Transcript
The Ideas Exchange - Episode 53

Beyond buy and hold: A guide to long/short strategies

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Aaron Viscayno (00:00):
Hello and welcome to The Ideas Exchange, ASX's regular podcast where we cover investment trends, market updates, and ideas for your portfolio. My name's Aaron Viscayno, business development associate from the investment products team here at ASX, and it is our mission to deliver to you the latest in market updates and ideas through the conversations we have with investment experts.

Speaker 2 (00:23):
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Aaron Viscayno (00:51):
Everybody welcome back to the ASX Ideas Exchange podcast. I'm your host, Aaron Viscayno, and welcome to the final episode of our thematic series. Today I'm glad to be joined by the head of Long Short Strategies and the portfolio manager of the Plato Global Alpha Fund at Plato Investment Management. Dr. David Allen, thanks for joining us.

Dr David Allen (01:09):
Thank you very much. Great to be here.

Aaron Viscayno (01:11):
With more than two decades of experience working with global equities, Dr. Allen has spent 15 years at JP Morgan Asset Management in London where he managed the JP Morgan Europe Equity Plus Active Extension fund and also founding and managing the JP Morgan Europe Equity Absolute Alpha Market Mutual Fund. He holds a bachelor of business with first class honours from UTS and a PhD from Cambridge in quantitative finance. Dr. Allen was also given the honours as the European Hedge Fund Manager of the Year with UCITS back in 2014.

David, the accolades go on and on and on. Most notably to me though, is that prior to your investment management career, you used to be a professional rugby union player.

Dr David Allen (01:52):
Yeah, long time ago. Long time ago, but yes, did my first degree in Australia. Then a couple of years after that, I was playing for Eastern Suburbs in Sydney and then got a contracts to play overseas, was playing over in Ireland for Ulster. And then in the first 12 months actually I managed to injure my neck. I kept losing feeling in my arms and the doctors got together and said that it would be prudent to hang the rugby boots up, but it was probably a good thing that they did. I was in London two weeks later and two weeks after that I was in the right place at the right time. Landed a great job at JP Morgan Asset Management in London, and I remember thinking I'd be there for just a year or two, do the typical Aussie thing where you're over there, see the world for a bit and then come home. But ended up being there 15 years for my sins and had some great memories and worked with some incredible people before coming back about half a dozen years ago.

Aaron Viscayno (02:55):
Terrific, thank you. And look, now at Plato for more than seven years. For our audience listening in, could you give a brief overview of what you do at Plato?

Dr David Allen (03:03):
So I am co-head of research, so what that entails is driving the investment process, helping to create that investment process, which is really about how we pick winners and losers, how we manage the risk in our portfolios. I'm also a portfolio manager or the portfolio manager for the Plato Global Alpha Fund, which it's a long short strategy. So what does long short mean? There's a lot of jargon in finances in there, but all it really means is we just use a lot of jargon to make ourselves seem smarter than we really are. But a long short fund, all that means is we buy stocks, so that's also known as going long stocks that we hope will appreciate, that'll do well. But we also do the opposite where we identify companies where we think there might be fraud, there might be a business model coming under pressure or potential bankruptcy, and we go short those companies and if those companies go down, then we actually profit from those positions.

Aaron Viscayno (04:08):
Got you. And it sounds like you're the man to be speaking to when it comes to long short strategies here in Australia. And I'm actually kind of keen to break it down into the two respective components. So let's start with long positions. What are they and why do investors do it?

Dr David Allen (04:22):
Yeah, sure. Thanks. So long investing is just buying companies. It's the oldest, most traditional, most plain vanilla way of investing, and really in the long term, markets work, capitalism works and the market appreciates over time. So that traditional buy and hold strategy can be phenomenally successful. It's just a way of accumulating wealth over time and stocks for the long run.

(04:54):
A great story I always remember hearing was a friend of mine, his grandfather was in the war and he was a doctor and he was seeing a patient one time, and this was many, many years down the track, and his secretary came in banging on his door saying, "Dr. Dunlop, Dr. Dunlop, I've got something to tell you." And he's saying, "Oh, I'm with a patient. Go away. Come back later." And she goes, "Oh, you're going to want to hear this." And they found some old share certificates that he'd bought just after the war 50 years prior and it was for a few thousand pounds and he'd lost them and forgotten all about them, but they're worth over a million dollars now. So the power of compounding, the power of buy and hold is that's why you'd go long companies.

Aaron Viscayno (05:42):
Got you. And on the flip side as well, short positions, could you provide some more context on what that is?

