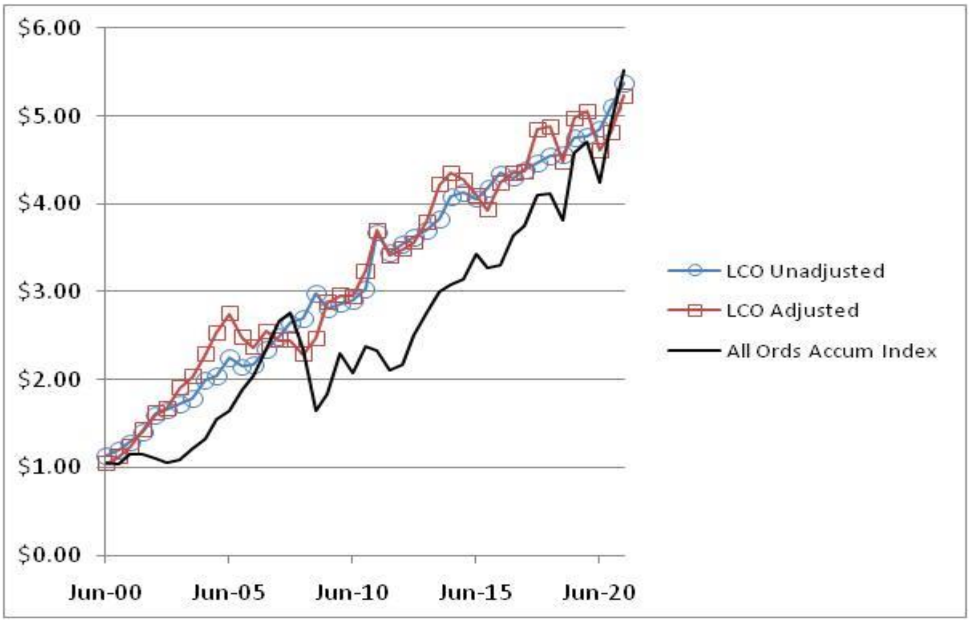
Our Performance History

Leithner & Company Limited ("Leithner & Co") is an unlisted public company, established in 1999, limited by shares and based in Brisbane, which specialises in the purchase and long-term ownership of securities. Although past results don't guarantee future returns, we're cautiously optimistic that – subject to the caveats below – our conservative approach to investment and risk management will enable its portfolio's future long-term rate of return to match and possibly exceed that of a diversified portfolio of Australian stocks, bonds and cash.

Our Returns since Inception

> *Over more than 20 years and through three crises (Dot Com Bust of the early 2000s, Global Financial Crisis of 2007-2009 and Global Viral Crisis of 2020-?), Leithner & Co has generated solid returns for its shareholders (Figure 1).*

Figure 1:
Growth of an Investment in Leithner & Co, June 1999-June 2021[1]



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1 In September 2013, RPSs replaced the former class of shares. We have adjusted the results in Figure 1 to ensure that the results reflect what would have occurred had the RPSs been on issue since inception.

Each dollar used to purchase Leithner & Co's Redeemable Preference Shares on 30 June 1999, if the dividends received every six months had been reinvested to purchase more of its shares, would by 31 December 2020 have grown to \$5.38 (unadjusted for the portfolio's unrealised "mark to market" capital gains and losses) and \$5.23 (adjusted for MTM).

This equates to total gains of 438% (unadjusted) and 423% (adjusted), and compound rates of growth of 8.3% per year (unadjusted) and 8.2% per year (adjusted). Each \$1.00 invested in the All Ordinaries Index in June 1999 (dividends reinvested) would have grown to \$5.52 in June 2021. This equates to a total gain of 325% and a compound rate of growth of 8.5% per annum.

Some Cautions for the Future

It's important to emphasise that past results don't guarantee future results. Accordingly, when considering Leithner & Co's objectives, past results and future prospects, keep these points in mind:

- risks accompany any investment (including Leithner & Co's shares);
- the more ambitious are your expectations, the greater is the likelihood that they'll be disappointed;
- in ca. 30% of 12-month periods since the 1870s, stock markets in Australia (which were state-based until the formation of the Australian Stock Exchange in 1987) have generated negative results;
- investors such as Leithner & Co who perform well over the long-term nonetheless regularly "underperform" (i.e., produce year-to-results which are inferior to others' or some relevant benchmark) in the short-term.
- Leithner & Co has tended to "underperform" during periods of economic boom or financial euphoria; on the other hand, its actions during busts (when it has deployed its large cash reserves to the purchase of attractively-priced securities) have underpinned its long-term performance.

