# Four Lessons from Druckenmiller

As noted last month, the legendary Stan Druckenmiller officially retired from public money management in August.

The media reaction to Druckenmiller's exit stage right was a classic example of *sic transit gloria* — glory fades.

With a focus on professed tiredness and stress, short shrift was given to the fact that Druckenmiller was, **undoubtedly, one of the greatest money managers of all time.**

With a track record in his Duqesne fund of 30% compound returns over 30 years — *with no losing years* – Stan Druckenmiller is to money managers as Wayne Gretzky is to hockey, Michael Schumacher is to Formula One racing, or Jack Nicklaus is to golf.

(The "Michael Jordan" moniker is taken by Paul Tudor Jones, a good buddy of Druckenmiller's who is still active.)

Druckenmiller also has the distinction of sharing the most profound piece of wisdom in the entire *Market Wizards* series. **If you truly understand this observation, then you understand how to become rich:**

> *The way to attain truly superior long-term returns is to grind it out until you're up 30 or 40 percent, and then if you have the conviction, go for a 100 percent year. If you can put together a few near-100 percent years and avoid down years, then you can achieve really outstanding long-term returns.*
>
> - Stanley Druckenmiller, New Market Wizards

And of course, that is exactly what Stan the Man did…

Reflecting on Druckenmiller's retirement — and track record — leads to four conclusions applicable to traders and investors today.

## Lesson #1: SIZE MATTERS

Yes Virginia, size does matter. But not in the way one might think. (Geez, get your mind out of the gutter!)

At the time of Druckenmiller's retirement announcement, Duquesne Capital Management LLC was handling $12 billion. That's a lot of dough. In fact, it's a bit like **trying to steer an ocean liner.**

The great global macro managers are known for their ability to nimbly exploit opportunities in deep, liquid markets. And the more liquid the vehicle the better, because liquidity allows the manager to turn on a dime — or to step aside and quickly go to cash if need be.

But the bigger you get, the harder it becomes to implement a pure trading style. Size becomes a headache in that it's an impediment to getting in quickly, and sometimes an even bigger impediment to getting out.

*Forbes Magazine* recently estimated Druckenmiller's personal fortune at $2.8 billion. No wonder he wants to just run a "fun" portion of his own money again, farming out the rest to colleagues through a

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family office. Cutting back total size to a measly $500 million – $1 billion or so would feel like a speedboat in comparison to the full Duquesne load.

As an important takeaway here, **size matters to regular investors and traders too, in respect to the fact that being small comes with a huge advantage!**

And what is that advantage, you ask? It is the ability to load the boat on your best ideas.

If you are trading with anything less than $100 million — or, heck, a few hundred million for that matter — then **your highest conviction ideas have a much better chance of adding outperformance to the portfolio**, due to a practical lack of capacity constraints.

Hedge fund manager Joel Greenblatt, whose Gotham Capital earned 50%+ returns for more than a decade, explains this phenomenon in his book You Can Be a Stock Market Genius. (A terrible title, but a great read.)

To explain the small investor's edge, Greenblatt uses the example of "Bob," a pseudonymous friend of Greenblatt's tasked with allocating billions under strict institutional rules:

> From a practical standpoint, when Bob [a bigtime equity fund manager] chooses his favorite stocks and is on pick number twenty, thirty, or eighty, he is **pursuing a strategy imposed on him by the dollar size of his portfolio, legal issues, and fiduciary considerations**, not because he feels his last picks are as good as his first or because he needs to own all those stocks for maximum portfolio diversification.
>
> In short, poor Bob has to come up with scores of great stock ideas, choose from a limited universe of the most widely followed stocks, buy and sell large amounts of individual stocks without affecting their share prices, and perform in a fish bowl where his returns are judged quarterly and even monthly.
>
> **Fortunately, you don't.**

Is it any wonder Druckenmiller grew wary of steering an ocean liner? "I plan on managing a decent chunk of my money, but only an amount that will be fun," he told *Bloomberg*.

The man wanted to be light and nimble again. (Relatively speaking of course.)

## Lesson #2: OUTPERFORMANCE IS POSSIBLE

If you'll pardon the color, we at Mercenary Trader can't help but fully agree with this assessment from Helmut Weymar, a founder of the legendary Commodities Corp:

> *I thought random walk was bullshit… The whole idea that an individual can't make serious money with a competitive edge over the rest of the market is wacko.*

Amen to that. (Paul Samuelson, a godfather of EMH and the dean of neoclassical economics, apparently didn't buy the bullshit either, as fully clarified here.)

As Market Wizard Larry Hite once observed, everyone he ever met who believed in efficient markets was poor. The poor eggheads argue, miraculously, that markets have some mysterious source of efficiency, unknown in source or sustenance, that prevents outperformance from being possible, *even for the alpha dogs supposedly dominating markets in the first place*!

