

APPALACHES

capital

For the Love of the Game

Why I Started Appalaches

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*Reflections on Investing is a long form written series of content related to designing an investment process generally. The series is intended to add value to other investors as they think about their own investment process, as well as industry clients as they evaluate the process of their own advisors. This series assumes that skilled active management is able to add value. This is provided for informational purposes only and **is not** a detailed description of the methods by which Appalaches Capital manages client assets. Please see all disclosures at the end of this document.*

Introduction

Just two months ago, Appalaches Capital completed its first year investing client assets. Come next month, my fledgling firm will already be two years old. Personally, I am surprised at how quickly this milestone has come.

Even today, one of the questions I get asked most often is some derivation of: “Why?” When kindly asked, the question is normally “Why did you decide to start an investment firm?” Sometimes, the question is less kindly asked: “Why do you think you’ll be able to make this work?” While I certainly prefer the tact of the former, they are both fair questions.

I first started mulling over the idea in July of 2022 in the middle of an internship at a hedge fund platform that would, ultimately, not be the right fit for me. While the work was still close to markets and interesting, my personality and temperament did not immediately mesh with the firm's culture. I was born and raised in the great Bluegrass State, and I certainly do not come from an affluent background. In New York City, this makes me somewhat enigmatic, and even more so in the institutional ecosystem.

Given the cultural gap, I began to wonder what I would do going forward. If I did not receive a return offer, I could have gone to work for another firm. I knew that I wanted to continue to invest for a living. However, in all likelihood, I would be in a similar situation as I was before. Well-paid, but having no autonomy. Secure, but having little motivation. How long would I find this satisfying, if at all?

The other path would be starting my own firm. If not now, then later. And, if it was later, it's not as though I would be starting at a much greater scale. Unless you lift out of a well-known platform, most launches tend to be small, even among seasoned professionals.

After the summer, I entertained more practical opportunities to try to ignore the itch to strike out on my own. But this effort didn't seem to make much progress; the idea instead continued to eat at me for months. I must admit, I was a little disillusioned with the industry and how it worked, but this same disillusionment also proved to be a source of motivation. What if I could build something truly different? What if building something different could actually lead to better outcomes?

A few months had passed. I knew what I wanted to do but also knew that I would not be able to travel down this path alone. This is a relationship business after all! I finally decided to sit down with a mentor and ask for his opinion, fully expecting to be told how silly it was. And yet, that's not what happened; he instead told me that I had his full support. I didn't need to hear anything else. I took that and ran with it.

Investing Deliberately

Sure, I had made up my mind. But many others thought that I had lost my mind, and I think that was a fair assumption to make from their perspective. If it were financial motivations that led to my decision, I would surely be taking the wrong end of the proposition. I could have very easily started my career

somewhere else to make two or three times as much as I do now with much more certainty. I did not overlook that. However, I have never viewed a career in investing simply as a means to an end.

In some capacity or another, I have been investing since the ripe old age of twelve. I don't quite remember how it started—possibly because buying stocks seemed like a better way to make money than betting trifectas at Churchill Downs—but I have not found anything else that comes even close to being as intellectually rewarding. And since I began, all I have wanted is to grow to become better. There are very few pursuits where someone's efforts have such a measurable and tangible result, yet also where the destination is permanently affixed to the horizon. Every day I am urged to understand the world a little bit better, think deeper, and act with respect to a decision's significance. My analyses, discoveries, and actions directly lead to outcomes for myself and clients, both good and bad. I am not sure if there exists another medium where someone can express their thoughts and opinions of the world in such an efficiently significant way. Appalaches was born out of necessity; I believed that this was the only way to preserve the integrity of this ideal.

Above all else, my inspiration to start Appalaches was rooted in a love for the game. Likely, had I gone to another large fund platform or asset manager, I would have found myself in a position of structural complacency. Fundamentally, I would not own my work or my decisions. My path towards true and unrestricted improvement would constantly be at odds with the external influences of safety steeped in layers of hierarchy. I would be too far removed from the consequences of my actions, while being embedded within a highly mechanical investment process designed to fit arbitrary risk frameworks. Rejecting the norm and pursuing authenticity was my way of placing myself in the best position to succeed in the long run. It was my way of preserving an honest perspective on my efforts in order to truly grow as both an investor and individual. If Appalaches fails, I will not have anyone to blame but myself, and I would not prefer to have it any other way.

