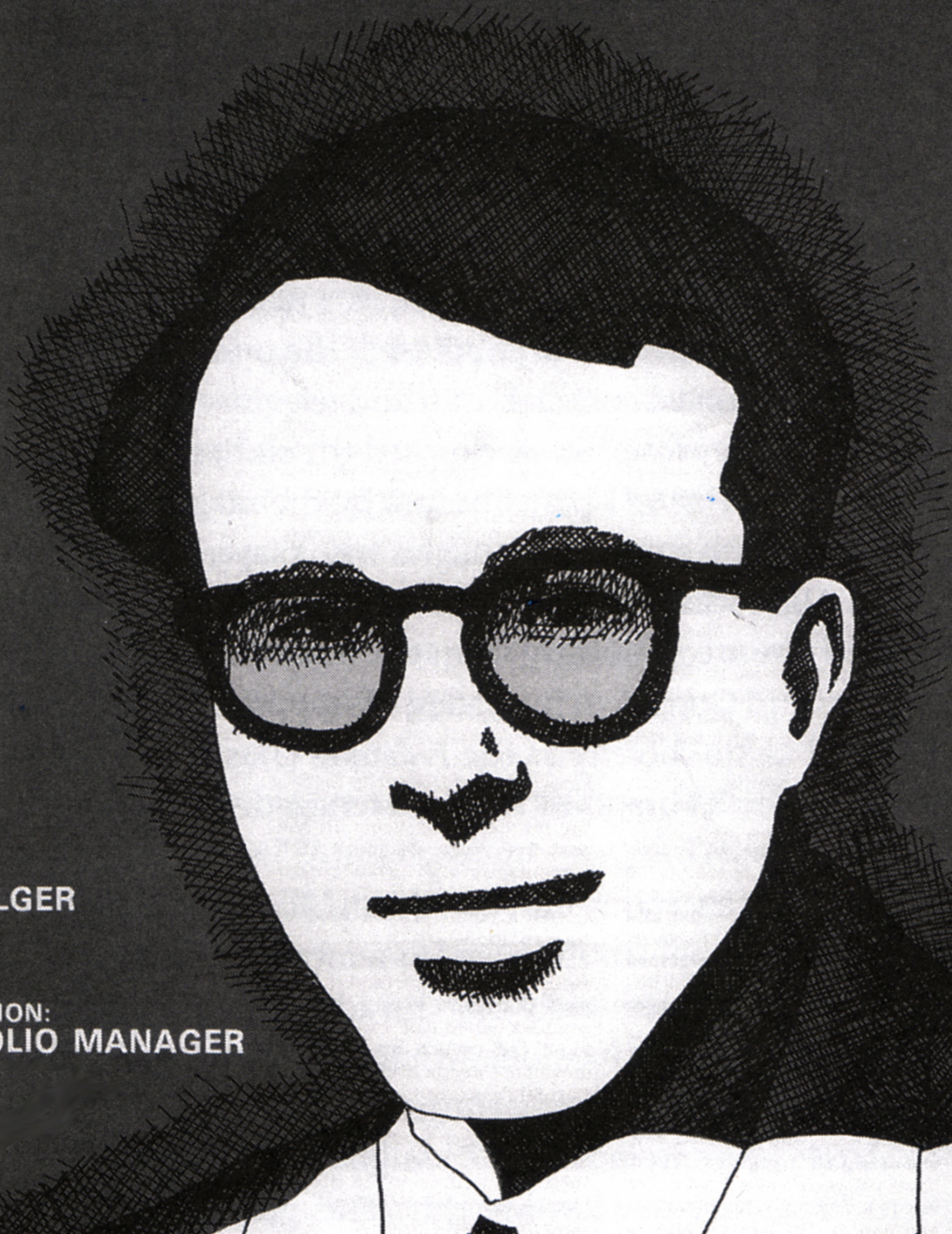
February 1968

THE Institutional Investor

The journal for professional investment managers



Fred Alger:
PORTRAIT OF A STAR by Chris Welles

Chris Welles is Business Editor of **Life Magazine.**

Fred Alger, who is 32 years old, made $1,100,000 last year.

Fred Alger does not co-star regularly with Elizabeth Taylor in movies. He is not a good-guy cowboy on a TV show with a Neilsen rating like Bonanza's, and he does not sing in Las Vegas.