> *Accordingly, given the very high and perhaps extreme valuations that currently prevail in the world's stock markets – including Australia's – it's neither prudent nor realistic to expect a medium-term (ca. 5-10 year time horizon) or long-term (ca. 10-20 year time horizon) compound annual return of more than ca. 5-10% per annum.*

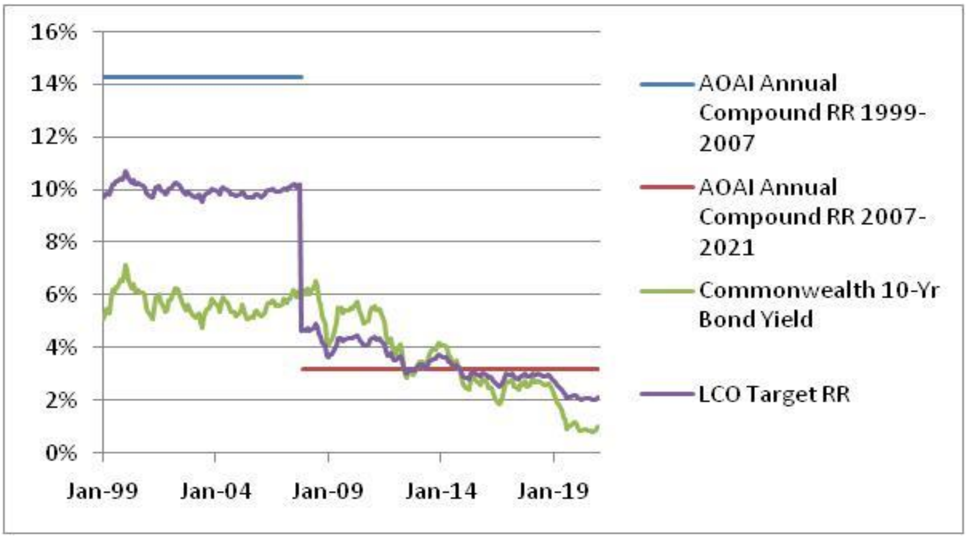
To understand this key point, bear in mind that, since its inception, Leithner & Co has sought to acquire and hold a portfolio of quality securities whose long-term rate of return can reasonably be expected to (1) exceed the yield of the ten-year Commonwealth Government bond and (2) approach the rate of return of the All Ordinaries Accumulation Index (AOAI). Figure 1 confirms that we've achieved these objectives. When stocks are excessively dear (which, as detailed in our Annual Reports and Half-Year Reports over the years, has been the case most of the time since 1999), prudence demands that we accumulate cash and term deposits. The more we do so, the more our return will tend to approximate the ten-year bond's yield than the AOAI's average return. A portfolio comprising 50% bonds/deposits and 50% stocks, which reflects Leithner & Co's since 1999, implies a target rate of return midway between the bond's yield and the AOAI's long-term return.

It's vital to acknowledge that since the GFC both the AOAI's annualised rate of growth and the Commonwealth bond's yield have plummeted. Consequently, Leithner & Co's target rate of return has, too.

Using monthly measurements, Figure 2 plots

1. the AOAI's annualised compound rate of return from June 1999 to June 2007 (i.e., the period from Leithner & Co's inception to the GFC);
2. the AOAI's annualised compound rate of return from June 2007 to December 2020 (i.e., the period since the GFC);
3. the yield of the ten-year Commonwealth Government bond; and
4. Leithner & Co's target annual return (that is, the midway point between the Index's rate of return and the bond's yield).