Dr David Allen (05:48):
Sure. So shorting is just the mirror image of that. It's just when you're identified. There's a lot of great companies out there, absolutely. But there's a lot of companies that aren't so great that they're the Nokias of their time, where the iPhones come along. They're the Kodak cameras prior to the digital cameras coming along. So we're always looking for companies that are being disrupted in terms of their business models or maybe they're being managed very, very poorly and we can take short positions in those and if they go down, then it allows us to make profit for our investors. At its most simplistic level, long short investing, when you put those two components together, you can think of it as a pairs trade almost.

(06:41):
So say for example that there's two stocks in the world, there's Pepsi and there's Coca-Cola, and you're of the view that Pepsi is going to be the huge winner going forward and say that this is 25 odd years ago and Coke are just going to release their new version of Coke, which was a business disaster. They reformulated the product. It tasted differently and it was still used in case studies in business schools for what not to do. So say that you were sitting there way back then and you knew, you had this foresight, say Coke's really going to come under pressure, then what you

could have done then is go long Pepsi and go short Coke. The great thing about that is whatever happens to the general market, it goes up or down, whatever happens to that consumer sector of the market goes up or down, that doesn't really matter because it affects both stocks broadly equally, and you'll just make that differential return based on, in this case, Pepsi outperforming Coke.

Aaron Viscayno (07:45):
Sure. And I mean to go back to your talk through long positions, I think that's what the majority of our investors are going to be familiar with. In terms of a comparison between a long only kind of strategy versus a long short, what kind of advantages and disadvantages would you be seeing?

Dr David Allen (08:00):
Yeah, great question. So say that for a traditional long only manager, you've identified one of these companies where you think the accounting's really aggressive and could even be fraud or the management's subpar or any of these sorts of things, all you can really do if you're a long only traditional investor is not only the company, so you can't really monetize that hard-earned information that you have. The beauty of long short investing is it's sort of you can then make money on the downside as well. So by comparison, you could argue that long only investing is sort of fighting with one arm tied behind your back.

(08:42):
And fundamentally, I'm totally convinced that I've run big long only funds and big long short funds, and it is far, far easier to generate great returns for your investors in a long short structure. And the sovereign wealth funds around the world, the big Middle Eastern and Asian sovereign wealth funds, they're fully aware of the benefits of that long short investing and have huge asset allocations along that dimension. And it really is traditional long only funds management. It is challenging to outperform the market. Not many funds can consistently do it, but the second that you're more unconstrained, the ability to short, you can generate a lot of alpha. Our strategy played at Global Alpha over the last almost four years, we've generated almost 24% returns per annum after fees. And in terms of that performance, over half of it has been through the short side.

Aaron Viscayno (09:42):
Great, thanks so much. So with long short investing, it sounds like you're looking to strike a real balance between long and short investing obviously. How does you, as a fund manager, how do you achieve a balance between them to determine the net exposure?

Dr David Allen (10:00):
Yeah, good question. Generally, and I sort of mentioned the terms pairs trading before and in what we do, it is similar to that. So we don't want to just go along a whole bunch of technology names because then say that there's a tech crash that can really hurt us. But if you go long collection of fantastic technology companies and also short selection of really stressed unprofitable technology companies, then the real benefit of that is that sort of hedges out your technology sector risk. And that's really the beauty of long short investing. It allows you to balance up the different sides of the portfolio and give smoother returns for investors over time.

Aaron Viscayno (10:45):
Great, thanks for that. And so obviously you've talked about a lot of the plus sides of the long short strategy. For our listeners who are avid investors as well, could you just talk to what kind of a role a long short strategy can play in their portfolio as a retail investor? Say for example, can they be used as a core investment or satellite investments?

Dr David Allen (11:06):
Yeah, no, really good question. And the answer is it depends. There's long short strategies that are quite volatile, high octane, sex and violence, swing for the fences. Our approach is definitely not like that. We have a very diversified portfolio, and if you look at the risk of the portfolio overall, it's very similar to the volatility of a Vanguard Index Track that has thousands of securities in there. So it's quite modest in that amount of risk and as a result is often used as a core allocation in client's portfolio. So it really depends which long short strategy you're really looking for. Particular to our approach is that we are long 150% and short 50%. So 150 long minus 50 short gives 100% net exposure. So that's the same as a long only fund, and it means that it can play that part of a core equity allocation in your basket of investments.

Aaron Viscayno (12:14):
Yeah, got you. And look, I mean you kind of touched on it there with market volatility as well. I think everyone's kind of talking about volatility, especially over the past calendar year. I'd also like to know how long short investing is impacted by this volatility and what can you do as a portfolio manager to mitigate that? You mentioned before that volatility can be on par with a Vanguard Index Fund as well, which is remarkable.

