Epsilon Theory

Notes from the Road: Path to the Super Bowl

November 7, 2018

Did the Cowboys secure a Greg Bell among the five players they received from the Vikings? If so, where is he? That's the disappointing aspect of this deal – no substance among those five players…those stealin', dealin' Vikings didn't miss a trick…it's a textbook example of how the strong fleece the weak in a blockbuster trade. All they had to do was find somebody dumb enough to fall for it.

- *"Take wool from Cowboys' eyes, Vikings flat out fleeced them" Randy Galloway, The Dallas Morning News (October 14, 1989)*

The media, and the public all made precisely the same mistake: They figured that I was so shorthanded that I'd have to keep all the old Minnesota players…bringing them in was essentially a formality. I wanted the draft picks.

- *Turning the Thing Around – My Life in Football, by Jimmy Johnson (1993)*

You live in Texas now. You love the game of football. You just don't know it yet.

- *Friday Night Lights, Season 5, Episode 1 ("Expectations") (2010)*

When I traveled to Ireland this summer, I went almost five days at one point with zero human contact. I found the cure for an associated momentary bout of homesickness in the most unlikely place imaginable: Friday Night Lights on Irish satellite television. Not the decent movie from 2004. I'm talking about the last great network television drama. The source of the line from Ben's recent note Clear Eyes, Full Hearts, Can't Lose. It's a show that I can't imagine a European audience would really have understood, so steeped as it is in the special rituals of small-town football in the rural USA. But maybe they would. After all, even I didn't grow up loving football. After years of living in Texas, I would come to. I just didn't know it yet.

There is something magical about walking through a small town in America on a Friday night between Labor Day and Christmas. Empty streets, other than the odd through-traveler. Darkened storefronts, the third or fourth reverberation of a snare drum in the distance. It's too far to hear trumpets, cheerleaders or whistles, but the bass of the marching band's sousaphones carries. Every once in a while, if you stay long enough, you'll hear the swell of the crowd in the distance, a universal roar that all sports fans would know and appreciate. The picture at the top of this note is from a typical Friday night in my hometown in Texas.

For some reason, in football anyway, the legends of these games always seem to come from towns like this. It's easy to come up with cynical explanations – that small towns elevate gifted young men and women into legends because there isn't that much else going on. I choose to see it a different way. I think these towns are uniquely willing to invest themselves in celebrating and exhorting their neighbors. Sure, some of us might prefer it if they channeled that encouragement to more productive passions than just football, but I still believe that the spirit that creates legends is a marvelous one.

And oh, we had legends in Texas. We had Eric Dickerson. Born and bred in little Sealy, an hour and change west of Houston, he did things with a football no man his size should have been able to do. Big, fast, shifty and smooth, he may still be the most underrated to ever play the game. We had Adrian Peterson, whose father was serving an eight-year prison sentence, who saw his brother die in a car accident when he was seven years old. All Day, they called him, because that's exactly how he ran. Inventive, agile, fast, with an impossibly strong grip, A.D. was Eric Dickerson 2.0. Most of all, we had Earl Campbell. He grew up dirt poor, the seventh son of a man who worked on a rose farm outside of Tyler, Texas. He was the hardest-hitting running back that ever held a football, but he didn't lift weights. I think he may have done more to turn Texas off to the evils of segregation than any man alive. Earl Campbell wasn't content to beat you. He wanted to destroy you.

There will be no Earl Campbell 2.0.

Georgia had Herschel Walker. If YouTube had existed in 1979, he would have broken it. He was the Georgia state champion in shot put, 100-yard dash and 220-yard dash. He rushed for 3,167 yards his senior year. If you're not familiar with these totals, this is the rough equivalent of the statistics you would produce if you got the ball every play and just never got tackled. He was the top recruit in the nation when he agreed to play for his in-state Bulldogs in 1980.

