LIONRIDGE
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Don't Just Do Something, Sit There!

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Dear Clients,

There is an inclination that's common among many investors to constantly be doing some amount of trading. This goes for professional and amateur investors alike. I think this happens for a number of reasons. One is a misguided belief that one can control the outcome of investment returns by generating regular trading activity. This is contrary to my own belief that the best way to grow your wealth is to identify and invest in solid companies that are actually generating value for shareholders, buying them only if I believe the price is reasonable, and then holding them patiently and allowing the companies to generate wealth for you by way of their profitable business activities. I also believe in concentrating the number of holdings in my portfolio. As a result, there is typically not a lot of trading going on in the portfolios that I manage.

Another characteristic of my approach is my willingness to let cash build up at certain times. I've discussed this a number of times over the last few years, and recently the cash position in the Lionridge Total Equity Portfolio has risen to around 35%. My discipline makes me very choosey about the types of investments I will allocate this capital to, and I'm in no hurry to invest this cash just for the sake of doing so.

The main reason for the recent increase in cash is the sale of Lionridge's position in Nestle. This company had been a core holding for some time. When I initially added it to the portfolio, it scored highly on my various criteria that include financial strength, inherent levels of profitability and rational stewardship by strong management. The company sells great brands in multiple markets, including strong penetration in emerging markets. None of those factors have changed, so why did I sell?

When I first identified Nestle as a good investment opportunity, it was trading at a reasonable price as compared to my estimate of its intrinsic value. The good thing is that over a period of a few years, as I held it patiently, the markets came to also recognize Nestle's value and pushed its price to a level that I believe it is now expensive. On the one hand that's a positive, as my goal is to make you money. On the other hand, such a movement in price compelled me to sell the stock as a great company is no longer a good investment if the price is too high. In fact, a high priced stock not only diminishes prospects for future gains, but it also becomes risky as markets don't usually overprice securities indefinitely.

So now I'm faced with even more cash in the portfolio, and if the markets continue to rise this cash can be a drag on my returns. Typical portfolio managers would not be willing to take on the career risk that comes with short term underperformance, and they would be scrambling to put this cash to work. They don't have the luxury of sitting on cash, they are compelled to do something with it.

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I'd love to use this cash to buy stocks as well, as that is my mandate for the Total Equity Portfolio. However, I will only deploy it in opportunities that meet my strict criteria. Attractive valuation is a paramount criterion for me, for reasons of increasing your future returns as well as protecting your capital. My own money is in the same portfolio.

Markets appear to be richly valued and risks are high. I can only find enough stocks that I believe are attractive and safe to fill around 65% of the portfolio, and I'm very happy to be patient with the cash until the appropriate opportunities arise. Rising markets cause a level of euphoria that can become self-perpetuating, but never indefinitely. More investors pile into rising markets, not realizing that higher market valuations can actually expose them to risk of permanent losses that could be avoided with a proper combination of diligence and prudence – attributes that often become unfashionable in times of euphoria.

It's actually misleading for me to suggest that I'm just "sitting here". My analyst and I are constantly scouring the markets for potential investment opportunities, as well as keeping abreast of Lionridge's current holdings. My point is that I'm not going to trade in or out of stocks just for the sake of doing so – that would not add anything to my goal of growing and preserving your wealth. The opportunities will eventually arise, maybe one by one or perhaps all at once, and I will act when I believe prospects are both advantageous and prudent. ■

At Your Service,

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