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Men More Frequently Require To Be Reminded Than Taught

"Locking into that observed propensity for wonderful businesses to compound wealth for their owners is at the heart of our approach"

Dr Samuel Johnson is a great hero of mine and this report is inspired by one of his many memorable flashes of wisdom. He wrote:

"Men more frequently require to be reminded than taught."

After 32 years as a professional investor, I find myself acknowledging the truth of Johnson's statement. Everyone who faces the intellectual and emotional challenges of the capital markets needs to keep learning – and for me of late it's been grappling with the implications of cloud computing. But despite this I know that I benefit just as much from a periodic revisiting of the longstanding principles that Lindsell Train uses to run clients' equity capital. Reminding ourselves of those principles keeps us on the straight and narrow.

So below I review the ideas that shape our clients' portfolios. I'll introduce each one with a quote or comment that has proven influential to the development of our thinking.

1. "If you want different investment performance you must invest differently." Sir John Templeton

This is an unpalatable, but incontrovertible truth. If you want different performance – for which I suppose read "better performance" – then you have to do something that others don't. We hope our clients are happy with the "different" performance we have been able to deliver for them over time. But they mustn't ever lose sight of the risks that we've had to take to achieve that return – we certainly don't. Our portfolios at times perform very differently from their benchmarks and will do so again, for good or for ill, in the future.

Perhaps the most obvious difference about our approach is the unusually long time horizon we work with, as measured by levels of portfolio turnover. Last year turnover for our Global Equity representative portfolio, for example, was 0%. More generally, the average annual turnover of our portfolios is likely to be nearer 5% whereas we expect that the typical equity fund will experience annual turnover of closer to 100%. We think it's helpful – though not strictly scientific – to say if a given portfolio turnover is 100% in a year that implies the investment manager is taking on average a one year time horizon for each holding. By contrast, at 5% pa, the implication is that each position will be held for 20 years or longer. The one certain benefit of our relative inactivity – although there are uncertain disadvantages too – is that total running costs for our portfolios will tend to be lower, potentially much lower, than for other funds with higher frequency of costly transactions.

2. "Stocks are simple. All you do is buy shares in a great business for less than the business is intrinsically worth, with managers of the highest integrity and ability. Then you own those shares forever." Warren Buffett.

The explanation for our low turnover (and our choice of the type of company we invest in) is found in the above advice from Buffett. Now, I always feel a bit guilty tabling this quote as an account of what we do. How can such a simple suggestion – even from the world's greatest investor – be the basis of a credible and competitive investment philosophy? But it is what it is and by and large it has worked – for Buffett obviously. In passing, let me assure you that it's not so easy to identify, then stick with investments in even great companies. The pressure to "do something", particularly when a great company is going through an inevitable dull patch, is intense. The dull share performance of Unilever in 2013 is an example. We fortify ourselves during such episodes by remembering the comment below of another outstanding investor – Peter Lynch – who, just like Buffett, is famous for running his winners.

3. "Other investors invent arbitrary rules for when to sell."

Lynch ran his winners, arguing that if a share has done well – at least for reasons that are explicable and not wholly speculative – then there is every reason to expect it to continue to do well (although always remembering that nothing goes up in a straight line). He (and we) dispute the conventional wisdom that says: "It's never wrong to take a profit". It can be very wrong. If by doing so you permanently reduce your interest in a great long-term investment. Share prices of the best companies double, then double again and again over time. Locking into that observed propensity for wonderful businesses to compound wealth for their owners is at the heart of our approach. Running your winners. For instance, for a global equity portfolio that we have managed since early 2009 Diageo shares have doubled on their book cost. We have no doubt that Diageo shares will double again over time – as its cash flows grow and as the pricing power of Diageo's brands protects investors against monetary inflation.

We continue to find inspiration in our stock selection from this recommendation made by my former, much admired boss – Vivian Bazalgette. Vivian once told me :

4. "If a company's products taste good buy the shares."

We are drawn to companies whose products or services are regarded as irreplaceable by their customers. So, for instance, scientists and lawyers around the world have little option but to subscribe to Reed Elsevier's services – they can't do their work without them; the same is true for investment bank customers of Fidessa's software. But, as Vivian recognised, consumer loyalty to a tasty product is just as reliable and highly profitable. Our clients can take comfort knowing that their investment is being supported by people's insatiable love of, for instance – Guinness, Johnnie Walker, Jack Daniels, Southern Comfort, Oi Ocha, Dr Pepper, Cadbury Dairy Milk, Oreos, Toblerone, Magnum ice cream, Hellman's, Knorr and my own "that without which I cannot do": Marmite. These products will be enjoyed 30 years from now and, in an uncertain world, that is enough to mean the companies that own these brands are likely to be terrific investments over time.

We run concentrated portfolios, with rarely more than 25 holdings. In part the inspiration and example for this policy comes from the man who gave me my break into the investment industry. This was Richard Thornton, the "T" of GT Management, who hired me in 1981. Sadly Richard died in 2013, mourned and respected by colleagues as a rainmaker of the first rank, as well as a formidable stock market operator. I've never forgotten Richard's account – to a group of then feckless graduate trainees – of his secret to investment success:

5. "First, identify your great idea. Next, invest into it as much as you can possibly afford. Third, double the size of your holding, so you can no longer sleep at night. Finally – TELL EVERYONE ELSE ABOUT IT!"

Richard knew that great investment opportunities are rare and must be backed with conviction, when you happen across one. He also knew how easy it is to suffer "diworseification", from a lazy proliferation of "it seemed like a good idea at the time" holdings cluttered across a portfolio. So we stick to his advice and all the rest from our elders and betters.

Turning to the outlook for equity markets - we remain bullish for both global and UK equities. It seems to us that the background conditions are as encouraging for equity investing as at any time since, say, 1801, when the London Stock Exchange was founded. For sure, three current macro factors are unequivocally positive. First, technology change is creating new industries, new companies and new opportunities for existing companies – at a faster pace than ever. Next, the world's population not only continues to grow; in addition more and more people on the planet are being lifted out of poverty. Finally, the risks to the real value of the competing asset classes to equity – namely government bonds and cash – look as scary as ever. To us that adds up to a compelling case to commit long term capital to stocks.

We know it would be comforting for cautious investors to be offered more certainty as to the likely shape and timing of those promised equity returns. If we look at Anglo-Saxon equities, for example, they have delivered 6-7% pa total returns over and above inflation over decades, if not centuries. But they have never done so with a metronomic, regular 6 -7% pa pace. No, the truth of the likely shape of equity returns is best expressed in this wonderful observation from light versifier, Ogden Nash:

6. "Shake and shake the ketchup bottle, First none will come and then a lot'll"

It is indeed hard, we might say impossible, to time the equity markets. And yet it is imperative investors maintain adequate exposure to equity. This is the reason that as far as possible our clients' portfolios remain fully invested.

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