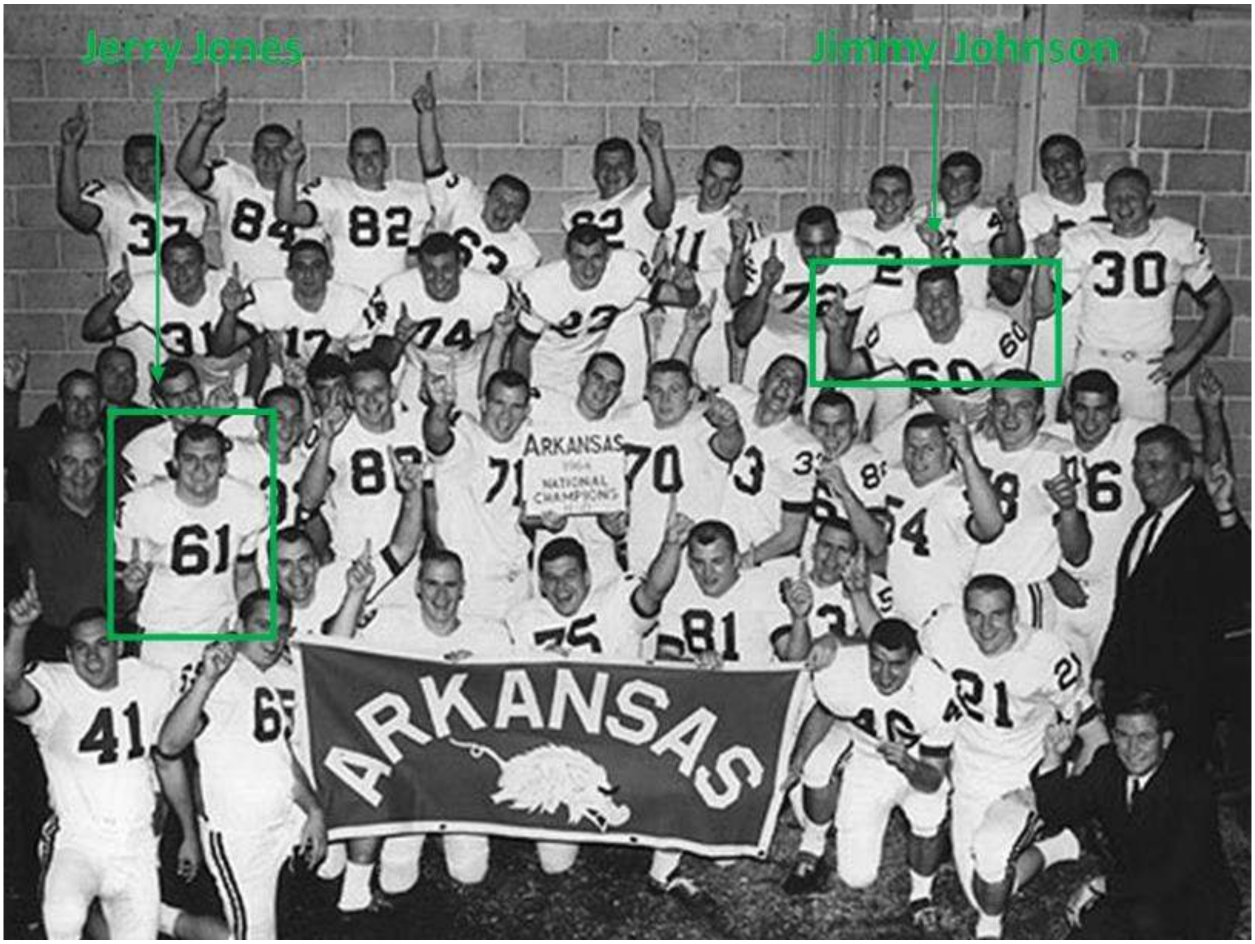
After having won the Heisman as a true freshman in 1980, and after equally impressive sophomore and junior seasons, Walker had a choice. He could stay in college for another year and enter the NFL draft. Alternatively, he could leave school right then and there and join the USFL, a new league which didn't require him to complete college. It would also allow him to sign with any team he wanted. And Herschel Walker wanted to sign with the New Jersey Generals.

It was an incredibly lucrative contract for the time. It paid Walker a $1.5 million signing bonus and a little over $1 million a year for three years. By comparison, the most highly paid running back in the NFL at the time was future Chicago Bears Hall of Famer Walter Payton, who made around $700,000. The NCAA was furious. The NFL was furious. Team owners were furious. Herschel Walker was rich.

