

OUR INVESTMENT PHILOSOPHY

When we invest in stocks, we invest in businesses represented by stocks. We try to select good businesses with excellent economics. Ideally we want to stay with them for a long time and participate in their growth and prosperity. The market price of the stock is there only as a reference point to see if anybody is offering to do anything foolish, either to pay a price that is too high or to offer the stock well below its intrinsic value. We have to be skillful enough to understand and evaluate the business far better than the market does, otherwise we don't belong in the game. Beside the analytical skills we have to be patient. Many people don't have the temperament to buy undervalued stocks because it requires so much patience. Everyday the market offers you investments at varying prices. You wait and refuse, wait and refuse until you are sure that you buy a bargain. They are most often found in those areas that are out of favour with the majority of investors. It will take time and discipline for a security selling below its true value to be recognized and increase in price. It is important that the client is patient and confident too and let the investments work out without forcing the investment manager into unproductive action. Less is more.

What constitutes a good business? Every investor or industrialist has his preferences. A master investor has listed the following characteristics:

- Have a good return on capital
- Are understandable
- See their profits in cash
- Have strong franchises and therefore pricing freedom
- Don't take a genius to run
- Have predictable earnings
- Are not natural targets of regulations
- Require low inventories and have a high asset turnover
- Have a management that is owner oriented
- Are a royalty business that benefits from the growth of others and that requires little capital.

The list eliminates a lot of businesses because they may be capital intensive, require a lot of research or are turnarounds. Shunned are also businesses that may be real bargains assetwise but with poor economics.

You may wonder why we do not pay much attention to business cycle analysis, why we do not recommend a top down approach that is widely followed by big institutions and the scientific world. In our opinion it doesn't work well. People who worry too much about the business cycle are usually not able to grab wonderful bargains when the market is giving them away. We

prefer to acquire excellent businesses when the outlook is perceived to be clouded instead of buying mediocre businesses during periods of euphoria. The true investor has his best opportunities in uncertain times. One pays a high price for a cheery consensus.

While stocks are more fun and have greater potential whenever they are available at reasonable prices we also like medium term bonds for their steady cash flow which lends stability to a portfolio. We follow here also a long term approach. If we find the yield attractive and the quality acceptable, then we keep the debentures without worrying unduly whether rates are moving up or down. Since nominal rates are presently low (along with inflation) we prefer floaters or relatively short maturities. The danger of runaway inflation has only a low probability but cannot be completely excluded.

We are convinced that the investor who adheres to sound principles and has enough patience will be eventually rewarded by above average returns. Money will be a by-product of a job properly done. And never forget the first rule of investing, which is not to lose.

November 1993