



> **ARTICO Partners Are Major Co-Investors in all their Funds:** **The Importance of Having Skin in the Game**

Imagine you visit a Casino. At the bar, there is this well-dressed guy – let’s call him Ricky. He offers you the following deal: “I will come with you to the table and provide my professional advice for as long as you wish. I am an expert on probabilities and my advice will very likely make you rich.”

As you are not an experienced and skilled gambler, it sounds tempting to get help from a professional, but you don’t want to pay high fees.

Surprisingly, Ricky continues: “Not only that, but you will get my advice for free! I shall only charge you if you win: you will keep 80% of your gains and I will get 20% as an incentive to make you win as much as possible.”

After some reflection, you find the deal to be more than acceptable and agree to the terms Ricky proposed. What you don’t know at this stage, is that your new partner offers the same deal to many other players. After a long night, you go

back to the bar for drinks. There, by coincidence you meet all other players who took advice from Ricky. Together, you discover that some of the players have won money thanks to Ricky’s advice, while others have lost. Adding it up, you realise that as a group a significant amount of money has been lost. In another corner of the bar you spot Ricky who seems to be enjoying himself big time: he has become rich! Fury and anger slowly comes creeping up, while you struggle to understand what has just happened.

You are depressed and about to leave the bar when a guy next to you offers you a last drink. "Hi, I am Nassim. I heard your conversation. You should have read my latest book *Skin in the Game*¹, if you had this would not have happened to you."

You slowly realise that, luckily, you just met Nassim Taleb, the multi-faceted thinker and philosopher on decision-making, uncertainty, risk and randomness. He is also the author of many books including *The Black Swan* (2007). In that book he recommended a different approach to measuring risk, introducing the notion of unpredictable events ahead of the 2008 financial crisis. It only takes you a short moment with Nassim to fully understand what went wrong in the casino.

"It is very simple," Nassim explains: "Ricky benefitted from two key factors: randomness of the game plus a total asymmetry in the deal he offered you. First, the odds of winning or losing at the Casino tables are very close to 50%, regardless of Ricky's professional advice. Second, he managed to agree with the players a completely asymmetric deal: He would take a 20% share of your (random) wins, while not being exposed to any of your losses! Intuitively, you believed that the profit sharing was an incentive for him to make you win the most. But the structure of the deal incentivised Ricky to play as often as possible with as many players as he could find with the largest possible wagers. He knew that he could expect to win in 50% of the cases. And, each time he would take 20% of the winnings. Not surprisingly, he became rich without having any professional foresight on the casino outcomes. On the other hand, as a group, all players had to lose, as the outcomes were random, but each player was always rewarded with only 80% of the wins. He could only win, while the group could only lose.

Nassim's explanation is so simple - and obviously true - that you fail to understand why you did not figure it out yourself. Nassim goes on: "Ricky had absolutely no skin in this game! If he had to share in your losses, he would not have offered you this silly deal to start with. Skin in the game is the backbone of risk management. The symmetry that comes with skin in the game is a simple rule that is necessary for fairness and justice. Never trust anyone who doesn't have skin in the game! Without it, fools and crooks will benefit, and their mistakes will never come back to haunt them."

We are going to move away from the casino now, but, sadly, similar deals are offered and accepted around the world on a daily basis (in particular, when it comes to investment management or advisory). The difference is

that financial markets host millions of players and an army of "Ricky's", most of whom are operating without any true skin in the game.

Looking at the performance of active global equity managers over the past five to seven years, it is mind-blowing to see that over 75% of managers have underperformed the global equity benchmark². Well, it is not the managers who have suffered these losses, but the investors. Most of the managers did not have skin in the game. Some may have lost their job, their reputation, their clients, but only few had exposed a significant amount of their private wealth in respect of the investment decisions they took. So, is it still a surprise that the average manager did not add value to his investors over the long term?

ARTICO Partners strongly believes in the concept of skin in the game. They consider this a necessary condition of operating as a professional asset manager. They have developed an investment approach in which they believe. It is both simple and compelling: ARTICO invests in good companies, having invested thousands of hours of research to develop the necessary selection skills. The companies invested in have a higher growth rate, stronger profitability, a healthier balance sheet and a significantly lower valuation. These unique characteristics are the reason for ARTICO's achieved outperformance over the past seven years. More important, it gives their portfolios a higher probability to outperform in the future. They know this. But how can investors decide whether ARTICO really believes in what is said? It could just be a cute marketing story based on past (random) outperformance. Professional investors will of course perform a detailed due diligence which will convince them about the validity of the ARTICO approach. But one of the most important aspects, the key fact that really makes the difference, is for investors to know that their advisor has a lot of skin in the game. As significant co-investors in all their funds, ARTICO benefits from outperformance and suffers in phases of underperformance. This – and only this – can ensure that its own interests are truly aligned with the interests of investors.

Do not grant unconditional trust in advice that – when things go wrong – has no meaningful negative impact or consequences on the persons taking investment decisions for you. You should expect skin in the game from everyone that takes decisions on your behalf. Always. ❖

¹*Skin in the Game: Hidden Asymmetries in Daily Life* by Nassim Taleb. Random House & Penguin (2018)

²Source: Citywire. Performance of global equity managers 7/2011-7/2018

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