Signing Herschel Walker was part of an increasingly aggressive strategy by the USFL. It would become even more aggressive in 1984 with the purchase of the New Jersey Generals by a young man named Donald Trump. Trump – now Herschel's boss – wanted to force the NFL to absorb the USFL in the way many other sports leagues had done with their competitors in the past. If successful, it would instantly multiply the value of his investment. He moved the USFL to primetime in the fall to compete directly with the NFL, and he led an anti-trust lawsuit against the league, seeking $1.7 billion in damages. After years of expensive litigation, the USFL won its suit, but was awarded nominal damages of only $1. Cash poor from its aggressive strategy, it would soon fold, more or less in line with the end of Walker's 3-year contract.

The Dallas Cowboys were shrewd and saw the pending failure of the USFL on the horizon. At the urging of Gil Brandt (the most important guy in NFL history you probably haven't heard of) they used a 5th round draft pick in 1985 as a flyer to reserve Walker's rights, just in case he had no choice but to enter the NFL. It paid off, and he almost immediately became a very productive player. The problem is that an NFL roster carries 53 men. One productive running back, even one as otherworldly as Herschel Walker, couldn't turn a lousy Cowboys team into a good one. (Also pictured: Saquon Barkley and the 2018 New York Giants)

Walker continued to be productive, but the Cowboys kept getting worse. In 1987, they won seven out of fifteen games. In 1988, they won only three out of sixteen. In February 1989, the Cowboys were sold for $140 million to oil man and Shakey's Pizza franchisee (no, really, look it up) Jerry Jones. Jones wasted no time in putting Tom Landry, the only coach the Cowboys had ever known, out to pasture. In his place, Jones hired his former Arkansas Razorbacks teammate Jimmy Johnson, who was by then the successful head football coach at the University of Miami.



The Cowboys got off to a rough start in Jerry and Jimmy's first season. By mid-October they were 0-5, and had lost those five games by a combined score of 146-54. This was a very bad team, and it wasn't going to get better soon. They needed to rebuild, which meant trading players for as much value as they possibly could. The problem was that, while Jimmy's first draft only months before would ultimately produce a Hall of Famer and a few other extraordinary talents, they really only had two proven bargaining chips in any trade: wide receiver Michael Irvin and running back Herschel Walker. As the story goes, it was Oakland Raiders owner Al Davis who talked Jimmy out of trading Irvin. But Walker? Well, the offers that Jimmy got for Walker were too good to pass up – although he was the only one who seemed to know it at the time.

Dallas ultimately traded Walker for five players and three draft picks: one first round, one second round and one sixth round pick. Not bad. But the agreement also stipulated that if the five players were not on the Dallas roster because they were cut or traded, the compensation would revert to additional draft picks. It's a detail that escaped the notice of most sports media, but it was what Jimmy had in mind all along. He had every intention of simply securing the alternate draft pick compensation for these players. And that's exactly what he did.

In the end, Dallas ended up with three first round picks, three second round picks, a third round pick and a sixth round pick from Minnesota. They used those picks to draft players who would go on to play critical roles in Dallas's three Super Bowl victories in 1993, 1994 and 1996. Johnson had changed the NFL forever. He had written a script. He had created a Path to the Super Bowl, and everyone was now on notice that it ran through the NFL Draft.

Imitation, Flattery, Etc.

The Vikings were brutally skewered for their lopsided trade, although they remained a successful team throughout much of the 1990s, with a better than average track record of getting into the playoffs. But Walker didn't win them any championships. Jimmy had caused the value of draft picks to skyrocket, which meant that no one was going to win a trade like that again. Still, many teams tried to follow the path that Jimmy's Cowboys had charted.

In 1994, the Colts traded quarterback Jeff George to the Falcons for multiple top picks. The 2000 New York Jets traded Keyshawn Johnson for multiple top picks. The 2002 New Orleans Saints dealt Ricky Williams for multiple picks from the Dolphins, just a couple years after they had traded their entire draft to the Washington Redskins for the rights to the same Ricky Williams. Not all of the draft capital-driven strategies involved trades of players. Some stockpiled picks through combinations of tanking (i.e. trading away any talent with an understanding that it would result in losing and higher draft status) and trading away of very high picks in the first round for multiple later picks (teams are often willing to trade several first and second round picks for one of the few very top picks in the first round). The 2012 Rams traded their #2 overall pick for a huge number of picks from the Redskins and other teams. And the Cleveland Browns have been pursuing a…perhaps accidental tanking strategy for the last decade, stockpiling pick after pick to take the best possible players from college ranks.