While not often mentioned in such a glowing review of the merits of capitalism, Henry David Thoreau said something of a similar effect quite elegantly in *Walden*:

"I went to the woods because I wished to live deliberately, to front only the essential facts of life, and see if I could not learn what it had to teach, and not, when I came to die, discover that I had not lived. I did not wish to live what was not life, living is so dear; nor did I wish to practise resignation, unless it was quite necessary..."

I am, of course, far removed from Thoreau, and certainly not living as a hermit in the woods. Still, the motivation to live deliberately is certainly one that I can understand. Embarking on this journey so far has been full of nothing but deliberate actions. No one really has a blueprint for starting a business like this just a few months after walking off the stage with a diploma in hand. Metaphorically speaking, I *am* in the woods. I am comfortable with the risk of being different, although, I did not choose this path to be different for contrarianism's sake. More than just living deliberately, I wanted to *invest deliberately*.

Agency Costs

My epiphany, my big “ah-hah” moment, was when I realized that many opportunistic quirks of the market could be explained by agency costs. Believe it or not, I do think that markets are typically highly efficient at disseminating and digesting information. However, similar to mechanical systems, intermediary processes reduce the efficiency of taking information and incorporating it into prices. Most investing is performed by agents (investment managers), who will very naturally have different incentives than their principals (clients). These frictions between the sometimes-competing incentives of the investment manager and the client are considered to be agency costs. These frictions can be small or large, as well as temporary or ever-present.

Narrow investment mandates can make it easier to raise capital but more difficult to pursue the best opportunities. Investment committees with dozens of individuals signing off on each decision may sound appealing to an allocator but also encourage groupthink and herding. Boring, “steady Eddie” stocks may be ignored in favor of other more volatile and presently popular issues that give a manager a greater chance of being a top-quartile performer for the year (or quarter). Investment managers possessing a client base that is short-term in nature will be pressured to think and invest accordingly. Managers who benchmark to a cheaply available index will be incentivized to minimize their tracking errors so as not to risk material underperformance in any given year. The deeply entrenched barriers that prevent investors from investing deliberately are the agency costs that they have unknowingly incurred in their structure.

I did not just want to avoid these costs; I wanted to take advantage of them. Logically, the only way to do this was to build something outside of convention. It would have been far too naïve to start this venture only because I liked the work. Rather, I truly believe that there is a tremendous amount of value to be captured by being intentionally structured differently than the rest of investors, whether it's by mandate or otherwise. Some of this value can be quantified, some of it cannot.

Many of the greatest investing track records can be in large part attributed to having the right structural elements, whether it was Berkshire's permanent capital, Baupost's willingness to hold cash, or Nomad's well-defined vision and expectations. Whatever the case, the principal-agent structure has a significant but oftentimes hidden effect on investment outcomes.

In light of this, Appalaches was designed to capitalize on this philosophy, even if it made its services less marketable. The firm's strategy is agnostic to size, geography, and sector, Morningstar would likely have a hard time fitting it to any specific style bucket. The portfolio is concentrated and at times eclectic, and while it is never my goal, the portfolio additionally holds significant cash when limited discernable opportunities are available. I have not sought to benchmark its performance against any index in the near term, because I think it is both counterproductive and difficult to find an index that is suitable. I have done my best to keep costs reasonably low such that the business can persist without the need for a large infusion of capital, instead keeping the focus on investment performance rather than marketing. My competitive focus is on keeping our agency costs as low as possible while taking advantage of the agency costs of others. I believe this is what makes this effort worthwhile.

Conclusion

Before I officially launched Appalaches, I had some people ask me how I would manage to grow assets while also keeping up with managing the portfolio. To be honest, I did not have a great answer at the time, aside from stating, that assets would grow at least as fast as my returns if I did my job right. The idea that the two acts should be mutually exclusive is a prime example of the shortcomings of the industry.

Now, with more reflection, I still hold the same opinion. However, I also realize that I am only one piece of the puzzle. The principal-agent relationship is two-sided. So now, my revised answer is instead:

- 1) Compounding current assets, and
- 2) Sharing this vision with potential like-minded clients and partners.

And of course, having a love for the game doesn't hurt either.

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Endnotes