Figure 2:
LCO's Benchmarks and Target Rate of Annual Return



The bond's yield forms the lower bound of LCO's target, and the AOAI's return is its upper bound. From 1999 to 2007, the AOAI's compound rate of return exceeded 14% per year and the bond yielded an average of 5.7%; hence LCO's target rate of return was (14.3% + 5.7%) ÷ 2 = 10.0%. From June 2007 to December 2020, however, the AOAI rose just 3.2% per year, and the bond yielded an average of just 3.5% – and since early 2019 less than 1%. *As a result, our target rate of return slid from 4.7% in late-2007 to below 3% in 2016; in 2020, it hovered just above 2%.*

This target, bulls snort derisively – and particularly in the wake of the market's rapid erasure of the huge losses it incurred in February-March 2020 – is far too modest. Yet unlike their assertions, it's logical and realistic; it also mirrors responsible actors' assessments. According to *The Sydney Morning Herald* ("Are Investor Expectations Realistic in a Low-Return World?" 30 October 2019), for example,

> There are almost daily reminders that we are living in a world of slower growth and ultra-low interest rates, and few see this situation changing anytime soon. However, how much have investors adjusted their expectations about likely lower returns? Probably not enough ... [Therefore] you have to ask, just how realistic is it to expect returns in the double digits?
>
> *Not very, unless you are comfortable taking on quite a bit of risk.* [That's] also the view of the Future Fund ... Chairman Peter Costello ... says it will be hard for the Fund to keep hitting its much less ambitious target return of the inflation rate plus 4-5% ... "We would say that in the environment we're looking out to, that's a very aggressive target ..." *If you add all that up, the starting point is pretty low in terms of [realistic] return expectations* [italics added].

Beware Others' "Average Return"

Investment managers seldom report their results meaningfully. As a result, we believe, and whether unintentionally or otherwise, they do so misleadingly! Specifically, they hardly ever follow the approach adopted in Figure 1:

- take a given (say $1) amount as a starting point;
- invest this amount over one, five, 10 and 20 years;
- compare the original investment to the amount (after fees and taxes) that emerges after these given periods of time;
- compare these results to those of the AOAI or other justifiable benchmark.

In other words – and vitally – other investment firms seldom express their results (and its comparison to its benchmark) as a *geometric mean*, i.e., as a compound annualised growth rate. Instead, managers typically parade an average (arithmetic mean) or series of averages over some non-representative (and, almost always, flattering to themselves) interval.

> *In particular, they laud their short-term results during booms, or during the recoveries from busts; rarely, however, do they show long-term results that encompass both booms and busts. Even worse, they laud their "average return" over this advantageous interval as if it were meaningful. Yet an average percentage return often isn't informative: quite the contrary, and regardless of the interval it purportedly describes, it can often be downright misleading.*

Consider as an example a two-year period of investment. Let's say it gains 20% in its first year and then loses 20% in the second. What's the investment's return? Many people would say zero. The average (that is, arithmetic mean) of these two percentages, after all, is (20% - 20%) ÷ 2 = 0%. Yet that's potentially deceptive. If you invest $1 in this example, then during the first year your investment increases by 20%, such that at the end of the year you have $1.20. During the second year, however, you lose 20% such that you have $1.20 x (1 – 0.20) = $0.96. At the end of Year 2 you've lost an amount ($0.04) equivalent to 4% of your initial investment.

> *The average return might be zero, but the total return is -4% and your compound annualised growth rate (CAGR) is -2.02%.*

This example draws attention to another important point: in order to recoup a given loss, the investor requires a greater positive return than the negative return that generated the loss. A loss of 20% requires a gain of 25%: $0.80 x (1.25) = $1.00. Further, the CAGR from x periods of y% returns exceeds any other sequence that averages y%. If you earn 5% per year for three years in succession, then both the simple average return and the CAGR are 5%. If, however, you earn 6% in the first year, 5% in the second and 4% in the third, your simple average return remains 5% but your CAGR drops to 4.997%.

This difference is seemingly insignificant; its implication, however, is anything but. *The greater is the volatility of year-to-year returns, the lower is the CAGR versus the average return.* If your return is 9% in the first year, 5% in the second and 1% in the third, the CAGR falls to 4.95%. And if you gain 10% in the first year, lose 10% in the second and gain 15% in the third, the average rate of return remains 5% but the CAGR falls to 4.42%.

> *The greater the number of negative returns in a series of returns, and the more volatile the components of the series, the less meaningful and the more misleading is the average percentage return. Even before others' deductions of various and hefty management fees, this combination of negative returns roughly one-third of the time and volatile returns most of the time conspires to compound investors' capital at a much slower pace than the propaganda of the funds management industry – and its average percentage returns– encourages investors to believe.*

Beware Exceptional Short-Term Results!

How important are short-term (that is, over the preceding 12 months) rankings of investment mangers' (which are typically managed funds) results? How should investors interpret them? In a key sense, these rankings ARE important – but NOT in the way that many advisors, journalists and others assume and want you to believe.

