



September 2020

More Superstar Investors: Spain's Value Investors

Executive Summary

In our 2019 article “More Superstar Investors: Francisco Garcia Paramés” we extended the work of Brooks, Tsuji and Villalon’s “Superstar Investors,”¹ by examining the track record of Spanish investor and founder of Bestinver Asset Management, Francisco Garcia Paramés. As in the original paper by Brooks et al., we found that a large part of Paramés’ long-term success was attributable to patient exposure to well-rewarded factor premia (i.e., “fishing in the right pond”).

In this short article, we come back to Paramés and study his more recent track record since founding Cobas Asset Management in 2016. We also study the work of some other well-known value investors in Spain; firstly Beltrán de la Lastra, who took over as CIO and portfolio manager at Bestinver when Paramés departed in 2014; secondly, ex-colleague of

Paramés, Álvaro Guzmán de Lazaro, who now manages funds at azValor Asset Management; and last but not least Iván Martín Aránguez, who founded Magallanes Value Investors in 2015.

We once again stress that after-the-fact studies do not detract from real performance, but we additionally stress here that it is difficult to assess a manager’s performance over short horizons. Each of these managers are stated value investors, a strategy which we know has struggled in recent history, so the relatively short time periods we study here will be dominated by Value’s drawdown. Brooks et al. concluded that “investors may be able to become more superstar-like by identifying edges such as the ones we analyze here, and having the patience to stick with them over the long term.” At least for Value, now is a time when such patience is warranted.

Thomas Maloney
Managing Director,
Portfolio Solutions
Group

Alfie Brixton
Associate, Portfolio
Solutions Group

1 Brooks, Tsuji and Villalon, (2019), “Superstar Investors,” *The Journal of Investing*, Vol. 28, No. 1.

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Introduction

In this article we follow on from our 2019 article *More Superstar Investors: Francisco Garcia Paramés* where we studied Paramés' impressive 20-year track record at Bestinver from April 1994 - August 2014. Over this period, Bestinver's Bestinfond significantly outperformed its benchmark² (annualized excess of cash returns of 13.5% versus 5.8%), with only slightly higher volatility. We found the investment returns of this "superstar" to be consistent with his investment philosophy. Paramés' emphasis on identifying "good companies" at a "good price" was captured by our Quality/Low-Risk and Value factors respectively.

We found that although market timing did not appear to contribute to Paramés' success, patience did. He was able to stick to his investment philosophy, which allowed the small edges created by exposure to the factors identified here to accumulate into an excellent long-term track record.

Since 2014 much has changed. Paramés founded Cobas Asset Management in 2016 and Bestinfond had a new CIO and portfolio manager, Beltrán de la Lastra.³ Furthermore, an ex-colleague of Paramés at Bestinver, Álvaro Guzmán de Lazaro (to whom we can also attribute some of the stellar track record

of Bestinfond), is now CIO and portfolio manager at azValor Asset Management, and there has been the emergence of an additional value investing star in Spain, Iván Martín Aránguez, who founded Magallanes Value Investors in 2015. It is worth noting that these well-known and respected managers have suffered large prolonged drawdowns recently, leading some of their investors to wonder whether their original investment philosophies are still intact.⁴

Herein we will study the recent performance⁵ of our Spanish superstars from a factor perspective with an aim to find out whether their factor exposures are consistent with their stated investment philosophy, and whether their recent hard times are the result of a divergence from that philosophy, or just tough times for a good strategy.

Some caveats from Brooks et al. are important enough to reiterate here: any study such as this one has (unavoidable) hindsight bias when choosing which factors to include. This results in some overfitting and "over-explanation" of the track record studied. In addition, the factors used here are gross of fees, trading costs, and other real-world frictions. Therefore, the alpha from our regressions is likely understated.

2 Bestinfond's custom benchmark, 80% MSCI World and 20% split 70/30 between the General Index of the Madrid Stock Exchange (IGBM) and the PSI Geral Index.

3 Beltrán de la Lastra announced his departure from Bestinver in March 2020 and is expected to leave by the end of the summer.

4 Our focus is on performance, and not how much of it a specific portfolio manager was responsible for. In other words, we cannot say how much azValor Asset Management's results reflect the contributions of Álvaro Guzmán de Lazaro versus Fernando Bernard, and the same goes for our other managers. Although these names are generally associated with these successful track records, we recognize that success is often the result of a team effort.

