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Money Matters

Profit In Numbers and Common Cents: In the Art Of Interactive Investing, Who You Know Counts

Some ideas are so obvious it takes a genius to think of them.

Steven Abernathy does not claim to be a financial genius, but he is quick to call you a fool if you think you can beat his investments. Yet it is not a matter of pride; in fact, he needs your help.

The Abernathy Group is a professional money management team that specializes in the health-care and technology fields. Its client base comprises industry experts in these two sectors who participate in what Mr. Abernathy calls "interactive investing"—a requirement of information to accompany any money the group takes in.

"The surest way to get the best information is to have those who are providing the information have the same money on the line that you do," said Mr. Abernathy, whose mantra is, simply, "The idea is so simple."

The group currently manages $150 million for its nearly 150 interactive investors. Mr. Abernathy meets with each client twice a year to throw ideas around and get the real scoop from the users and buyers of the health-care and technology products in which he seeks to invest.

Mr. Abernathy's approach differs from that of most money managers, who usually consider themselves all-around experts. His humility lies in the realization that he can understand a company's financials in and out but can still learn from the preferences of the experts actually using the products. "Interactive investing is the amalgam of product expertise and financial expertise, and you need to have both," he said. "It's almost impossible for one person to have both with any breadth."

Mr. Abernathy's investment style is not for everyone. He chooses companies that will perform in the long term and eschew overdiversification. Those not comfortable with his style are encouraged to find help elsewhere.

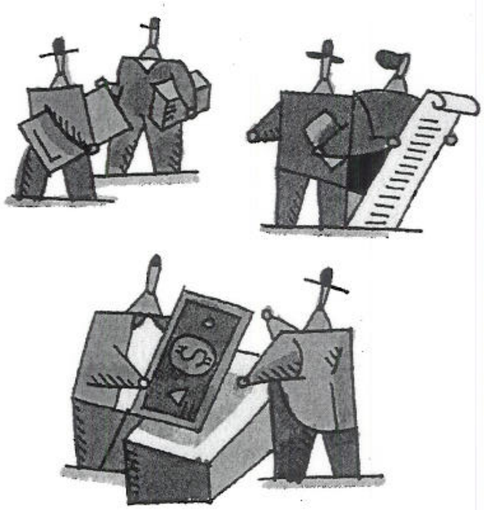
An investor might want to think twice, however, before venturing too far away. Abernathy was ranked the No. 1 money manager by Nelson's for 1-year and 5-year funds ending in March 1998. Highlights from the aggressive fund are astounding, with returns in 1991 of 142.65%, in 1993 of 147.17%, in 1995 of 46.67% and in 1997 of 39.37%. An investment of $1 million in Mr. Abernathy's aggressive growth fund in 1991 would be $19,361,387 now, compared with $4,768,709 had the money been bet on the performance of the Standard & Poors 500 index.

All of Mr. Abernathy's ideas revolve around his concept of interactive investing, and the main goal has always been to attain an informational advantage and then to act upon it. Mr. Abernathy reduces his strategies into simple logic: "The less you know, the more you diversify; the more you know, the less you diversify." To that end, he refuses to keep more than 12 companies in his portfolio; his experience has demonstrated that the work involved in taking on too many companies necessarily detracts from the ongoing research that can be performed on his present investments. Ultimately, "the added diversification you gain doesn't benefit the sum," he said.

Whereas some would consider this risky, Mr. Abernathy sees it as merely a function of making his hard work pay off. He takes great pains to spend time with the management of companies in which he would consider buying a stake.

Only by understanding the business model and the sales and manufacturing structures can he form a time frame for a company's viability as an investment.

This is when his talks with his clients steer him to a final decision. "It's likely, as often as not, that this keeps us out of bad areas," Mr. Abernathy said.



He cited the case of Medicis, a company that provided an office management service to doctors in private practice. On paper, Medicis was a winner, but four out of the six doctors Mr. Abernathy spoke with hated the group. Based solely on these recommendations, he decided to hold off any acquisitions. He then watched without surprise as the stock tumbled in a matter of months from $60 per share to a paltry $8.

The flip side of this interaction occurs when his business acumen steers him away from what looks like a sure thing strictly from the medical side. Demonstrating this scenario, Mr. Abernathy thought a laparoscopic surgery device made by U.S. Surgical Corporation could be a strong bet. According to Mr. Abernathy, surgeons agreed that the product, while selling for the same price, was superior to its competition. Johnson & Johnson, however, waged a secret price war by bundling its product with unrelated, discounted items, said Mr. Abernathy. In no time, U.S. Surgical found itself overstocked and bloated on the market. And in the end, Mr. Abernathy was able to avoid making such a mistake by conferring with the buyers. Once again, the informational edge gained through his investment contacts helped him steer clear of a dud that otherwise appeared ready to explode.

Mr. Abernathy lists Cisco and Merck as two companies that he bought against market trends based on the interaction he shared with his clients. "They've been great companies," he said. "We owe a lot of that to our investors. They help us distinguish between what the market thinks and [what the reality is]."

'Interactive investing is the amalgam of product expertise and financial expertise, and you need to have both. [But] it's almost impossible for one person to have both with any breadth.'

—Steven Abernathy

When you meet with Mr. Abernathy, it is very clear that you are the pupil and he is your teacher. His thoroughness and preparedness are broad, evident traits, and you feel compelled to give him the cash in your pocket because you no longer feel qualified to spend it yourself.

Mr. Abernathy is happy to see that people are warming up to his concepts. The third quarter of 1998 delivered a strong blow to his portfolio, but despite 20% losses, the money continued to flow in. "People were starting to understand that when we're down, our companies are just down temporarily and we need to buy," he said. "We're going to put more money in if it's down. Those people ended up having a pretty good year because they bought at a low price and everything rebounded in the last quarter."

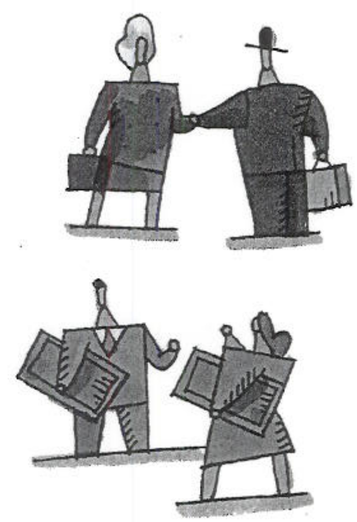
Not every year has been stellar for the Abernathy Group. In 1994, for example, a miscalculation of the semiconductor industry led to a 6.3% annual loss. Overall, though, Mr. Abernathy has ridden the bull market to great heights—just as his research and information told him he would.

"I don't get a salary," he said. "I don't get a penny unless we perform. None of the partners here gets one red cent a year. I have my money where my mouth is."

When he talks, that money usually performs very well. And that's because when an expert in his stable of investors talks, he makes sure to listen.

—John T. Carr

Based on an interview with **Mr. Steven Abernathy.**



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