> *At the beginning of the calendar year, and again at mid-year, when they come thick and fast, as an investor you should heed them in one respect only: use them to consider culling funds that have greatly "outperformed" (if you own one or more) or exclude them from consideration as new holdings (if you don't). Otherwise, ignore them – and certainly don't chase short-term outperformance!*

What the speculating crowd – which, unfortunately, includes most professionals – mostly ignores is what really matters: in the short-term, it's vital to avoid the risks that occasionally achieve astounding but ephemeral gains but eventually produce hefty and often permanent losses. The prudence that generates unexceptional outcomes year after year and through thick and thin might be monotonous; yet it also cumulates into rewarding long-term results.

"It's January," wrote Mark Hulbert ("The Year's Fund Returns Are In – Do They Matter?" *The Wall Street Journal,* 7 January 2018), "which means it's time for all those performance scoreboards, highlighting top-performing financial advisers, investment-newsletter editors [and managed] funds of the previous year."

- According to these rankings, a handful of funds and managers "outperform" – that is, their returns for the previous 12 months greatly exceed their peers and benchmarks.
- Journalists don't just profile short-term outperformers; they laud their seeming brilliance – particularly their ostensible prescience. "A year ago, Fund A's managers anticipated that X, Y and Z would occur," runs the standard patter, "and these things did come to pass. Its managers implemented an appropriate strategy, and the results speak for themselves."
- Mainstream and "social" media don't merely imply that short-term outperformance is a matter of foresight: they also hint that top-performers' alleged insight will continue during the next 12 months – and that you would do well to mimic or join them.

What Short-Term Rankings Seldom Mention

"In theory," writes Jason Zweig ("What We Already Know about Investing in 2021," *The Wall Street Journal*, 8 January 2021), "investing is all about markets; in practice, it's more about marketing. What will financial marketers sell in 2021? The same thing they always sell: whatever did the best last year." What they don't tell you is that chasing short-term outperformance – that is, ploughing your capital into one or more of the current crop of star performers – is a thoroughly bad idea.

> *Short-term outperformance is mostly the consequence of chance rather than skill. Moreover, repeated short-term outperformance is more likely a sign of recklessness than of shrewdness.*

Hulbert cautions that speculators who enjoy terrific results today will, more often than not, suffer terrible ones tomorrow:

> Consider the Persistence Scorecard that is periodically updated by S&P Dow Jones Indices. It measures the odds that a [managed] fund will remain an above-average performer for several years in a row … S&P DJI found that "an inverse relationship generally exists between the measurement time horizon and the ability of top-performing funds to maintain their status." *In other words, as you focus on shorter and shorter time periods, there is a higher and higher chance that the top performer in one period will be a bottom performer the next [italics added].*

If that's not bad enough, notes Hulbert, it gets even worse:

> These scorecards can provide some worthwhile information. *But beware: They also can be hazardous to your wealth. That is because sooner or later, but probably sooner, ... investing kingpins will incur losses so large as to make it almost impossible to ever recover.*
>
> Consider the performance of a hypothetical portfolio that each January invested in the recommendations of the investment newsletter at the top of the previous calendar year's performance rankings. According to [research conducted by Hulbert Interactive], this portfolio created from each year's winners has lost

> almost everything – incurring an 18.0% annualized loss since 1991. *So, $100,000 invested in this portfolio back then would be worth just $471 today. This suggests that the appropriate response to the one-year performance sweepstakes is to run, not walk, the other way* (see also "How to Lose 93% of Your Money … And Be Happy About It," *The Wall Street Journal*, 12 January 2018).

What causes a handful of advisors, funds and managers, during almost any 12-month interval, to produce results that greatly exceed that period's average? *Hulbert finds that it's NOT skill. It's probably mere chance; and if it's not a lucky roll of the dice then it's the draw of a dodgy set of cards. Most short-term outperformers, in other words, are mere flukes; and a few "pursue wildly risky strategies."* Consequently,

> Though on average they lose, occasionally one of them will hit the jackpot and rise to the top of the annual rankings. By choosing that lucky adviser or manager, investors who invest ["speculators who speculate" is more apt] with the previous year's top performer are in effect betting that lightning will strike twice. *They inevitably get sabotaged by … sky-high risk.*

