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PROFILE

Parus Fund: Going for Growth

By Michael Shari July 26, 2014

June Hedge Funds: Best, Worst, Biggest

As a child growing up in Paris' wealthy 16th *Arrondissement*, an elite enclave of French high society, Fabrice Vecchioli was fascinated by his long talks with his grandfather about stocks and bonds. Investing for his own account, the elder Vecchioli made money through World Wars I and II and the Great Depression. "He looked at the opportunities in the darkness," recalls the Belgian-born Vecchioli, 52. "He said it was always good in the long run."

So Vecchioli looked for investment opportunities as soon as he graduated from the esteemed *École Polytechnique* in Palaiseau, France, in 1986 with a master's degree in mathematics and physics. At a time when European interest rates were falling from historic highs of 18% to 20%, the most lucrative opportunity in sight was in fixed income. Starting out as a market maker in government bonds, he went to work for a couple of French fixed-income managers, following rates all the way down to 3% to 5%. After the dot-com crash of 2000, Vecchioli made the switch to equities, snapping up growth stocks on the cheap. In 2002, he struck out on his own as a long-short global equity hedge fund manager, founding the Parus fund with his younger brother, Edouard, and \$4.4 million from family and friends.

Since then, Vecchioli, his brother, and their two portfolio managers have beaten the vast majority of equity hedge funds by being early to spot growth companies that invent, and seem likely to dominate, new technologies. His biggest holding today is [Facebook](#) (ticker: FB), which makes up 7.5% of assets, followed by Internet giant [Google](#) (GOOGL), at 6.2% of assets. A smaller holding is [Apple](#) (AAPL), which he bought for a split-adjusted price of about \$5 a share in June 2005, two years before the introduction of the first iPhone. Since then, Apple is up a whopping 1,788%. Prescient bets like that got Vecchioli through the crisis in 2008 with only an 8.9% loss, while the Standard & Poor's 500 index fell 37% that year.



London-based hedge-fund manager Fabrice Vecchioli likes big U.S. stocks with clear paths to rising profits.

Photo: Chris Gloag for Barron's

The performance of the Parus portfolio, which has about 35 long positions and as many as 20 shorts at any time, earned a spot on our list of Best 100 Hedge Funds in May. From inception in December 2002 to June 30 this year, the fund's U.S. dollar class has delivered an annualized 17.13% return net of a 1.5% management fee and a 20% performance fee, according to BarclayHedge. For the three years through June 30, the fund is up an annualized 13.92%.

But performance fell virtually flat during the first half of 2014, as investors sold growth stocks, like the ones Parus owns, and took refuge in safer, dividend-paying stocks. To power up the fund, which is currently 15% short and 75% long, Vecchioli is planning to short more stocks. "We really want to short companies that are at risk of disappearing," he says. He recently shorted three offshore-drilling companies: [Diamond Offshore Drilling \(DO\)](#), [Ensco \(ESV\)](#), and [Transocean \(RIG\)](#). He sees their earnings being crushed by cutbacks in spending by big oil companies, increases in shale-gas and shale-oil supplies, and a proliferation of solar energy.

Earlier in the year, he shorted [Best Buy \(BBY\)](#), [Staples \(SPLS\)](#), and [Bed Bath & Beyond \(BBBY\)](#), which he believes could be put out of business by lower prices on [Amazon.com \(AMZN\)](#). *Barron's* made a case for the other side of the trade in a recent cover story ("[Summer Bargains](#)," July 14).

Short positions have generated 21% of the fund's gains since inception.

TODAY, TWO YEARS AFTER Vecchioli moved the Parus office to London from Paris, the Ireland-registered flagship fund has \$404.6 million in assets. Another \$370 million is in two smaller hedge funds that Vecchioli runs under exactly the same strategy—an offshore fund launched for U.S. investors in April and a fund registered for European investors a year ago. Minimum investments in the funds vary from \$135,000 to \$500,000.

Vecchioli will buy a stock only if he's convinced the price will rise by at least 15% a year over the next five or six years, based on his model for earnings growth.

A case in point is Facebook. Vecchioli did not invest immediately after the social network's May 2012 initial public offering, he says, because "we were not clear about the mobile strategy." But he took a closer look when the stock price fell by about 50% that summer. But with mobile use growing at nearly 70% year on year, he determined that the company would generate \$5 of earnings per share by 2018. At 25 to 30 times earnings, the stock could be worth \$125 to \$150 by 2018, he figured.

Vecchioli first bought Facebook in September 2012 for about \$20 a share; it traded at \$75 late last week. He continues to be bullish, noting that about a quarter of all mobile minutes in the U.S. are now spent on Facebook and its photo-sharing app Instagram.

When he looked at electric-car maker [Tesla \(TSLA\)](#) last year, he concluded the loss-making company could grow sales as fast as the U.S. auto industry did in its infancy a century ago. He thought Tesla could sell about 500,000 cars a year for about \$50,000 each by 2020, with earnings before interest and taxes of \$4 billion; that assumes an operating profit margin of 16%, in line with Porsche and Harley-Davidson. He bought Tesla for about \$70 in May 2013; the stock recently traded at \$223. Vecchioli recently sold half of his stake in the company, but is still bullish on the stock long term.

"Tesla is a little like Google in the very early days," says Marc Chatin, a portfolio manager at the firm. "It is difficult to do what they do, and it's very much ahead of the competition."

Vecchioli stands ready to change his outlook on a stock when the situation changes dramatically. Earlier this month, Fannie Mae and Freddie Mac proposed stricter capital requirements for mortgage-insurance companies such as [MGIC Investment \(MTG\)](#) and [Radian Group \(RDN\)](#), which together make up nearly 10% of the Parus fund's assets. The stocks fell on fears that mortgage insurers could be forced to raise new capital, potentially diluting shareholders.

He bought shares of both companies in March 2013, after delinquency rates on home mortgages had fallen, he says, to "near zero" levels. He thought that profit margins, then negative, would fatten from there. MGIC has more than doubled since then, even after the pullback. Radian is up about 31%. Now Vecchioli is reassessing these investments.

The months ahead could be challenging for the fund as it looks to refresh its gains. But the manager professes not to be worried. Nor, it seems, are his investors.

"Vecchioli has always been early to anticipate structural economic change in the industries he invests in," says Charles de Germiny, a private banker at Pictet in London whose clients invest in the fund. "He's been here before, and he has rebounded."

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