It hasn't worked.

Oh, sure, the Colts' trade allowed them to select Marvin Harrison, who was part of the team that would go on to win the Super Bowl a decade later. The Broncos won, but they won with a quarterback they signed as a free agent, not the guy they picked with their first round bounty, who is now a 31-year old leftfielder for the…<checks notes>…Binghamton Rumble Ponies. The current LA Rams team looks very potent and might prove the exception, too – except that the players selected with their bevy of picks are almost all gone, outside of an above average defensive tackle. The teams who pursued Jimmy Johnson's path to the Super Bowl over the last two decades haven't found the promised land.

In fact, of the teams which have reached the promised land in the last several years, most have been much more aggressive acquirers of veteran players with draft picks rather than the other way around. The Philadelphia Eagles managed to mortgage their future, at least how most pundits described it, to select a talented young quarterback. He promptly got injured, only for their backup to lead them through the playoffs and into history. The team with the best record in the NFL, the LA Rams team mentioned above, has been more influenced by a recent trade in which they disposed of a massive number of draft picks to select their current quarterback, Jared Goff. And the New England Patriots have been the New England Patriots.

So why did the Stockpile Top Picks and Win strategy stop working? Is it broken? Did it just become a crowded trade that will mean-revert? Was it ever a legitimate strategy to begin with? And why, if it doesn't really work, are teams like the Oakland Raiders still pursuing it with gusto?

The Problem with Process

We are obsessed with process at Epsilon Theory. We think it is a necessary – if usually insufficient – condition to almost any worthwhile analysis of investments or politics. But just like you, we are faced with two basic problems when we evaluate the processes of both general managers and portfolio managers:

- We are wired to associate outcomes with the **biggest single visible variance** from norms. We struggle when forced to accommodate multiple influences, and invariably fail to identify hidden influences.
- Even when we have good data to evaluate the relationship between a process and outcomes, the stories we hear about why a process was being pursued in the first place are almost always **after the fact**.

In other words, to continue the theme of the Notes from the Road series, the path of events matters, but the path of our exposure to information matters, too.

When teams evaluated the Cowboys dynasty from the 1990s, the biggest single visible variance was the process which led to the Herschel Walker trade and its impact on the drafts between 1990 and 1992. In reality, however, the Cowboys success was dependent on a much wider range of variables. The quality of their selections in 1989 – before the Herschel trade – ended up being among the best in NFL history. Troy Aikman, Daryl Johnston, Tony Tolbert and Mark Stepnoski became roster cornerstones. Even the player they jumped ahead of Oakland to select in the second round (after which they traded him for Johnston and others), Steve Wisniewski, went on to play at a high level for 13 years. A few years later, Al Davis would get revenge on Jerry Jones by jumping in front of him to draft an offensive lineman, this time out of Iowa State. That guy is now a strategist at Schwab and one of the funniest guys in financial services (you can follow him on Twitter @77cyko).

That wasn't all. The Cowboys spent money – a lot of money – on players like Deion Sanders. They dominated the weird few years of Plan B free agency. The players they selected in the 1991 draft would go on to play 1,222 combined games in the NFL. They were successful on all 9 of their picks in the first 5 rounds in 1992, even borderline Hall of Fame receiver Jimmy Smith, whom they traded to the Jaguars. And then, in 1994, they took a small school lineman out of Sonoma State, who just happened to turn into the best offensive guard in the history of the NFL.

A million things had to go right for the Cowboys. But our desire to simplify processes causes us to see the path to the Super Bowl as the result of their **biggest single visible variance**: the Herschel Walker trade.