Career Risk + Investment Risk + Fund Mortality = Overstated Long-Term Results

Why, according to Hulbert, do some advisors and managers act so recklessly? *The risk to their careers that results from underperformance compels them to jeopardise other people's money.* Unless they take big risks, they can't hope to generate the stellar short-term results that attract the mainstream media's fawning attention. The publicity that results from a lucky roll of the dice, in turn, enables the large inflows that underpin fat management fees. *Yet as time passes risky actions produce increasingly bad results.* For this reason, before long many funds (their average lifespan in the U.S. is ca. 7 years) close or merge; the rotation of managers within funds is even more frequent. *This high rate of "mortality" obscures many funds' poor long-term records; it thereby encourages their managers to resume (albeit under a new guise) their risky short-term ways.* The resultant "survivorship bias" understates most managers' – and funds' – long-term "underperformance."

In the surveys it's conducted annually since the 1980s, S&P Dow Jones has found that at least 85% of investment managers have failed to meet their benchmarks over periods of five years; of the rather small number that last long enough, ca. 95% fall short over 15 years. No wonder they're culled ruthlessly! In the decade to 2012, according to John Bogle, the founder of Vanguard, every year an average of 7% of all funds closed or merged. That's versus just 1% per year in the 1960s. Of the roughly 6,500 funds that existed in 2002, approximately 5,500 – an astounding 85% – had "been liquidated or merged" by 2012. Bogle expected that this high rate of mortality would continue. If so, then at least 3,000 of the 4,600 funds that existed in 2012 won't in 2022.

In "The Mutual Fund Graveyard … and Its Implications for Investors" (*Seeking Alpha*, 1 June 2016), Louis Kokernak asked: "what problems arise from all these 'deaths'? One of the foremost is the survivorship bias introduced to mutual fund performance aggregates." Survivorship bias is the error of logic that occurs when you observe and measure only the people or things that passed (or survived) some selection process – and overlook those that didn't. If the average scores of survivors and non-survivors differ significantly, then biased inferences occur.

In other words, if we take surviving managed funds as representative of all funds (and thereby ignore those that have closed, failed, merged, etc.) and if existing funds' performance exceeds extinct ones' then we exaggerate funds' performance. Survivorship bias plagues the managed funds industry. Kokernak concludes: "The funds that disappeared tend to be those that have logged poor investment performance … It's pretty clear that a lot of skeletons are getting stuffed in the closet" (see also "Can We Be Brutally Honest about Investment Returns?" *The Wall Street Journal*, 19 January 2018).

What, Then, To Do? A Hypothetical but Realistic Example

Consider a well-to-do couple, family trust, SMSF, etc., which possesses a long-term perspective and the brains, but not the desire, to invest and manage their own funds. What should they do? *First, given the results of Hulbert's, S&P's and others' research, they should either ignore the latest performance ranking – or else use it to exclude recent "outperformers" from consideration.* In Hulbert's words, managers who invest prudently and thereby possess strong records of "long-term performance … are hardly ever at the top or bottom of the calendar-year rankings. Slow and steady really does win the race."

This point is fundamental. To see it as clearly as possible, consider as a hypothetical but realistic example the three managed funds in Table 1. (As an aside, the order of each's annual results doesn't affect its three-year compound rate of return.) Fund A greatly outperforms in Year 1 – at whose end, and as a result of laudatory media reports, it likely attracts hefty inflows from speculators. Alas, it incurs a hefty loss (and wins the wooden spoon) in Year 2 – which prompts strong outflows. Speculators who thought they were investors (or investors advised by speculators) bought its units high and sold them low – which is hardly a recipe for success! Fund B greatly lags in Year 1 but excels in Years 2 and 3.

Table 1:
Three Funds over Three Years: the Steady Tortoise Beats the Erratic Hares

Fund	Year 1	Year 2	Year 3	3-Year Std Dev	Annualised Compound RR
A	20%	-12.5%	10%	16.6%	4.9%
B	-10%	15%	12.5%	13.8%	5.2%
C	10%	7.5%	6.25%	1.9%	7.9%