Alger is another kind of star. He gets all that money for managing other people's money. Until recently, this was not a field that produced stars. Prudent men in hallowed institutions, quietly tending casks of slowly maturing capital—these are not stars. Stars come out of one kind of drama or another. You could say Gerry Tsai was the first star of this era, when the $274 million came over the transom for the opening of the Manhattan Fund. Now the thirst for gains is so great in the fund business that managers are stars, and they get a piece of the profits. Just like Paul Newman and Elizabeth Taylor.

There are some, of course, who believe that stardom in the investment business is a fad, that the accent on youth is a fad, and that "performance" is being overdone. Perhaps all these things are true, perhaps not; no one has yet figured the net consequences of the whole trend.

The lunch-bag office

Alger is a quiet, unassuming, thoughtful-looking man with tousled hair and glasses, who wears nondescript grey suits and black shoes and sits most of the day in a tiny office in downtown Manhattan. He has a battered wooden desk covered with clutter, and a great view of the airshaft of the building. Wall decoration consists of scotch-taped messages. Three other associates and two secretaries are crowded into the premises. There are a few wooden folding tables littered with paper cups. The rug has coffee stains. There is no stock ticker, no stock quote machine, no broad tape—only a couple of well-worn slide rules and a blackboard.

There is approximately $200 million whose disposition depends on what Fred Alger happens to feel like at any particular moment. The reason he got paid $1 million last year, the reason he is a star, is that in the way the $200 million is handled, Fred Alger has Talent. Alger's talent is such that Security Equity Fund, for which Alger's company, Fred Alger & Company, Inc. is Research Consultant, has during the past three years chalked up an appreciation of over 215 percent, the best in the industry. An associated fund, Security Investment Fund, has outperformed the market every year, for the past five years, despite a high percentage of high income bonds.

Alger and his associates also advise a small growth fund in Nassau, Fiduciary Growth Fund Ltd., which is sold only in the sterling area, plus a fund in Bernard Cornfeld's Fund of Funds complex called FOF Proprietary Fund Ltd. (which was recently moved to Canada to comply with Cornfeld's agreement with the SEC) plus six private corporate accounts. Alger says that, except for Security Investment, all of these accounts invest in similar stocks and have recorded similarly impressive records.

For his services to the Security funds, which are part of the Security Benefit Life Insurance Company of Topeka, Kansas, (an underwriter of about $1.5 billion in mutual life policies), Alger's company receives a ⅛ of 1 percent of the assets portion of the customary ½ of 1 percent fee paid to the management company. This brings in about $100,000 a year. Security Equity assets in mid-December were about $70 million; Security Investment's about $12 million.

But the Security funds are for Alger kind of loss leaders—hardly very profitable but a public advertisement of his abilities. This advertisement has attracted other money involving fees somewhat more interesting. The transformation of stardom into remuneration occurs when you get paid extra for performance. From his other accounts, Alger's companies (a separate corporation with the same personnel called Falco Associates works with FOF Proprietary) get 1 percent of the assets or, providing the Standard & Poor's 500 is sufficiently beaten, 10 percent (5 percent for FOF) of the total realized and unrealized appreciation, whichever is larger.

Talent is one-of-a-kind

In money management today, there is a growing feeling that though good, solid, steady, diligent work may be adequate to achieve respectable results, for a heady performance record that leaves the Dow far behind, something more is needed. Talent, Feel, Knack, Sense, Touch. Either you has it or you doesn't.

Talent is not cheap. Men who are paid for simple brainpower are expendable. If they get sick or tired or fired, a replacement is always waiting. The assistant moves up. The bureaucracy inches on. But talent is a one-of-

a-kind commodity. No one looks quite like Elizabeth Taylor. No one flashes his teeth quite like Paul Newman. Fred Alger, though possessed of much quiet self-confidence, does not regard himself as the beneficiary of any miraculous gift. "It's not that we're any smarter," he says. "We just work at it, minute by minute, all day long." But he will agree, "If you want to draw the talent, you have to pay for it." To lure stars these days, this means dangling in front of them a piece of the action. The sight of men in their late 20's hauling in over a million a year (many managers of hedge funds get a straight 20 percent of the gain) has not exactly provoked joy among more elderly managers of such money as pension funds who may get a mere $50,000 fee for careful annual nurturing of a $300 million nest egg. Believers in the Dart Throwing or Random Walk theories naturally scoff at high performance fees since they tend to deny the efficacy of fund management in general. But most money managers would agree with First National City senior v.p. and University of Rochester endowment fund head H.W. Tripp who says "If a performance fee is the contract, and everyone recognizes the risks, then I don't see anything basically wrong with it." Investment counsellor John Hartwell points out that profit splits of 50-50 between investors and operators have long been a tradition in other venturesome business fields.