5 We study performance over the longest period available for each manager in charge of their current flagship fund. Since the performance start date for each manager will vary, we do not recommend direct comparison of each manager's performance. It is their factor exposures which we are interested in here.

Cobas Seleccion FI: Francisco Paramés

11/2016 - 06/2020	Average Excess	Volatility	Sharpe Ratio	Annual Outperformance	Information Ratio
Cobas Seleccion FI	-13.6%	22.7%	-0.60	-19.0%	-1.42
Benchmark*	5.4%	13.8%	0.39	—	—

* MSCI Europe Index.

Source: AQR, Bloomberg. Returns are excess of cash denominated in EUR. Risk-free rate is the ICE BofAML Euro Treasury Index. Past performance is not a guarantee of future performance; please read important disclosures at the end of this presentation.

In our previous study of Paramés we analyzed the Bestinfond FI fund from inception in April 1994 to Paramés' departure in August 2014, and found that the fund outperformed its benchmark by an average of 7.7% per annum. Paramés' more recent track record at Cobas Asset Management has been very different, with the Cobas Seleccion FI fund earning a Sharpe ratio of -0.60 compared to 0.39 for the European stock market.

To find out whether his investment approach has changed from a factor perspective, we will revisit his exposure to the market (MSCI Europe) and several systematic investment styles (or factors) using returns-based regression analysis. The factors we will use in our regression are:⁶

- **Value:** the “High-Minus-Low Devil” (HML Devil) factor from AQR's data library (Europe universe)
- **Momentum:**⁷ the “Up-Minus-Down” (UMD) factor from AQR's data library (Europe universe)
- **Low-Risk:** the “Betting-Against-Beta” (BAB) factor⁸ from AQR's data library (Europe universe)

- **Quality:** the “Quality-Minus-Junk” (QMJ) factor⁹ from AQR's data library (Europe universe)
- **Size:** the “Small-Minus-Big” (SMB) factor from AQR's data library (Europe universe)

In our previous study we found statistically significant exposure to Value, Low-Risk and Size, suggesting that each of these investment styles played a role in Paramés' success during his time at Bestinver. We also found positive exposure to Quality, but this exposure was not statistically significant at the 95% confidence level.

Our new regression results are presented in the table at the top of **Exhibit 1**. We once again find significant exposure to Value and Size, but not Low Risk or Quality. To provide a sense of magnitudes, we also show an attribution (based on the regression results) in the chart on the right of Exhibit 1. Note that despite significant positive exposure to the Value and Size factors over the study period, the return impact for both is negative due to the average Value and Size premia over this period being negative.

⁶ See Appendix for details on factor construction.

⁷ In our previous study of Paramés we did not include Momentum as this investment approach is not in his investment philosophy, however we include it here to be consistent with later regressions.

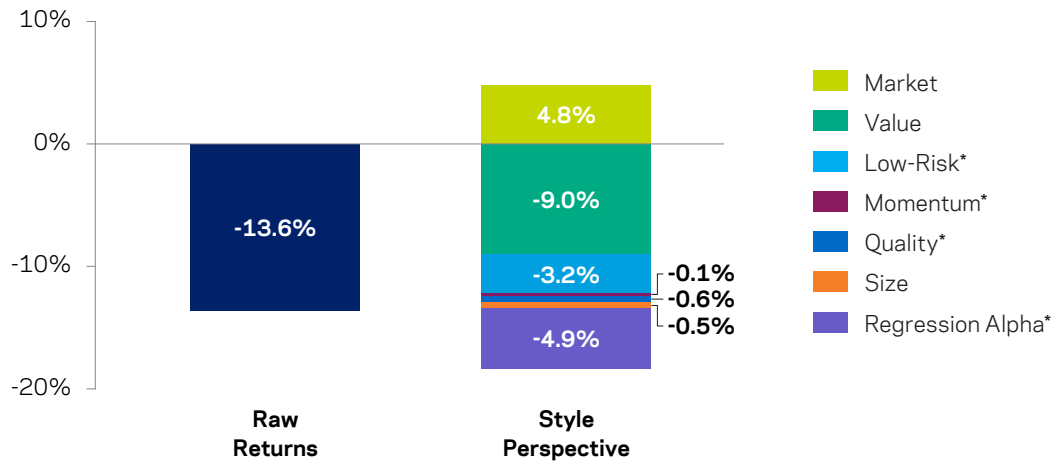
⁸ As defined in Frazzini and Pedersen (2014).

