CREDO WEALTH

Five Years of Best Ideas

This past April, our Best Ideas Portfolio celebrated five years since inception. While we typically use this space to talk about a purchase we have made, or provide updates on matters we believe to be of interest, today we offer a belated retrospective and an assessment of how our long-term value driven investment approach has performed.

Over the five years since inception, the Best Ideas Portfolio has returned 72.0%, beating its benchmark – the MSCI World – by 13.8%. As a pure equity portfolio, this has been achieved on the back of fundamental company analysis and while valuation is a key consideration, for us, it comes with many caveats. Though we lean towards value, we do not invest on the basis of value alone, but rather assess the full measure of a company's potential. To give an impression of how this strategy has performed, what follows is a selection of our best hits and worst misses.

Though the decisions were made nearly two years apart, we invested in both Volkswagen and BMW for similar reasons. Despite both being best in breed companies, they traded on low multiples and, with Chinese growth still notionally at 8% at the time, we deemed this a substantial tailwind to future growth. As it happened, our thesis was on the mark and we later sold both as their margins peaked and prices met our fair value estimates, resulting in a total return of 90.4% and 93.2%, respectively. Though we cannot claim to have anticipated the emissions scandal that the two later became embroiled in, we noted that growth projections in Germany and Asia were becoming too ambitious and sold, avoiding, in the case of Volkswagen, a subsequent -29.6% collapse in the stock price.

At inception, we also invested in Apple which, like now, was a quality business albeit with a more compelling valuation. At the time, growth in the iPhone, iPad, Mac, and ancillary services was still nascent. After nearly three and a half years, however, we reassessed our position and saw fit to sell, for a total return of 116.7%. Our concern was that with nearly 75% of sales coming from the iPhone, the company was too dependent on the success and innovation of this single product. As new competitors entered the market, Apple had to either out-innovate whilst retaining mass appeal, or see their margins eroded. Since we exited the position, such a new class of product remains to be seen and the stock has plateaued, returning only 4.2%.

However, even our most considered analysis can be wrong. For instance, in the wake of the financial crisis we invested in HSBC. At the time, the company enjoyed the best balance sheet in the sector and offered vast geographic exposure, particularly in Asia. We also saw the potential for a turnaround in their US business which had suffered significant write-downs and losses. In this case, our analysis was on the mark and HSBC subsequently enjoyed a recovery in the US while sustaining their formidable position in Asia. Yet the company's European operations have struggled: in spite of years of restructuring and cost cutting, efficiency in the region has lagged and costs have remained high. Although the company retains a high dividend and the valuation is far from prohibitive, we decided to sell – resulting in a -16.9% loss – as we believed the investment tied up in the stock can be better deployed elsewhere.

Our worst investment, however, was in the miner Anglo-American. We invested at inception on what seemed like a solid thesis: the company offered excellent exposure to numerous tier one assets – such as base metals, platinum, and diamonds – but traded at a discount to competitors. Moreover, having slumped from previous highs, we believed commodity prices were nearing a bottom and the near term, supported by a seemingly stable Chinese economy, looked positive. In hindsight, our latter premise – the stability of China – was sadly mistaken. As the economy stuttered, the commodities underpinning Anglo-American's revenues slumped. As a result of poor management, costs escalated and, suspecting the complete suspension of the dividend and further downward pressure on the share price, we exited our position. As it happened, the dividend was suspended and the share price has continued to disappoint.

Lacking both panaceas and palliatives, investing can be a fraught process; even our most rigourous analysis cannot hope to fully anticipate the future course of global and regional events. Even if our analysis identifies a company trading at an attractive valuation, there is only one arbiter and that is the market itself. In spite of all these difficulties, over the past five years our strategy of seeking strong investments at a reasonable price has succeeded in adding significant value to client portfolios.

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