Yet nearly everyone sees potential dangers. "If the incentive gets too high," says George Chestnutt, Jr., who runs the American Investors Fund, "you can get a go-for-broke attitude where people feel that if they lose the investors' money, it doesn't hurt them but if they can double it, they'll get rich." There is the possibility of outright dishonesty.

Says William Scheerer of Alger's staff, "Too high a fee encourages such dishonesty as running up the price of a couple of your thin stocks right around the fee date." And when people are stars only as long as they're hot, an atmosphere of instability is produced in the business. Says a pension fund manager at a large bank, "It is like a quarterback who gets intercepted nine times in one game. The next game he sits on the bench." Fred Alger, for his part, is too busy throwing passes at the moment to worry much about the bench. Last year, of the $1.1 million that was paid to his two companies (Alger himself gets a good slice of this figure) about a million dollars was performance money.

Yet Alger, quite atypically, tends to regard this latter as "swing money" with a bit of scorn—nice to have but basically froth. "If your brain freezes up for a year and all you've got is a performance cut, you're dead," he says. "It's all too easy-come, easy-go." He has been working with his accounts to raise the minimum guarantee and cut the performance fee. He budgets his office overhead to match only guaranteed income.

Alger's hangup is that he really doesn't give a damn about money. True, he has a nine-room Park Avenue apartment, but then he has a wife and three children under seven. His possessions and material desires are as bereft as his office walls. He is really oblivious to the outside world. Every day he plods through the same dull routine, including a subway ride to the office and a BLT sandwich and chocolate pudding for lunch. His social life is almost nonexistent (a highlight is Wednesday night duplicate bridge). "I still get lost around New York," he says. "I don't think I could tell you the name of one play on Broadway." Excess personal income is all plowed back into Security Equity. He says he never makes investments for himself.

Second best is a loser

So if it isn't the money, what is it? The thing that makes Fred run is: The Race. Winning. Number One. Beating the other funds. "I would rather be down 60 percent in a year and be number one than be up 60 percent and be number ten," he says. "It is perfectly all right to win by a nose." He likes the spectators to know who is winning. One of Bernard Cornfeld's incentive schemes is the monthly circulation of a performance ranking of all the funds in his empire. One month, due to a misprint, Alger's fund was listed #2 instead of #1. Alger immediately flew to Geneva to straighten things out. "We get a little upset if they don't have us right," he explains.

Thus Alger's strategy is dictated, not by some higher standard of desirable gains, but by what the other funds are doing. The starting gun sounds January 1. For most of the time, the idea, says Alger, is to "stay with the pack. After a while, it becomes clear which funds are in the lead and we get into the stocks that are making them move." This keeps Alger pretty much up front; Alger's talent for market timing allows him to match the pace though he is usually reacting to what the others do.

Chances to win the race come "during those five or six times a year when you have a chance to do something distinctive, to leave the pack, change your portfolio mix, and move ahead." Stocks that will cause him to leave the pack, he says, fall into two broad groups:

- Companies whose unit volume growth is much greater than that of the economy as a whole, growth that can translate into earnings either now or sometime in the future. Alger recently moved quickly into California Computer when others were selling because "they bring a high quality of thought to their industry. They are trying to create their own fate with a pioneer display system that hopefully will be a big thing around 10 years from now." (Alger loves things or people who are trying to "create their own fate.")
- Companies which have experienced a "momentous happening" which will result in "multiple play" for the company's stock. A good example is another of Alger's present favorites, Mary Carter Paint Company. Mary Carter, by buying into Paradise Island in the Bahamas, is transforming itself from a dull paint firm into a diversified company with a strong stake in the booming travel business which Alger regards as "infinite." He is especially on the lookout for cyclical companies which for one reason or another may experience the earnings leverage that comes when lots of excess plant capacity is suddenly put to use.