⁹ As defined in Asness, Frazzini and Pedersen (2019).

Exhibit 1

Cobas Seleccion FI, November 2016 – June 2020 Regression Statistics

	Alpha (Annualized)	Market	Value	Momentum	Low-Risk	Quality	Size	R ²
Coefficient	-4.9%*	0.88	1.13	-0.01*	-0.39*	-0.09*	0.84	83%
T-stat	-0.7	5.0	2.8	0.0	-1.6	-0.2	2.6	—



* Not statistically significant at the 95% confidence level.

Source: AQR, Bloomberg. All variables are excess of cash. Risk-free rate is the ICE BofAML Euro Treasury Index. Return attribution is factor coefficient multiplied by average factor premium over this period.

Paramés’ exposure to Value, which was one of the largest drivers of his outperformance in our previous study, drove losses over this period. We are unfortunately very familiar with Value’s recent troubles, but these do not detract from our belief in the long-term efficacy of the strategy.¹⁰ Going forward we would expect this exposure to contribute positively to performance.

We previously found that Paramés had significant exposure to Low-Risk, but we do not find this exposure over the recent period. We also find that unexplained return variation detracted -4.9% from annualized performance over the period, but this negative alpha is not statistically significant, and it is very difficult to judge alpha (or manager skill) over such short horizons (even over 5+ years alpha is difficult to assess with conviction).

¹⁰ See the recent ‘Cliff’s Perspective’ [Is \(Systematic\) Value Investing Dead?](#) for why we think value investing isn’t ‘dead’, and why we think the recent drawdown has led to an opportunity for the strategy going forward.

Bestinfond FI: Beltrán de la Lastra

11/2014 - 06/2020	Average Excess	Volatility	Sharpe Ratio	Annual Outperformance	Information Ratio
Bestinfond FI	5.0%	15.8%	0.32	0.2%	0.03
Benchmark*	4.8%	14.1%	0.34	—	—

* MSCI Europe Index. Note that in our previous study Bestinfond FI was managed versus a custom benchmark: 80% MSCI World and 20% split 70/30 between the General Index of the Madrid Stock Exchange (IGBM) and the PSI Geral Index.

Source: AQR, Bloomberg. Returns are excess of cash denominated in EUR. Risk-free rate is the ICE BofAML Euro Treasury Index. Past performance is not a guarantee of future performance; please read important disclosures at the end of this presentation.

When Paramés left Bestinver in 2014, Beltrán de la Lastra took the helm as CIO and Portfolio Manager.¹¹ Performance of Bestinfond FI since the change in management has not been as exceptional as that shown in our previous study (annual outperformance of 0.2% vs. 7.7%) which may lead some investors to wonder whether the investment philosophy is materially different under de la Lastra.

We present the regression results and return attribution in **Exhibit 2**. We find similar factor exposures for the funds as in our previous study, with significant loadings on Value and Size. But we do also find some differences,

there is no longer a significant loading on Low-Risk and there is a significant loading on Quality. The loadings appear consistent with the fund's stated investment philosophy which is to select "good businesses" (Quality) at a price "significantly lower than the intrinsic value" (Value).

The positive Quality loading contributed positively to performance over the period (3.0%), but this was offset by underperformance from Value (-4.3%). 1.7% of annual performance is unexplained by our regression and attributed to 'alpha', however this is not statistically significant.