Dr David Allen (12:39):
Yeah, so we spend about a third of our time on that risk management piece, and I think in many cases, many fund managers will spend the vast majority of their time on just stock picking. But if you don't marry that up with a very well-thought-out discipline risk management portfolio construction, you can easily turn what should have been a good result

into a poor one. So having a real focus on that, we specifically perform 96 stress tests on our portfolios every single day. Anything from a collapse in Chinese property, what if the Straits of Hormuz were blockaded? What if there's a huge tariff shock? Any of these things that they make for great dinner table conversation, but they're really hard to definitively and accurately forecast ahead of time.

(13:30):
So we look to first measure all these risks in our portfolio and we've got some quite sophisticated systems to do so, but whenever one of these risks starts to get large, we'll look to change the composition. It might mean adding some shorts in the portfolio to hedge out some of these risks so we can get that smoother journey for clients. Because ultimately clients, they want to grow their wealth, but first and foremost, they want to preserve their wealth and want to be able to sleep at night, I think.

Aaron Viscayno (14:00):
And you've also touched on some of the benefits right there as well, obviously with the reduced volatility, with the long short strategy as well as the ability to identify companies that are on the slide as opposed to only just identifying companies that are on the up. Were there any other benefits to the long short strategy that you can think of that investors might want to be aware of?

Dr David Allen (14:20):
Sure. So they're the key ones in terms of generating superior alpha by going alpha, so that's excess returns performance by going short companies and also controlling risk. They're the real key ones that stand out. So I wouldn't really, really add to that higher returns with better diversification, lower draw-downs, then I think that's what really people are looking for.

Aaron Viscayno (14:49):
As we all know, no investment strategy is completely bulletproof. Are you able to talk on some of the risks that are involved with long short investing?

Dr David Allen (14:57):
Yeah, absolutely. Absolutely. Well, the risks will often come on the short side. Shorts are inherently more risky than longs. If a long doesn't work, it can go to zero, but if a short doesn't work, it can keep climbing and climbing. You can keep losing money. If you shorter a stock, you can have a short squeeze where everyone's racing for the exits at the same time. If you shorter stock, it could get a bid for by an acquirer and can jump up 50% like that. So there's lots of things that you need to be very careful of. So it's definitely not for the faint-hearted. So how do we approach that? Well, one of the most important ways that you can protect against risk is

by sizing your positions quite modestly. Okay. There's long short managers out there that will say, "CBA, oh, look how expensive it is. It's at a P/E of 32, I'm taking a 5% short," or "Tesla, it's at a P/E of 170 and the company's imploding. I'm going to take a 5% short." That is extremely risky. I wouldn't be able to sleep at night doing that.

(16:03):
So a typical short position for us is like 0.3%. So when a name does go wrong, which will happen from time to time, it doesn't necessarily even mean we're going to have a down or a negative day. So diversification is absolutely your friend, lots and lots of small bets, small thematics in the portfolio. So an analogy that I often will use is greatest test cricketer of all time, the great Don Bradman average of, I think I'm sure someone will correct me after if I get this wrong, 99.97. I'm getting a shaking head. 99.94. Okay, thank you. And so greatest batsman of all time, but a great stat about him is that how many sixes he hit in his test match career, which was only six. Okay.

(16:56):
So it's quite unusual and it's a whole philosophy, very different from everybody else. It's hard to get out if you don't hit the ball in the air, so just work the singles, and that's very much our approach on the long side, but particularly the short side where rather than going for the big kill and getting overconfident on any one idea, then you've got hundreds of ideas that you've got in the portfolio at any one time. And that way you won't get carried out when you get a bit unlucky.

Aaron Viscayno (17:27):
Great, thanks. And look, just for our final segment here, I did want to actually talk about Plato in particular. Could you outline Plato's investment philosophy?

Dr David Allen (17:37):
Yes. So the philosophy is quite straightforward. We're looking for great quality businesses that are trading at a discount to what they're really worth. They must have positive sentiment and a low number of red flags. And if you think about it, they're the fundamentals of investing that you really should apply to anything. Like say you are buying a new house. You're looking for a high quality house. The price has got to be attractive in terms of valuation. You want to see great sentiment and trends, new people moving into the neighbourhood, and not too many red flags with noisy neighbours and termites in the basement. So it's really the same. And we apply that on the long side and the short side is the mirror image of that. So we're looking for companies that are a low quality, commoditized businesses, low market share, that have stretch valuations, that have negative sentiment, negative trends in play, and a

high number of red flags. They're the companies we really want to be short.

Aaron Viscayno (18:42):
Great and keen to actually put that investment philosophy into practice here as well. As mentioned, you are the portfolio manager of the Plato Global Alpha Fund. For the folks listening, that's ticker code PGA1. How does this investment philosophy drive or dictate your management of the fund?