In contrast, in no single year does Fund C lead the field; indeed, each year its return is just one-half of the top-ranked fund's. Furthermore, in Year 3 it trails the others – and its results fall year by year. Yet two key points distinguish it: first, it never incurs a loss; second, from year to year its results are the steadiest (i.e., its standard deviation is the lowest by far). *Over the three-year period, these traits make all the difference: Fund C's three-year return,* *expressed as an annualised compound rate of return, handily exceeds A's and B's.* Ignoring costs, fees, taxes, etc., $100 invested in Fund C at the beginning of Year 1 would compound to ca. $125.64 at the end of Year 3. That amount exceeds Fund B's cumulative total ($116.44) by almost 8% and Fund A's ($115.50) by almost 9%. *If this disparity persists, then as time passes Fund C will leave A and B ever further in its wake.*

What to do? Secondly, advises Hulbert, focus on those managers, strategies and vehicles with excellent long-term results. "The clear implication," he elaborates, is that

> You improve your chances of picking a [winner] by focusing on performance over periods far longer than one year. How long? *Our analysis … suggests that even 10 years isn't enough. Only when performance was measured over at least 15 years were there better-than-50% odds that a top performer would be able to repeat*. [Moreover,] when following a top performer over the previous 15 years, you are unlikely to be at the top of the rankings in any given calendar year ...

To Hulbert's second point we add a twist. It seems to us that it makes sense to locate investment managers with a track record of 20 years or more, and then ascertain:

- What kinds of results did they generate during the Dot Com Bubble of the late-1990s and the boom years before the GFC?
- Do these results suggest that they took undue risks? What about their results during the Dot Com Bust of the early 2000s and the GFC? Do their results in the bust confirm that their actions during the boom were unduly risky?
- How many years did they require to recoup the losses they incurred during bear markets?

The problem is that few managers possess track records of 20 or more years; fewer still lose comparatively little during bear markets and crises, and are therefore able to recoup their losses reasonably quickly. The good news is that your list of candidates certainly won't be long; hence your choice probably won't be difficult!

Long-Run Outperformers Are Short-Run Quiet Achievers

Three attributes distinguish long-run outperformers: first, year after year they generate reasonably consistent, almost always positive but rarely top-ranked results; secondly, their number is very small; thirdly, in the short term they're quiet achievers. It's important to emphasise: *long-term outperformers' results within any 12-month interval are usually unremarkable; indeed, as Table 1 showed, they're often sub-par.* For this reason, journalists' coverage of performance scorecards ignores them. Hulbert found that long-run outperformers'

> average yearly performance rank ... was at the 59th percentile. But that's a shortcoming only if you're a thrill seeker who finds it intolerably boring to be merely ... at the top of the rankings for very long-term performance … *[Accordingly, and assuming that] you are seriously focused on building up wealth*

over the long term, you should be more than willing to give up the hope of ever being at the top of the calendar-year rankings.

To the mainstream, the implications are startling and disconcerting:

1. Short-term outperformance doesn't promote long-term outperformance; if anything, it hinders it.
2. Hence chasing short-term outperformance depresses long-term results.
3. Moreover, how much your investments gain during booms isn't important; what's vital is how much they avoid losing during busts.

Never forget that investment is a long-term marathon and that speculation is a short-term sprint. Moreover, you're not competing against others; you're striving to reach the destination you've set. Also recall Aesop's parable of the tortoise and hare – and its lesson that boringly slow yet reliably steady ultimately prevails. Accordingly, either ignore short-term rankings entirely or heed them in one respect only: use them to consider culling (if you own one or more of them) or exclude from consideration (if you don't) "hares" that have greatly outperformed during the past twelve months. Those that have merely been lucky almost certainly won't repeat their good fortune; and those which have taken undue risks will sooner or later receive their comeuppance at your expense.

If you're an investor then you should either be a "tortoise" or seek one to manage your funds. It's not despite their unremarkable results year after year, but because of them, that they generate exceptionally good compound returns over periods of 20 or more years. If you find one, it likely won't put you in a position to brag at weekend barbeques during the next few years. Equally, you won't be sobbing into your beer at your next couple of Christmas lunches or New Year's Eve parties. But in a decade or two, the odds are that you or your heirs will have plenty to celebrate.

Conclusion

Leithner & Co's portfolio – which from its inception has always carried a heavy load of cash and term deposits – generates a short-term expected rate of return that's somewhat lower but much more stable than an all-stock portfolio. Its relatively stable returns over shorter intervals – and particularly its avoidance of large losses – underpin its strong long-term results. So too does its heavy reliance upon dividends and other income from distributions and de-emphasis of capital gains ("speculative returns").