Alger, of course, is sufficiently bright and sufficiently flexible to know that though it may be nice to surround one's buying and selling with an impressive aura of Philosophy, what really matters is that the stock you buy goes up, for some reason: it doesn't matter why. And of course purchase of few attractive growth situations could not, after some stretching, be justified by the above two points. And so what if they can't be justified? Alger, for example, will launch into a furious attack on conglomerates. "Conglomerates don't contribute to the thinking of an industry," he says flatly. "All you pay for is the fancy creation of earnings and you're not supposed to think about how they are created or what they represent." Fine. It then turns out that Alger has on occasion sampled such stocks as Walter Kidde and White Consolidated. Indeed, one of the chief reasons for his good year in 1966 was his buying of Gulf & Western within a point of its low before the other performance types got in (he got a discount to boot by buying Paramount Pictures stock before the merger with G&W was approved). "I didn't like it when I bought it at 19," says Alger. "But I knew it was going up."

Timing is all

One of Alger's major abilities has been his knack of understanding what the economy is up to. In early 1966, he and his staff noticed the growing multiple spread between basic industry stocks, which were drifting down, and the flyers. The flyers were being propelled even higher by Gerald Tsai's new Manhattan Fund money and similarly oriented funds. With money becoming tighter, Alger foresaw trouble. Before almost anyone else, he started lightening up on his flyers. He also began selling his airlines—then a hot performance favorite—which he correctly predicted would be soon hit by high new equipment costs and an increasing gap between capacity and volume. At one point, near the October market bottom, he was 30 percent in cash with his Security Equity Fund. Then he began moving back into the market. The only fund that beat his 8.9 percent gain for the year (against a badly slumping Dow) was New Horizons which was loaded up with the new technology OTC companies that began getting a big play around December.

In 1967, however, the same kind of strategy, he says, "cost us severely and dearly." First off, Alger was slow spotting the speculation that came out of the market bottom. In August, again sensing a disparity of multiples, he sold such favorites as Kalvar and Monogram Industries. He figured that, due to a probable recovery from the mini-recession, the cyclicals and basic industry stocks would move. He bought into such companies as B. F. Goodrich, Boston & Maine, General Electric, and National Airlines. When the flyers stayed aloft and the others stayed on the ground, Alger rejoined the pack. At mid-December Security Equity, even though it was up about 65 percent, was ignominiously in tenth place.

The reason for Alger's mistakes last year was not simply a misinterpretation of the economy. It was more serious that that: Alger got out of tune with the market. He was swinging but his heart wasn't in it and when your heart isn't in it, they are going to take the ball away from you.

Peaking at 14

To understand his problem, it is necessary to flashback to Fred Alger, eight years old, son of a well-to-do sometime Detroit politician (he ran once for governor of Michigan, and later was U.S. Ambassador to Belgium). Young Fred liked to invent things. Basically a loner, he spent afternoons and evenings drawing blueprints and making models of such things as vending machines and swept-winged jet airplanes. "Did you know I was the first to make a contour sheet?" he will inquire eagerly. "Then when I was around 12, I decided that I would become the greatest golfer in the world. I went out on the course, day after day, from 6:30 am to 8 pm. That's all I did. But I found I was physically uncoordinated. I had no sense of rhythm. My golf game peaked when I was 14. After that I did nothing."

Later, he drifted into Yale where, he says, "I spent my time sleeping and going to a lot of movies. It was all a vague shuffling around, a dreamworld and I don't really remember much about it. I do remember that I was left-handed and I smudged every test so badly no one, including myself, could read it." He managed to summon up enough energy to avoid flunking but when he graduated in 1956, "I had no plans for the future, had no job interviews, made no applications to grad school." Finally, in response to his father's demands, he went to work for a Detroit brokerager house for which his father was director. "For some reason," he says, "it turned me on. It wasn't the money. I guess I just decided that it was time to go to work."

He found as an analyst he could apply the same kind of creative approach to problem solving that he did as a young inventor. "I have a very limited curiosity about things around me," he explains. "But I do have an imaginative ability that allows me to reason very deeply into a problem, and I have a sense of urgency that allows me to concentrate everything on something until I solve it."

Once, thumbing through the A's in Standard & Poors he came across American Photocopy. It "looked interesting" and he started investigating. He spent days checking out other copiers, analyzing cost savings, talking to secretaries. "I know this sounds cloying," he says with characteristic self-effacement, "and you probably shouldn't print it because it makes me look a little too good, but after a while I came upon a company called Xerox and . . ."

The smartest person there

After periods at several other banks and funds (another research excursion allowed him to devise a highly complex method of predicting prices of cyclical stocks solely through analysis of inventory levels), he was hired by the Winfield funds, where he became a portfolio manager. In a big personnel struggle, he tried to take over Winfield because "I felt I was the smartest person there." Eventually, after much acrimony, peace was restored when Alger left and formed his own company with one account: a piece of the Winfield operation which brought in $8000 a year.

