

Killing the Market

The four-year-old equity-focused hedge fund founded by **John C. Thompson, '99**, is generating outstanding returns

John C. Thompson, '99, was a successful fund manager for Thompson Investment Management, a firm started by his father in Madison, Wisconsin. He grew an equity mutual fund from \$5 million to \$1.5 billion over 10 years, and boosted a bond fund from \$13 million to \$3.7 billion. But when he founded Vilas Capital Management in 2010 and started asking people to invest in the fund, which held a number of financial services stocks only a year after the crisis, they “looked at me like I was a serial killer.”

Thompson left his father's firm in 2009 to launch the value-based hedge fund. To establish a track record, he has spent the last four years “quietly managing” \$5 million for friends and family.

At the end of September, a Morningstar Inc. hedge fund report showed the Vilas Fund had ranked in the top one percent of its category (US Long/Short Equity) with a three-year annualized return net-of-fees of 62.63 percent, beating the market by over 39 percent per year. Only one mutual fund in the Morningstar database did better. In a September 30, 2014, BarclayHedge report, Vilas ranked No. 6 out of 3,224 hedge funds in all categories.

Thompson said his investment philosophy is inspired by his former professor, **Robert W. Vishny**, Myron S. Scholes Distinguished Service Professor of Finance, whose research found that value outperforms growth. “If you cut the market into tenths or deciles, the cheapest decile on a price-to-book basis outperforms the most expensive decile by something like 10.5 percent a year over rolling five-year periods,” Thompson said.

As part of its strategy, Vilas shorts very expensive stocks, something other investors are often loath to do. “Many investment firms aren't willing to suffer through the bad times,” Thompson said, “so they often ‘closet index’ [track a stock index] and investors end up getting index-like returns minus much higher active-management fees.”

“This is a fund that does not hesitate to take risk,” said **Lubos Pastor**, Charles P. McQuaid Professor of Finance, who has reviewed the reports on Vilas. “That is a good thing. If I'm paying a nontrivial fee to a manager, I want that manager to take risk. If I don't want him to take risk, I should go with an index fund. Why would anyone pay a fee like this if they didn't want to take calculated risks?”

Among Vilas's positions at the end of 2014: a large holding in Citigroup, one of the top-five credit-card issuers that was trading “extremely inexpensively” in terms of price to book. The fund's biggest short position was Amazon, a stock that was trading at over 500 times trailing earnings results.

Many traditional investors use backward-looking risk measures such as volatility, which can be misleading, Morningstar analyst Josh Charney wrote in the company's *Alternative Investment Advisor* newsletter last summer. Instead,

Vilas examines valuation and a stock's liquidation value, enabling it to be more forward looking, Charney wrote.

Thompson, who was born in the Chicago suburb of Hinsdale, moved back to the city from Madison to take advantage of the talent pool in finance. Thompson met one of those talented financial professionals, **Joe Cortese, '10**, at a networking event organized by the firm where Cortese was a senior investment consultant.

The two hit it off and found they shared the Booth MBA. In anticipation of the solid three-year return rankings, Cortese joined Vilas as managing director last year. Investment in the fund has more than doubled in the last year and currently stands at just over \$12 million. Thompson and Cortese believe that they are on track to grow it to at least \$100 million by the end of 2015 and well over \$1 billion by 2018. Cortese said he is in talks with several large institutional investors and his goal is to “take the Vilas message to a wider audience.”—*Rebecca Rolles*



John C. Thompson (left), and Joe Cortese

The following disclosures pertain to the article reprint titled “Killing the Market” originally appearing in the Winter 2015 edition of the Chicago Booth Magazine.

Performance data referenced represents past performance and does not guarantee future results. Performance includes the reinvestment of dividends and other earnings. Net performance is net of all fees and is based upon the current investors’ fee structure. Future performance will vary depending upon each investor’s capital account and fee structure. Any discussion of stocks within the article should not be considered recommendations to buy or sell such security. The Vilas Fund, LP’s specialized investment program involves risk. A detailed review of the risk factors are described in the offering materials, which you should read carefully before considering an investment in The Vilas Fund, LP. The current performance may be higher or lower than the performance data provided herein. The Vilas Fund, LP performance may not be directly comparable to the performance of other private or registered funds. *Current fund information including performance data, can be obtained by visiting www.vilascapital.com.*

As of 9/30/2014, a search of the Morningstar database found that only one unique mutual fund had a higher trailing three year performance record, net of fees, higher than Vilas Fund, LP. This data included all mutual funds, index funds, alternative funds, etc., numbering in the thousands. The Morningstar ranking is based solely on performance. Vilas Fund’s 3 year annualized return as of 9/30/2014 was 62.63% compared to the S&P 500 Index of 22.99% and the HFR Fundamental Value Index of 11.67 for the same time period. The S&P 500 Index represents 500 of the United States’ largest stocks from a broad variety of industries and includes reinvested dividends. The HFR Fundamental Value Index includes strategies which employ investment processes designed to identify attractive opportunities in securities of companies which trade a valuation metrics by which the manager determines them to be inexpensive and undervalued when compared with relevant benchmarks. A wide variety of investment processes can be employed to arrive at an investment decision and strategies can be broadly diversified or narrowly focused and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations and valuation ranges.

The ranking in the BarclayHedge report was based on trailing 3 year performance returns (net of fees) through September 30, 2014. The Vilas Fund, LP was ranked against all funds (including hedge funds and funds of funds) in the database, which consisted of 3,224 funds in total. BarclayHedge created this report at the request of Vilas Capital Management, LLC. *A copy of the report can be obtained from Vilas Capital Management by calling (312) 702-1976.*

The bond fund referenced in the article, The Thompson Bond Fund, was ranked #1 in the Morningstar Short Term Bond Category for the 1, 3, 5 and 10 year periods ended 6/30/09. Details of the ranking are as follows: Ranked 1 out of 416 funds for the 1 year period; ranked 1 out of 358 funds for the 3 year period; ranked 1 out of 301 funds for the 5 year period and ranked 1 out of 157 funds for the 10 year period. The Morningstar Ranking represented the fund’s total-return percentile relative to all funds that had the same Morningstar Category. The highest percentile rank was 1 and the lowest was 100. It was based on Morningstar total return, which included both income and capital gains or losses and was not adjusted for sales charges or redemption fee. John C. Thompson was the lead fund manager for the Thompson Bond Fund during the decade ending in 2009. As a result of the fund’s performance and ranking in 2009, which were due to securities that were purchased by him, the fund assets grew to over \$3 billion.

The Vilas Fund, LP is a private fund and the securities are offered in reliance on an exemption from the registration requirements of the Securities Act and are not subject to the protections of the Investment Company Act. The Securities and Exchange Commission has not reviewed the securities or the offering materials. The Vilas Fund, LP securities are subject to legal restrictions on transfer and resale and investors should not assume they would be able to resell them. All information contained herein is subject to revision and completion. Should there be a discrepancy between the offering materials and this document, the offering materials will control. This document is not intended to be a complete description of the business engaged in by Vilas Capital Management, LLC, nor is it an offering or solicitation to invest. Any such offer or solicitation may be made only by means of a confidential private offering memorandum. No subscriptions will be received or accepted until subscription documents are completed and Vilas Capital Management, LLC has approved the subscription agreement and an investor’s eligibility to invest. Prospective investors must be accredited investors and meet certain minimum annual income or net worth thresholds in order to be eligible to invest.