CREDO WEALTH

10 years of BIP

This April, we celebrated the 10-year anniversary of the inception of the Best Ideas Portfolio (BIP), a significant landmark in the life of Credo's oldest and largest equity product. We are pleased that, as of the 30th April 2021, the portfolio has returned 12.3% per annum, which exceeds the return of the MSCI World Index over the same period. The practical implication of this rate of return over 10 years, is that £100 invested would now be worth £319.

What makes this performance particularly pleasing is the backdrop against which it has been achieved. The last 10 years have not been easy for value investors. For most of the period, we have been swimming upstream against the overwhelming trend of the outperformance of growth stocks. Over the period the MSCI World Growth Index has outperformed the MSCI World Value Index by around 130%.

Nevertheless, we are always cognisant that there are lessons to be derived from every investment decision we make. As we reflect on 10 years managing this portfolio, we thought we would share some of our successes and failures and the key takeaways from each.

The best performing stock in the portfolio has been Microsoft, which we have held since inception. When we first bought the company, worries were that with the advent of smartphones and tablets, traditional PCs and laptops would become antiquated. However, we believed that, for those customers generating the majority of earnings, i.e. corporates, Microsoft's suite of products was indispensable. For work purposes, the switching costs would be enormous. Whilst Microsoft's revenue model would change over the period from upfront licencing fees to a subscription-based model, temporarily depressing reported growth, the value of its products and services would not. The company remained highly profitable, generating significant free cash flow and with substantial growth opportunities, driven by the secular shift towards commercial cloud computing. At the time of purchase, the company traded at around a 10x P/E but has re-rated over the years as earnings growth has accelerated to over a 29x P/E today.

When we think about the success of this investment, we are reminded that high returns on capital and strong free cash flow generation provide the pre-requisite compounding "fuel" to sustain above average earnings growth. There are other examples of this in BIP, such as AIA which is growing in Asia where insurance is underpenetrated, as well as the new opportunities available to The Walt Disney Company which has launched a streaming service, Disney+, to compete head-on with Netflix and Amazon Prime.

Investment theses can fail to play out for any number of reasons, poor management being one. This can come under many different guises, from poor communication with investors or poor asset allocation decisions through to full scale accounting manipulation. For the most part, we have been fortunate enough to avoid instances of complete fraud. However, Nielsen is an example of the way that a lack of transparency in communication can result in a loss of confidence by shareholders. When we first purchased the stock, investors were concerned about the impact of technological evolution on Nielsen's main business. This was compounded by what management claimed was a temporary slowdown in growth in another segment. Eventually, it emerged that management had been extremely disingenuous about the ongoing problems in existing contracts and the impact of new regulation on the company's main segment.

We were disappointed in the result of the investment, but the decision to sell was the correct one, as the stock has continued to underperform. The impact that the management team can have on a business is not to be underestimated. In contrast, the strong leadership on costs shown by, for example, the HCA management team during the COVID-19 shutdown, resulted in significant gains for shareholders upon re-opening.

We also reflect on the difficulty of balancing patience and conviction in a thesis with knowing when to sell a position. The contrast in experience between investments in Babcock and Flutter Entertainment illustrates this. Whereas a change in the political environment resulted in a significantly more negative long-term outlook for Babcock, the impact of regulatory changes for Flutter Entertainment has been more transitory. Both companies had substantial negative share price reactions to the changes and for both we believed that the risks were more than priced in. However, whilst in hindsight we should have sold Babcock earlier, Flutter has gone on to become a significant positive contributor to the portfolio and the best performer in the portfolio in 2020, rewarding our patience.

As we look forward to what we hope will be another 10 years of success for the Best Ideas Portfolio, we remain cautiously optimistic, particularly about our Value strategy. Although we have seen a significant rotation in recent months away from Growth and into Value, there is still plenty of room left to run. We will continue to focus on buying high quality companies at attractive valuations, with a long-term view. We will aim to balance patience and conviction with discipline and humility. And above all, we will aim to continue to do the best job we can for our clients. ■

Important notice