Dr David Allen (18:59):
Yeah, it is really, we stay true to that philosophy come hell or high water. And I think that's the only chance you have of having an investment performance that's repeatable through time. We don't blow with the wind and say, "Oh, it's all about value right now, or it's all about growth." We look for those four fundamental drivers in every investment that we take. The worst decisions you tend to make in life and investment is when you get emotional about things and you deviate from your process. So we're very much aligned completely on that and don't deviate from that whatsoever. And it really does save your bacon so many times.

(19:46):
A recent example of an Australian company that we were long was Cettire. So online, high-end luxury goods company. The company on the face of it was miraculous. They'd gone from zero to 700 million overnight. They had a very small number of employees. They had no inventory because they're using a drop ship model, and it just looked incredible. But the red flags kept ratcheting up and up and up. It got to, I think 11. One of the biggest ones I guess was the founder was selling hundreds of millions worth of stock. And we said, "No, it doesn't matter how good superficially this company looks. There's just too many red flags for us there." And we're probably a bit lucky with the timing on that one. The stock fell a lot after we got out. So just sticking to your process is so important in investing or indeed anything I think.

Aaron Viscayno (20:43):
Yeah, great. And thanks for that example there as well. On the short side, are there any war stories that you'd like to...

Dr David Allen (20:50):
Sure. So a great short, so what we're looking for on the short side, the red flags is a really important driver. So we've got 150 red flags that are fully systematized and allow us to really identify companies that can come under pressure. So yeah, there's so many great shorts from over the years. Some recent ones that were interesting was Liontown. We were short. It already had a dozen red flags, and then the CEO sold about a million dollars worth of stock right around after the stock price had

already come under huge pressure. That's unusual. Normally, CEOs will sell stock for a variety of reasons. They might be shares vesting, or their profit taking after the stock's done really well. It's statistically less common for them to sell large parcels of stock after the stock prices really come under pressure. It likely tells you they know something and there's more bad news on the horizon.

(21:58):
In this particular case, a few months I believe after that point, they're forced to disclose to the market their entire financing syndicate had collapsed. We're already short at that stage and the stock fell another 25% on the back of it. Another name that we were short a year or two ago was a company called... Another Australian company actually called BrainChip. They had 22 red flags, the second-highest number of red flags that we'd ever seen globally. And they had this amazing narrative, how they were going to revolutionize semiconductors, but there's one problem. They had a market capitalization of almost 3 billion and they didn't have much more revenue than your local coffee shop. Okay. So there are lots of red flags there, but that's not a sufficient reason for us to go shorter name because the sentiment on this particular name was really positive, really frothy, particularly amongst mom and dad investors. So we won't look to stand in the way of that. We'll wait for that sentiment to really start to turn and become negative before we'll implement short positions. And that's what we did. And that was a good short for Plato.

Aaron Viscayno (23:10):
Thanks for those examples and thanks for outlining that philosophy as well. Clearly, it's been working for you. You mentioned some numbers before, but since its inception as an ETF in November 2024, the Plato Global Alpha Fund, ticker code once again PGA1, has outperformed its benchmark, the MSCI World Net Returns Unhedged Index by a whopping 21.4%. Congratulations on that.

Dr David Allen (23:33):
Thank you. Thank you.

Aaron Viscayno (23:35):
A couple of quick fire questions before we get out of here, David. Let's keep the answers short and brief if we can.

Dr David Allen (23:39):
Of course.

Aaron Viscayno (23:40):
What's next for Plato and your fund?

Dr David Allen (23:42):

So really just keep your head down, keep working harder and trying to eke out that out for every day, week, and every month.

Aaron Viscayno (23:50):
Great. Last one, the Rugby World Cup. It's due to be hosted right here in Australia in 2027. Who have you got?

Dr David Allen (23:58):
Well, I'm actually originally a Kiwi, but I made the mistake after being at school in Australia and having the Kiwi accent bullied out of me pretty quickly that I quickly switched to the Wallabies but that was a bad mistake. I should have stuck with the ABs, but I don't know. I'll say Wallabies, but that's more my heart talking than my head perhaps.

Aaron Viscayno (24:19):
There you go. Wallabies to win out the final by 40 points in a blowout. Dr. David Allen, thanks so much for joining us today.

Dr David Allen (24:26):
Thanks so much. Really appreciate it.

Aaron Viscayno (24:27):
For those listening, if you wanted more information on the Plato Global Alpha Fund PGA1, or Plato Income Maximizer Limited PL8, head on over to their Plato website, plato.com.au. That's P-L-A-T-O, or of course, the ASX website, asx.com.au. That's a wrap for our three-part series on thematics. Tune in next month to kick off our next topic on all things earnings season. Talk to you then.

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