather than enforcing returns, complicated decisions are made easy and diversification goes out the window as portfolios become a list of favourites, Merkle finds, adding: "Effortless judgments have the potential to make investors overconfident about how competent they are in predicting returns and risk."

So if Baillie Gifford is serious about the science, perhaps it could try offering guaranteed performance?