If Baseball Were Played Clockwise

Norman Chait

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Introduction

Michael Lewis, of "Liar's Poker" fame, has once again written an excellent book called Moneyball. It chronicles how Billy Beane, the manager of the Oakland Athletics, used a statistical approach to determine the correct factors to select players and to build a championship-caliber baseball team despite a limited budget. Mr. Beane noted that players that excelled in the relevant statistical categories in the past would most likely continue to do so. This has largely played out according to plan. Some of Mr. Beane's rules for building a top-notch team include,

1. no matter how successful you are, change is always good
2. the day you have to do something, you're in trouble
3. know exactly how much each player is worth to you
4. every deal you will do will be publicly scrutinized by subjective opinion

We focus on constructing customized portfolios comprised of money managers. As such, we find these principles are relevant to the investment world too, where too many professionals prefer to take the conventional and often mediocre approach rather than think out of the box.

As expected, some investment managers have also read the book. They have noted in their quarterly letters how relevant Mr. Beane's system is to running a portfolio. They then emphasize that both their adherence to its principles and their "athletic prowess" is why they have outperformed until now and why they will continue to do so. In other words, despite the ever-present standard written disclaimer to the contrary, they imply that past performance can predict that of the future.

What has Changed in Investing ?

There are some inconsistencies with this approach. Firstly, baseball statistics are transparent. An independent scorer records the runs, hits and outs as they occur. There are no pro-forma simulated track records in America's favorite pastime.

Secondly, market conditions change far more frequently than the rules of baseball. The last two decades of the twentieth century were characterized by a bull market for equities. Many successful money managers recorded their performance statistics during this period, and displayed them with gusto at annual fan appreciation events known as investor conferences.

When the NASDAQ bubble popped in April 2000, conditions changed, and managers suddenly had to learn to make money differently. For example, in the hedge fund arena, long-biased equity managers now had to short stocks more aggressively, and event-driven specialists, who could no longer find attractive arbitrage opportunities, had to master investing in distressed debt, a different discipline which requires fewer trading skills and more research.

Today, fixed income managers can no longer enjoy the comfort of a 5% LIBOR rate and have to be far more aware of macro variables when trading bonds. Also, the reduction in proprietary trading activity by Wall Street firms has reduced market liquidity in certain areas.

And in Baseball ?

During this time, not much has changed in baseball, with the exception of the opening of new state-of-the-art ball parks that offer retractable roofs, better food and a slightly greater chance of seeing a home run being hit. But this change is incremental. What would happen if the Baseball Commissioner suddenly changed the rules, and reversed the order of play, so that hitters would round the bases clockwise instead of counter-clockwise?

This could impact the fielding ability of some players. For example, take Alex Rodriguez, who in 2003 became baseball's most expensive player at $25.2 million per season for ten years (*a contract revised in 2007 to $275 million over ten years*). He fielded then at the shortstop position, and subsequently at third base after his move to the New York Yankees. As such, he has had to rely on his right arm to throw to first base. Would his effectiveness and market value change if first base alternated with third? Is it possible that a new breed of left-handed shortstops or third basemen would emerge?

Summary

So, in evaluating the track record of an investment firm, one has to take into account the market conditions in which it was compiled. Comparing money managers' performance to that of baseball stars is simply not cricket!

Norman H. Chait, CFA

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