This is problematic for us as portfolio managers, not just because of this natural tendency, but because the people trying to sell us products aren't stupid either. They know we need a hook. They're waiting for us to ask about their edge. Hell, we even ask them the question in a way that is designed to deliver the biggest single visible variance: "*what is the thing which most differentiates you from your peers*?" They will always have an answer, and it will usually take a sexy, compelling form. A model, a quirk in the process, a database, a proprietary computational technique, a risk management framework. And it's never that, or at least, it's never *just* that. Want to know why Buffett hasn't spawned a thousand mini-Buffetts? Because everyone tries to define some biggest single visible variance, or a 5-point listicle of his principles, and none of them is right. None of them is sufficiently explanatory[1]. Not even close.

[1] I mean, other than a beta, leverage and luck explanation, but that's closer to being proof of what I'm saying that any kind of refutation.

Part of why our explanations are so flawed, however, gets back to the second problem with process evaluation. When we hire managers, we are almost always evaluating historical decisions on the basis of a process that is being described to us *after the fact*. I cannot tell you how many funds, strategy recommendations and third-party writeups I have seen which accept a fund manager's description of a process, then compare it to *historical* positions and performance to establish whether the manager has adhered to a consistent process. Well, yeah, it has, because they wrote the story about the process they're describing after they made those decisions. Most overhauls of a team's roster don't take place because of some master vision for maximizing value. Not *really*, anyway. They happen because there's a new coach or general manager who wants the players to be players that *he* picked. Then, if it works, five years later we get a version of the master plan. In the few cases where there really was a master vision from the very beginning, we usually stupidly **run them out of town** before it gets a chance to work.

We face uncertainty not only in our measurements of the nexus between process and outcome, but between philosophy and process. It's a system with every bit of a three-body level of complexity.

Process About Process

Some of these things are hard-wired. There's nothing I can tell you that will change how your eye will be drawn to the **biggest single visible variance**. But if you are in the business of hiring fund managers, evaluating models or allocating to investment strategies, I have some advice for improving your process for evaluating process:

- **Make distinct your processes for evaluating the nexus between process and decisions on the one hand, and process and outcome on the other**. Because we are always tempted to 'talk stocks' and 'talk markets', you will always be drawn into a discussion of selected decisions and their outcomes. Even the bad ones will end in humblebrags. Try to keep these discussions isolated. When you're evaluating consistency with process, don't introduce or allow the strategist/manager to introduce outcome into the discussion.
- **Don't stop asking about process and philosophy once you hire.** It is common practice to set it and forget it on these fundamental questions, and to shift the ongoing diligence process to decisions and outcome. Don't. Continually record how your people describe what they believe they are doing, note how and when it changes, and evaluate their decisions against both.
- **Engage new employees in reunderwriting old investments.** It's a rare practice – and resource intensive, so not feasible for all – but onboarding new employees by asking them to reunderwrite certain existing investments before they are familiar with them is an extremely valuable way to detect incrementalism in our own thinking, to evaluate independently whether process stories have changed, and to inculcate the new employees with your best practices and philosophies.
- **Follow along first.** Most allocators do this, but usually for the wrong reasons (waiting for another manager to stumble, or this manager to do really well). If you hire managers, funds or strategists, tracking their decisions after you've memorialized some assumptions and beliefs about them – even if you don't have money invested – is extremely useful. Sure, there may be times where access to an idea means taking some risk on pursuing it with less hard data and more intuition, but as a general rule, following at least one or two strategies with the same vigor and process as those you have invested is useful.
- **Don't throw away all your priors at once.** There ARE big shifts and events that can change everything about portfolio construction. Ben and I **have written frequently** recently about one we're concerned about. But false positives are far more common. It's not new, but for liquid markets strategies, I have had a lot of success deploying CUSUM – a standardized quality control technique – as a tool for evaluating the information conveyed by performance. When it's integrated into a "multiple alarm" framework, it can effectively highlight when a performance event is significant earlier than rolling measures, while still ensuring that big single events aren't driving

the boat. You can read more about these techniques **here**, but I'm also happy to walk you through their implementation. The math is trivial but it is cumbersome in Excel.

Even if you're not in the business of selecting strategies and hiring managers, it is worthwhile to remember: Anyone who is explaining a simple, single reason for something you know is complicated, they're probably either stupid, lying or selling you something. These traits are not, alas, mutually exclusive.

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