Exhibit 2

Bestinfond FI, November 2014 - June 2020 Regression Statistics

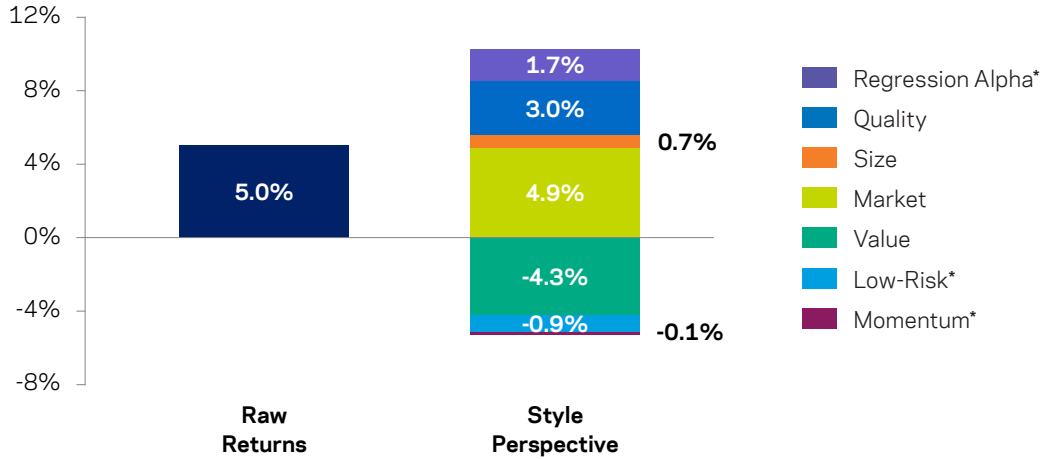
	Alpha (Annualized)	Market	Value	Momentum	Low-Risk	Quality	Size	R ²
Coefficient	1.7%*	1.01	0.54	-0.01*	-0.12*	0.39	0.67	93%
T-stat	0.7	16.6	4.1	-0.1	-1.3	2.2	5.9	—

* Not statistically significant at the 95% confidence level.

Source: AQR, Bloomberg. All variables are excess of cash. Risk-free rate is the ICE BofAML Euro Treasury Index. Return attribution is factor coefficient multiplied by average factor premium over this period.

¹¹ De la Lastra announced his departure from Bestinver in March 2020 and is expected to leave the firm by the end of the summer. Management of the international portfolio will fall to Tomás Pintó.

Exhibit 2 (Continued)
Bestinfond FI, November 2014 - June 2020 Regression Statistics



* Not statistically significant at the 95% confidence level.

Source: AQR, Bloomberg. All variables are excess of cash. Risk-free rate is the ICE BofAML Euro Treasury Index. Return attribution is factor coefficient multiplied by average factor premium over this period.

AzValor Internacional FI: Álvaro Guzmán de Lázaro

11/2015 - 06/2020	Average Excess	Volatility	Sharpe Ratio	Annual Outperformance	Information Ratio
AzValor Internacional FI	-1.1%	20.9%	-0.05	-4.0%	-0.28
Benchmark*	2.9%	13.3%	0.22	—	—

* MSCI Europe Index.

Source: AQR, Bloomberg. Returns are excess of cash denominated in EUR. Risk-free rate is the ICE BofAML Euro Treasury Index. Past performance is not a guarantee of future performance; please read important disclosures at the end of this presentation.

Álvaro Guzmán de Lázaro also worked at Bestinver and is at least partly responsible for the exceptional track record of Bestinfond FI in our previous study. He left Bestinver after 13 years and joined azValor Asset Management in 2015 where he is CIO and currently manages AzValor Internacional FI.

Over the period since Guzmán de Lázaro joined azValor in 2015, the fund has

underperformed MSCI Europe by -4.0% per annum. We examine what has been driving this performance in **Exhibit 3**. We find significant positive exposure to Value, Momentum, Quality and Size, and significant negative exposure to Low-Risk. The stated investment philosophy of the fund is to buy companies “with a long-term vision... at a price below their intrinsic value”, which would appear consistent with our findings.