He threw all his energies into making that account move. "I tried to avoid hot-stocking it with crud," he says. "I wanted to do well with the big companies that everyone owned by buying them at their bottoms." Eventually the fund was sold to Security Life but Alger's company was retained. At the end of 1965, after Alger had racked up the industry's highest performance record

(a 77.8 percent appreciation), he had a meeting with Bernard Cornfeld. Two weeks later Cornfeld gave him a $5 million fund. Other accounts flowed in.

And everything went along well until 1967. The trouble was that last year the action was with the small companies with the wild technological stories. Alger had spent his career making it with solid companies that moved according to the rules. A lover of substance, he was faced with intangibility and irrationality.

"We found that experience gets to be a debility," he says. "We had learned to be thoughtful but we found out that if you're too thoughtful you don't know what's going on. You have to guard against getting fixed ideas, but we simply didn't want to accept any of these new stocks. We couldn't develop a willingness to pay 50 times earnings for stocks whose stories we couldn't believe.

"Mohawk Data was typical of the things that happened to us all year long. When we first saw it at 25 we weren't impressed. It didn't have the technology. It just wasn't a classy kind of stock. So we watched it go to sixty and eventually we accepted it and went in and made a good profit. But it made us terribly nervous. There were a lot of other stocks we never did get in. Look at Victor Comptometer. Four years of flat earnings, and another coming up. But suddenly it goes from 30 to 90. We looked at it all the way up but there was really nothing there. Those that bought it were plain lucky. This sort of thing was terribly frustrating. It just didn't pay to be a skeptic."

The disasters are emotional strains

It was especially galling for him, after being lured into a dog, to watch if fall on its face. "Everytime you say it was junk when you bought it and it will always be junk and you vow you'll never buy junk again," he says. "But sometimes there's no other way." Yet he is just as upset when one of his carefully chosen potential winners slumps. "I forget the stocks we made money on," he says. "But I remember the disasters. We dwell on them here. We talk about them over and over, trying to figure out why they failed, why they crossed up our ideas. Emotionally it is terribly draining."

Alger would probably not admit it, but he is slowly coming to the realization that, as a means of applying his talent, the plotting of investment strategy—especially during a time when luck often predominates over skill—is far from ideal. Ever since his days as a young inventor, he has really been interested in figuring out ways to build something solid and permanent. "I would much rather create something myself than interpret what someone else has created."

Twice last year, when stocks Alger owned showed signs of going sour, he refused to unload them. Instead, he spent much time discussing the company's problems with management, and eventually he helped arrange mergers for both companies. His desire to raise his minimum fee guarantee, his incorporation of his firm (which personally is less financially beneficial than a partnership) are both ways to design stability into his own operation. Last year his company invested some money in Applied Logic, a small, privately owned computer software company in Princeton, N.J. He has even tried to sell several companies on an ingenious but highly complex method of financing through a blend of warrants and preferred that mollifies the effects of dilution of the common. Says a friend, "Fred could be a helluva a creative investment banker if he wanted to."

Is Alger getting old?

But in all this activity involving solidity, stability, permanence, logic, rationality, one gets a hint of a fundamental disease—at least in today's market—that may have afflicted Alger. Maybe he simply is getting too old.

He paused for a long time when he was asked about this last December. He leaned back in his chair and sipped some tea from a paper cup. "Perhaps I **have** peaked out," he said slowly.

But it was only a momentary twinge of doubt. New horizons of investment banking and the development of new companies may come. But for right now he was confident that a swingers' market was simply another problem that if worked at could be solved. He was convinced, he said, that the aggressive institutional demand for performance would, for the foreseeable future, continue the strong upward pressure on growth stocks, especially in such fields as computers.

"We're giving away this year," he said. "Right now we're selling the remnants of our August fiasco, throwing out everything we're unhappy with, and getting in shape for next year. This year we spent all our time playing catch up and running scared. Next year we're going to win." **it**

This article, which was originally published by Institutional Investor Magazine in February 1968, is not intended to be and does not constitute investment advice. The views expressed in the article do not guarantee the future performance of the markets, any security or any funds managed by Fred Alger Management, Inc.

Individual securities, industries and sectors mentioned should be considered in the context of an overall investment portfolio and therefore reference to them should not be construed as a recommendation or offer to purchase or sell securities. All investments involve risks, including possible loss of principal.

ALGER

Inspired by Change, Driven by Growth.