4 Invaluable Lessons to Learn From Billionaire “Hedgie” Bill Ackman

Description

Bill Ackman, the legendary activist investor behind **Pershing Square Holdings**, has been making a massive comeback in 2019, with his hedge fund soaring over 37% year to date thanks to some significant investments that have been going right for a change.

Ackman is a firm believer in making massive bets on a few extremely high conviction names rather than spreading bets across a plethora of different names as most other big-league investors do.

Going all-in on the highest conviction names takes guts.

It’s a great way to outpace the market, but any missteps are sure to hurt badly, as we saw in the case of Ackman’s significant stake in Valeant Pharmaceuticals back when Michael Pearson was running the house of cards that eventually collapsed, leaving a massive dent to the share price of Pershing Square.

Although many investors have moved on from Ackman after the Valeant flop and the ensuing multi-year slump, I still think there are invaluable lessons to be learned from the man that used to be known as Baby Buffett.

Ackman’s hedge fund still trades at a significant discount to NAV, but as it recovers ground lost following the Valeant days, we may see Ackman make an enviable comeback for the ages.

In any case, here are four lessons that investors can adopt if they want to invest like Ackman.

Beware of *diworsification*

Another legendary money manager, Peter Lynch, coined the term *diworsification,* which is “the process of adding investments to one’s portfolio such that the risk/return trade-off is worsened.”

While you always hear advisors touting that portfolio diversification is the only free lunch in the investment world, it’s also true that too much of anything, including diversification, can be a bad thing.

Overdiversification can be hazardous to your wealth because most investors can't stay in the know with more than 20 investments in a portfolio, and the more stocks one holds, the less chance one has to do better than that of the market averages.

Up to a certain point (around 20 stocks or so), the marginal benefits of additional diversification is negligible and only leads one to pay more commission for putting in more homework.

If you've got more than 30 stocks, you'd probably be better off in index funds because, with that many names, you'd essentially be mirroring a benchmark at a higher cost.

Beware of a lack of diversification

On the flip side, if you only own nine or fewer stocks as Ackman does, you could be exposing yourself to a high degree of unsystematic risk, which could have been avoided with a properly diversified portfolio.

Proper diversification protects new investors from themselves. But if you've got true conviction in a name and are aware of the additional risks you'll bear from improper diversification, only then does it make sense to be as concentrated as Ackman.

With such a concentrated portfolio, all it takes is one name to go sour before your entire portfolio takes a significant hit on the chin. So, a thorough analysis is required at all times.

Don't bet the farm on highly speculative businesses

Ackman made a massive bet on Valeant Pharmaceuticals (now known as **Bausch Health Companies** (TSX:BHC)(NYSE:BHC)), an M&A pharma play that was one of the firsts of its kind.

The company went on a greed-fuelled acquisition spree and Ackman "bought into" the model that the firm could just cut R&D expenses and raise drug prices to boost profits.

Although the model seemed fool-proof on paper, regulators ultimately called the firm out on its "loophole" of a business model, causing the highly-indebted firm to crumble like a paper bag.

Know when to throw in the towel

Ackman stuck with his Valeant investment on the way down, hosting calls in the attempt to stop the bleeding. Ackman was a massive fan of the Bausch + Lomb assets and believed many of the other businesses were severely undervalued.

This didn't seem to matter as the mountain of debt led many to believe that the firm was an insolvency waiting to happen.

Eventually, Ackman threw in the towel after a majority of the downside. Today, Bausch Health Companies has reinvented itself under new CEO Joe Papa. It's more liquid and is a legitimate contender, but is still a country mile away from its high.

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