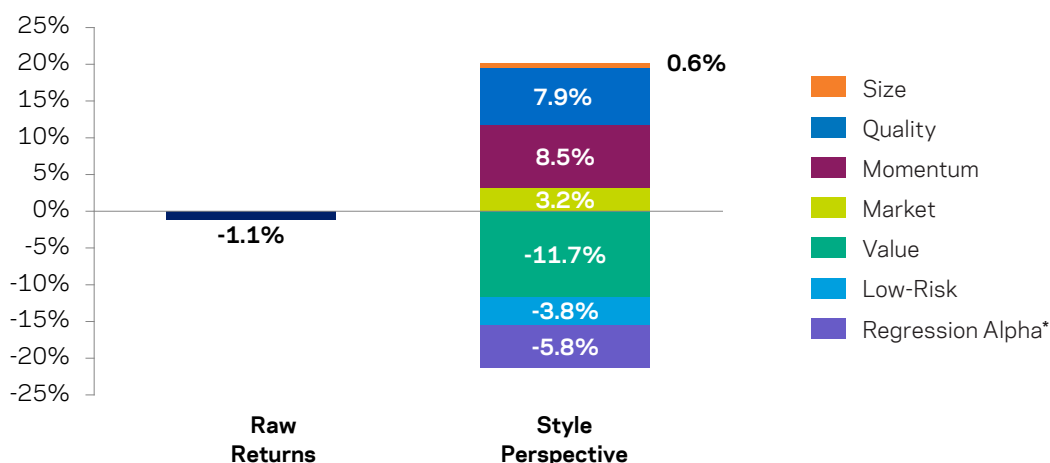
In the bottom half of Exhibit 3 we see that the biggest detractor from performance is Value (-11.7% annualized) which we know has struggled over recent history. The negative exposure to Low-Risk has also detracted from performance as companies with relatively low statistical risk tend to outperform on a

risk adjusted basis. There is also -5.8% of performance which is not explained by our regression, but it is not statistically different from zero at the 95% confidence level. The detractors were offset by substantial positive contributions from Momentum and Quality exposures, and to a smaller extent Size.

Exhibit 3

AzValor Internacional FI, November 2015 - June 2020 Regression Statistics

	Alpha (Annualized)	Market	Value	Momentum	Low-Risk	Quality	Size	R ²
Coefficient	-5.8%*	1.11	2.03	0.67	-0.48	1.19	1.25	77%
T-stat	-0.9	6.9	6.3	2.3	-2.1	2.7	4.0	—



* Not statistically significant at the 95% confidence level.

Source: AQR, Bloomberg. All variables are excess of cash. Risk-free rate is the ICE BofAML Euro Treasury Index. Return attribution is factor coefficient multiplied by average factor premium over this period.

Magallanes European Equity FI: Iván Martín Aránguez

02/2015 - 06/2020	Average Excess	Volatility	Sharpe Ratio	Annual Outperformance	Information Ratio
Magallanes European Equity FI	3.2%	16.3%	0.20	-0.2%	-0.03
Benchmark*	3.4%	14.1%	0.24	—	—

* MSCI Europe Index.

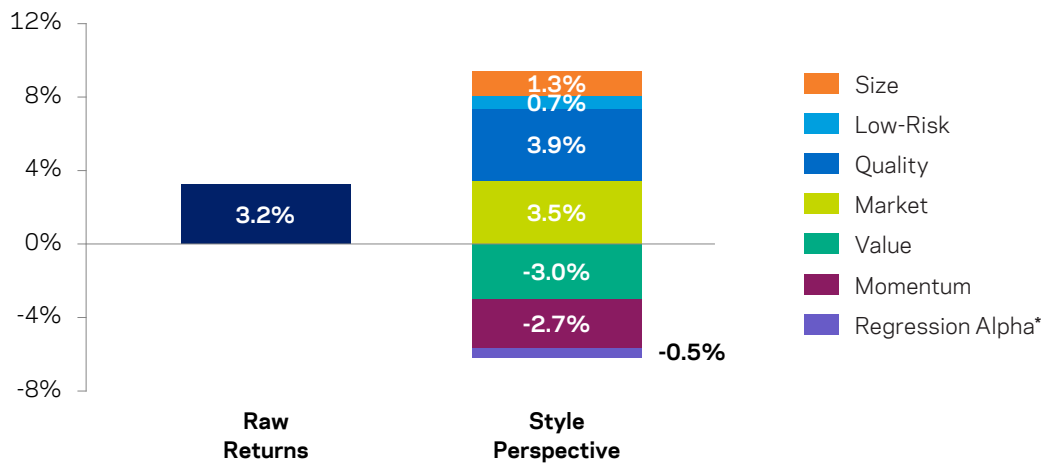
Source: AQR, Bloomberg. Returns are excess of cash denominated in EUR. Risk-free rate is the ICE BofAML Euro Treasury Index. Past performance is not a guarantee of future performance; please read important disclosures at the end of this presentation.