This line of thought deserves outright scorn and ridicule, and perhaps a sense of wonder at the sheer pigheadedness of the assertion. (Man as consistently rational utility maximizer? No. Talent equally distributed? No. Information objectively interpreted? No. As Yale professor Robert J. Shiller has

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observed, the efficient market hypothesis is **"one of the most remarkable errors in the history of economic thought."**)

When defending EMH in public, academic true believers resort to the "Trained Orangutan" argument, which basically asserts that money managers are little more than lucky coin flippers — and that with enough flippers on hand, one is bound to see the emergence of a few excellent track records solely on the basis of luck.

Warren Buffett, aka the greatest value investor of the age, took on this argument and demolished it in a tour de force titled "The Superinvestors of Graham and Doddsville." You can read the whole piece here, or otherwise find it on the web.

Buffett's essential rebuttal was that, if the trained orangutan / lucky coinflip charge held true, then the winners with long-term track records should have randomly distributed styles of varying logic and rationality.

One lucky flipper might believe in reading astrological signs, for example. Yet another might pray to Vishnu, or buy stocks that begin with the letter "R." Those might be slight exaggerations… point being, though, that if the market winners win based on luck, as the random walkers assert, then **the strategies of the "winners" should be sufficiently varied to suggest random intellectual distribution as a group**.

This is not what happens.

As Buffett pointed out, in his circle — the value investing circle of the Graham and Dodd school — a class of investors did things the same way, focused on the same things, and applied the same philosophies and methodological principles to consistently outperforming the market. As Buffett put it,

> If you were trying to analyze possible causes of a rare type of cancer — with, say, 1,500 cases a year in the United States — and you found that 400 of them occurred in some little mining town in Montana, you would get very interested in the water there, or the occupation of those afflicted, or other variables. You know it's not random chance that 400 come from a small area. You would not necessarily know the causal factors, but you would know where to search.
>
> I submit to you that there are ways of defining an origin other than geography. In addition to geographical origins, there can be what I call an intellectual origin. I think you will find that a disproportionate number of successful coin-flippers in the investment world came from a very small intellectual village that could be called Graham-and-Doddsville. **A concentration of winners that simply cannot be explained by chance can be traced to this particular intellectual village.**

Now, getting back to Druckenmiller — 30% returns compounded over 30 years. Was that a fluke, a quirk of genius, or an otherwise unapproachable result? No.

Besides the huge improbability of such a lengthy run via random chance, there is the fact that **Druckenmiller and colleagues come from an "intellectual village" similar in spirit to Buffett's —** one that I call *"The Supertraders of Global Macroville."*

In other words: Just as a class of value investors has managed to thrive and outperform over decades using the tenets of Graham and Dodd, a class of traders — the Supertraders of Global Macroville — has done the same thing using the essential principles as laid down by top practitioners over the years. Consider the following:

- Druckenmiller, a global macro specialist (and the architect of Soros' career-defining British Pounds trade in 1992), earned 30% returns over 30 years with no losing years.

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- Paul Tudor Jones — the "Michael Jordan" of trading — has compounded at 27.4% annually in his Tudor Futures Fund since 1984 — more than a quarter century — and, like Druckenmiller, with no losing years.

- PTJ and Druckenmiller were known **to talk virtually every day** when Druckenmiller was active. (Perhaps they still do…?)

- Druckenmiller was **a protege of George Soros**, whose legendary Quantum Fund compounded at 32%+ between 1969 and 2000 (30+ years).

- When Soros published the Alchemy of Finance, Paul Tudor Jones was so enthused by its insights he demanded that all his people read it.

- The habits and philosophies of Druckenmiller, Jones, Bacon, Kovner, Marcus, and other macro trading legends all have traceable links to Commodities Corp, arguably making "Global Macroville" a physical place.

- The essentials of the macro trading style can be traced even further back, to the timeless tenets first expressed via *Reminiscences of a Stock Operator* in 1923

That sounds very much like **an intellectual community founded on replicable strategies and principles**, does it not? (Which, of course, is exactly what it is.)

And of course, opportunities in the global macro or "top down" investing space remain as lucrative today as ever (if not more so), the basic elements of which are laid out in our Integrated Macro Analysis series. (More episodes are coming by the way — stay tuned!)

What's more, one of the most attractive aspects of global macro — that space in which one treats the integrated combination of "top down," "bottom up" and "price action" as Father, Son and Holy Ghost — is **its relative imperviousness to supercomputers, High Freqency Trading programs, and other forms of short-term automated churn**.

No computer program yet devised can match wits with a skilled and nuanced trader when it comes to isolating, targeting and exploiting the key thematic drivers of the day. In pulling all the threads together, and applying the accumulated lessons of market history and economic knowledge as one does so, there is simply too much embedded complexity for any silicon-based algorithm to handle.

