Rogoff's law

Lawrence Gosling talks investment strategy with Ben Rogoff, lead manager of the Polar Capital Technology Trust, and quizzes him on his formula

Lawrence Gosling: How do you approach buying into a stock?
Ben Rogoff: My very first investment job I worked for a guy who was a natural investor, and he taught me a lot about how people invest. The easy option is always to average down and the much harder thing – in life as well as in investing – is to average up.

Humans like the idea of buying and selling at 100 and then if it falls to 90, that's even better – but not necessarily.

It does depend on what you're investing in, however. With mean-reverting assets, it makes perfect sense to be averaging down. But in an industry like technology, where things are not really mean reverting, averaging up is key. MySpace hasn't come back, for example, and Yahoo! is not staging a recovery against Google any time soon.

In an industry where mean reversion is notably absent then buying the dips is a very different proposition. And much also depends on your investment timeframe, of course, that's the other key dynamic.

My experience is that some of the most expensive stocks I have owned have gone on to become the biggest winners in the portfolio. And some of the cheapest stocks I've ever owned have proven value traps.

That may be unique to technology, so I don't want to pretend I have the answers to how you invest across the spectrum, just about what I do in tech. And the answer there is we're keen to average up into stocks that are working and where the fundamentals are improving. I find it very hard not to average down when the opposite is true.

Obviously if a stock has fallen and it's not obvious to you why, to the extent you can establish there's no news, then I would add to it, but it's not slavish.

LG: What is your approach to selling?
BR: I'm pretty hard when it comes to selling. What we do as a rule is monitor all the stocks that aren't working, or aren't performing in the way you would expect. If you buy a value stock and value is out of favour, then you should expect it to perform poorly. It's the ones that don't act how you anticipate we are looking for.

This comes with experience. In the same way a doctor, or an expert in any field, will recognise something that doesn't feel right, it's the same for an investor.

We have a look at the portfolio of 100 stocks in the Polar Capital Technology Trust (PCT) every week, and then each month I will have more of a discerning look. For stocks that don't act right, you go back and redouble your efforts to check you haven't got it wrong. Next, call the analysts and, if you can, the company. Ultimately, the key about investing in my opinion is trying to cut losers.

LG: When do you initiate or add to a position?
BR: It depends how excited you are by it. For example, if you are looking at Google, post-initial public offering (IPO), it was a pretty unique asset at that time, likewise Facebook and Alibaba. As a professional manager, chances are I'm going to buy some and, in those particular cases, you might only buy a half of what you'd like to own.

I'll give you a real example: Airbnb, which went public last year, is an asset I wanted to own, and we'd done lots of work on it during the IPO process. We went for it but didn't get much because it was very over-subscribed. When the stock fell back and it hit levels we would have bought in at the IPO, we got more of it.

If it's a really important asset, a big index name or something that will change the world, as a professional manager you know you have to have it. And in the case of Airbnb, it's not a cheap stock, so we'll take a small position, keep an eye on it and hope that we'll get the chance to pick it up at cheaper prices.

LG: Where does the issue of patience come in?
BR: I'm not a big fan of patience. We make thousands of trades a year. We don't buy a hundred different stocks but we're trading around core positions. We have inflows or outflows on our open-ended funds, for example, so we're trading regularly.

One of the things about that is you don't get so hung up on what the initial price of an asset is. If you find winners, the price will never go back to what it was before people realised it was a winner.

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Understanding that the price of something - the audience for that stock – has a big impact on the clearing price. It doesn't get rid of the concept of patience, it sort of cuts across it.

One of my favourite sayings is, if you're going to panic, panic early. If it's an asset you really feel you have to have, then worrying about 5% here or 10% there on a stock that might be delivering 50% growth, the assumption is that you are being 'patient' but the implication is that you believe you know what the price of that asset is.

My advice would be that most of the time being prudent is the right thing to do in life. Sometimes when you have a strong feeling about something, or if your gut tells you to have exposure to something, I would scale my position.

So having told you that scaling down is not necessarily the right thing, if your gut says you should own some of this but you're uncomfortable with the asking price then buy some but buy less.

LG: What would be an important lesson for investors?

BR: Think about the value at risk. When you buy shares in, say, Google today, it's highly unlikely you are going to lose more than 50%. The value at risk is probably more like 20% or 30%. Mega-caps – well-established businesses – have a much lower value at risk than micro-caps.

It's an important point; to understand what you can lose as a percentage of your money and with that in mind, you build the position sizes of individual investments accordingly.

Another thing I would say on selling, there's obviously profit-taking, which is prudent. I liked it when it was 'X' amount and now it's much higher and I can't justify that, so I'm going to take some profits. That's a perfectly reasonable thing to do.

Again, if you ask various managers, they'd say that over time that's not a terrific strategy because if you've got the right asset and it's gone up because other people are recognising its worth, it's still the right asset. Selling it would be a mistake; you should run it and run it.

In theory, running winners is a good thing to do. You sanity check that with a valuation framework. We've owned Google and Facebook since IPO. And we run them as they are winners. But I like to take profits and that's why I trade around my core positions. What that does is give me firepower to buy that if it does pull back. If I've already got the maximum position I can ever hold in stock 'A' and then stock 'A' for whatever reason falls by 10%, I won't add to it. So the top slice is a method, not just to bank profits but also to then give me the ability to buy on weakness. ■

Lawrence Gosling is editor-in-chief of What Investment. www.whatinvestment.co.uk