Iván Martín Aránguez is another well-known Spanish value investor. He previously ran equity funds with a value investment style at Santander Asset Management, prior to founding Magallanes Value Investors in 2015. Magallanes’ stated investment philosophy is to invest in companies with “attractive fundamentals and a strong discipline in price”, he describes value investing as “the discipline of purchasing businesses which are priced below their real, intrinsic, theoretical or fundamental value and then waiting the necessary time for such value to be realized.”

Magallanes European Equity FI has slightly underperformed its benchmark (-0.2% per annum since inception), but we find that Martín Aránguez’ factor exposures are consistent with his investment philosophy. We find a significant positive loading on Value, as well as significant exposures to Quality and Size. Although not statistically significant, the negative exposure to Momentum has detracted from performance over the period, along with the positive Value exposure. The exposures to Quality and Size contributed positively to performance (3.9% and 1.3% respectively).

Exhibit 4
Magallanes European Equity FI, February 2015 - June 2020 Regression Statistics

	Alpha (Annualized)	Market	Value	Momentum	Low-Risk	Quality	Size	R ²
Coefficient	-0.5%*	1.02	0.45	-0.21*	0.08*	0.57	0.76	85%
T-stat	-0.1	11.1	2.3	-1.3	0.6	2.1	4.4	—



* Not statistically significant at the 95% confidence level.

Source: AQR, Bloomberg. All variables are excess of cash. Risk-free rate is the ICE BofAML Euro Treasury Index. Return attribution is factor coefficient multiplied by average factor premium over this period.

Conclusion

In our previous study we found that patience contributed to Paramés' success - he was able to stick to his investment philosophy, which allowed the small edges created by exposure to the factors we identified to accumulate into an excellent long-term track record.

In this study we revisited Paramés along with three other well-known Spanish value investors; Beltrán de la Lastra, Álvaro Guzmán de Lazaro, and Iván Martín Aránguez. We found that despite recent underperformance they have stuck with their investment philosophies which are rooted in value investing.

As Brooks et al. conclude in their research, we argue that these findings, along with those of our previous study of Paramés, should encourage investors to understand which styles their managers are giving them

exposure to and decide whether they believe in the long-term efficacy of those styles. If there is sufficient evidence to support the persistence of those styles,¹² then we believe investors should have the patience to stick with them through market volatility and reap the potential long-term rewards.

We reiterate that given the current low expected return environment for traditional asset classes,¹³ any non-market sources of return are especially valuable to investors. Historically, any excess return was considered opaque alpha; however, today much of this can be attributed to well-researched styles. With enough patience and the right implementation,¹⁴ exposure to these styles has the potential to provide a significant edge over the long term - acknowledging that no risk-taking investment strategy is a surefire winner over the short term.

12 See Asness, Ilmanen, Israel and Moskowitz (2015) for decades of evidence across multiple regions and asset classes for the factors we believe in.

13 The expected real return of the traditional U.S. 60/40 portfolio is 1.5%, compared to a long-term average of 5% (since 1900). This is based on historical real yields for U.S. large-cap equities and 10-year Treasuries; methodology and sources described in Appendix. See AQR Alternative Thinking 1Q2020 for a detailed discussion of realistic capital market assumptions.

14 See Israel, Jiang and Ross (2017), "Craftmanship Alpha: An Application to Style Investing."

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Appendix

Factor Descriptions

Market: MSCI Europe Net Total Return Index minus 1-month Treasury bills (the risk-free rate used elsewhere in this article).

Value: the "HMLdevil" (High Minus Low) factor from AQR's data library, as defined in Asness and Frazzini (2014). Formed from the Europe universe of stocks. "HMLdevil" is the average return on the two value portfolios minus the average return on the two growth portfolios, $HMLdevil = 1/2 (\text{Small Value} + \text{Big Value}) - 1/2 (\text{Small Growth} + \text{Big Growth})$. The superscript "devil" indicates that to compute book to market ratios we scale book equity (BE) by the current total market value of equity (ME) at the end of each month following Asness and Frazzini (2013). HMLdevil portfolios are value-weighted. The size and book-to-market breakpoints are refreshed every calendar month, and the portfolios are rebalanced every calendar month to maintain value weights.