As *Reminiscences* quite correctly observed so long ago,

> *There are men whose gait is far quicker than the mob's. They are bound to lead—no matter how much the mob changes.*

## Lesson #3: EXCELLENCE TAKES HARD WORK

For years, Druckenmiller had lamented that he couldn't get away — the markets demanded too much of his time, energy and vigilance. At age 57, and after 30 years, he finally felt ready to slow down the pace.

To stay on top of your trading game, you have to be aggressively in the mix. In some respect, being a top-flight trader is not unlike being a top athlete — golfer, tennis player, NBA star or what have you.

To get great and stay great, one must put in the hours, stick with the training, and maintain a ferocious competitive focus. There are simply no shortcuts (with the possible exception of having other great traders share their trades with you in real time).

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Paul Tudor Jones expressed the core of the trader's work ethic in this year 2000 interview excerpt:

> **Q:** What's your competitive advantage as a trader?
>
> **A:** The secret to being successful from a trading perspective is to have anindefatigable and an undying and unquenchable thirst for information andknowledge. Because I think there are certain situations where you canabsolutely understand what motivates every buyer and seller and have apretty good picture of what's going to happen. And it just requires anenormous amount of grunt work and dedication to finding all possible bits ofinformation.

So the #3 lesson from Druckenmiller (and friends) is that it takes a lot of effort to be great (on top of that special spark). This in turn reflects on the fact that, **to truly do well in markets, one has to truly love the game.**

When it comes to trading and investing, those who do <u>not</u> love the game are at <u>a distinct and permanent disadvantage to those who do</u>.

For the individual without passion — or with insufficient passion — trading is hard and grueling work for which the upside does not outweigh the downside.

For the individual who loves all aspects of trading, on the other hand, it becomes the most fascinating and fulfilling line of work imaginable. **Intensity of engagement makes the yoke easy and the burden light.**

(That is one of the many edges that we as Mercenaries bring to the table. Though Mike McD and I routinely put in ten hour trading days, day in and day out, the vast majority of them feel like play. Sometimes it feels almost criminal…)

Trading as one's prime vocation is unquestionably one of the greatest gigs on the planet. For a certain odd breed, there is nothing better than stepping up and solving the puzzle each day.

But sometimes it's *hard — damn hard* — in the way that being an ironman triathlete can be hard. The bone-deep level of commitment required can seem nutty for those on the outside looking in.

An elevated threshold for psychological pain and discomfort also counts as a "must-have." **You need the love to overcome the friction, and the joy to overcome the pain.** Druckenmiller had it for 30 years straight, and then he finally got tired. (Or rather, the tiredness finally got him.)

Note again too, Druckenmiller didn't say he's retiring completely, but only from public money, with plans to still run a chunk that will be "fun." The pilot light remains lit.

And that leads us to the final (perhaps surprising) lesson: <u>The money doesn't really matter</u>. Not once you've gotten past the thrill at least. (*"Woohoo, I'm rich! Wait a minute. Now what?"*)

## Lesson #4: THE MONEY DOESN'T MATTER

If you possess the requisite drive, temperament, and talent — and admittedly very few do — trading is unquestionably a viable path to getting rich. As Jack Schwager noted in Market Wizards.

> Trading provides one of the last great frontiers of opportunity in our economy. It is one of the very few ways in which an individual can start with a relatively small bankroll and actually become a multi-millionaire.

Yes, but…

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But at the end of the day, what matters most is **quality of life and overall personal fulfillment**, not dollars accumulated, Ferraris parked in the climate-controlled garage, or fleeting accolades achieved. *Sic transit gloria*, remember?

This is partly because the pursuit of monetary wealth, in and of itself, is largely a trick and a trap. Those individuals who pursue money for its own sake are almost invariably chasing some demon, or feeding some insecurity otherwise masking itself as ambition.

And in terms of personal stature, no matter how much money you have, **someone else will always have more**. If you delude yourself into thinking you're the richest guy around, that's just a failure to look around.

More importantly, one can be "rich" in plenty of ways *above and beyond* money. To benchmark one's sense of self against a bank account balance — equating self worth to net worth — is an invitation to shallow misery.

You get the idea… bottom line being, it's not about the money — no matter how many zeroes are tacked on to your net worth. Besides, as one less-rich-than-before Wall Streeter told the *New Yorker* after the 2008 meltdown: "Once you get above $30 million or so, it's all philanthropy anyway."

So why did Druckenmiller play the game for 30 years straight, piling up treasure he will likely never spend (or just wind up giving away)?

Most likely for a reason we have already touched on, and the same reason a great athlete fights off retirement until age forces the issue: **For the sheer love of the game**.

Doing what you love, and doing it every day, is a key ingredient in the secret recipe for a blessed and fulfilled life.

We'll close with a bit of wisdom from Zen And The Art of Motorcycle Maintenance:

> To live only for some future goal is shallow. It's the sides of the mountain which sustain life, not the top. Here's where things grow. But of course, without the top you can't have any sides. It's the top that defines the sides.

Carpe Jugulum,

JS

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