Momentum: the UMD (Up Minus Down) factor from AQR's data library. The portfolio construction follows Fama and French (1992, 1993 and 1996) and Asness and Frazzini (2013). We form one set of portfolios in each country and compute global factor portfolios by weighting each country's portfolio by the country's total (lagged) market capitalization. The momentum factor is constructed using six value-weighted portfolios formed on 1-year return (return over the prior 12 months, skipping the most recent month). At the end of each calendar month, stocks are assigned to two size-sorted portfolios based on their market capitalization. For European equities the size breakpoint is the 80th percentile by country. We use conditional sorts, first sorting on size, then on the second variable. Portfolios are value-weighted, refreshed every calendar month, and rebalanced every calendar month to maintain value weights. The momentum factor UMD is the average return on the two high return portfolios minus the average return on the two low return portfolios.

Low-Risk: the "Betting-Against-Beta" (BAB) factor from AQR's data library, as defined in Frazzini and Pedersen (2014). BAB factors are portfolios that are long low-beta securities and that short-sell high-beta. To construct each BAB factor, all securities in a country are ranked in ascending order on the basis of their estimated beta, and the ranked securities are assigned to one of two portfolios: low-beta and high-beta. In each portfolio, securities are weighted by the ranked betas (lower-beta securities have larger weights in the low-beta portfolio and higher-beta securities have larger weights in the high-beta portfolio). The portfolios are rebalanced every calendar month. To construct the BAB factor, both portfolios are rescaled to have a beta of one at portfolio formation. The BAB is the self-financing zero-beta portfolio that is long the low-beta portfolio and that short-sells the high-beta portfolio.

Quality: the "Quality-Minus-Junk" (QMJ) factor from AQR's data library, as defined in Asness, Frazzini and Pedersen (2014). The Quality Score is the average of four aspects of quality: Profitability, Growth, Safety and Payout. We use a broad set of measures to compute each of four aspects of quality; the score for each aspect is the average of the individual z-scores of the underlying measure. Each variable is converted each month into ranks and standardized to obtain the z-score. 1) Profitability is measured by gross profits over assets, return on equity, return on assets, cash flow over assets, gross margin, and the fraction of earnings composed of cash. 2) Growth is measured by the five-year prior growth in profitability, averaged across the measures of profitability. 3) Safety is defined as companies with low beta, low idiosyncratic volatility, low leverage, low bankruptcy risk and low ROE volatility. 4) Payout is defined using equity and debt net issuance and total net payout over profits. QMJ factors are constructed as the intersection of six value-weighted portfolios formed on size and quality. At the end of each calendar month, we assign stocks to two size-sorted portfolios based on their market capitalization. For U.S. securities, the size breakpoint is the median NYSE market equity. We use conditional sorts, first sorting on size, then on quality. Portfolios are value-weighted, refreshed every calendar month, and rebalanced every calendar month to maintain value weights. The QMJ factor return is the average return on the two high-quality portfolios minus the average return on the two low-quality (junk) portfolios.

Size: the SMB factor (as described in Kenneth French's Data Library): is the average return on the three small portfolios minus the average return on the three big portfolios: $SMB = 1/3 (\text{Small Value} + \text{Small Neutral} + \text{Small Growth}) - 1/3 (\text{Big Value} + \text{Big Neutral} + \text{Big Growth})$. See Fama and French, 1993, "Common Risk Factors in the Returns on Stocks and Bonds," *Journal of Financial Economics*, for a complete description of the factor returns.

Sources and Methodology for Long-Term Historical Expected Returns:

Sources for historical equity and bond expected returns are AQR, Robert Shiller's data library, Kozicki-Tinsley (2006), Federal Reserve Bank of Philadelphia, Blue Chip Economic Indicators, Consensus Economics and Morningstar. Prior to 1926, stocks are represented by a reconstruction of the S&P 500 available on Robert Shiller's website, which uses dividends and earnings data from Cowles and associates, interpolated from annual data. After that, stocks are the S&P 500. Bonds are represented by long-dated Treasuries. The equity yield is a 50/50 mix of two measures: 50% Shiller E/P * 1.075 and 50% Dividend/Price + 1.5%. Scalars are used to account for long-term real Earnings Per Share (EPS) Growth. Bond yield is 10-year real Treasury yield minus 10-year inflation forecast as in Expected Returns (Ilmanen, 2011), with no rolldown added.

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