Global Equity Investing
Keeping it simple in a complex world

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Complexity is for Eejits

(ee-jit) Dialect, chiefly Scots

Idiot, simpleton, one not possessed of all their mental faculties, one who is unable to properly conduct their own affairs (as in ‘Yer aff yer heid, you eejit’)

(See also bawheid, dunderheid)

Don’t be an Eejit!

Eejit phrases

- ‘This time it’s different’
- ‘This is a new paradigm’
- ‘Don’t be underweight this stock’
- ‘What was the whisper number?’
- ‘There is just no visibility in the near term’

Complex world?

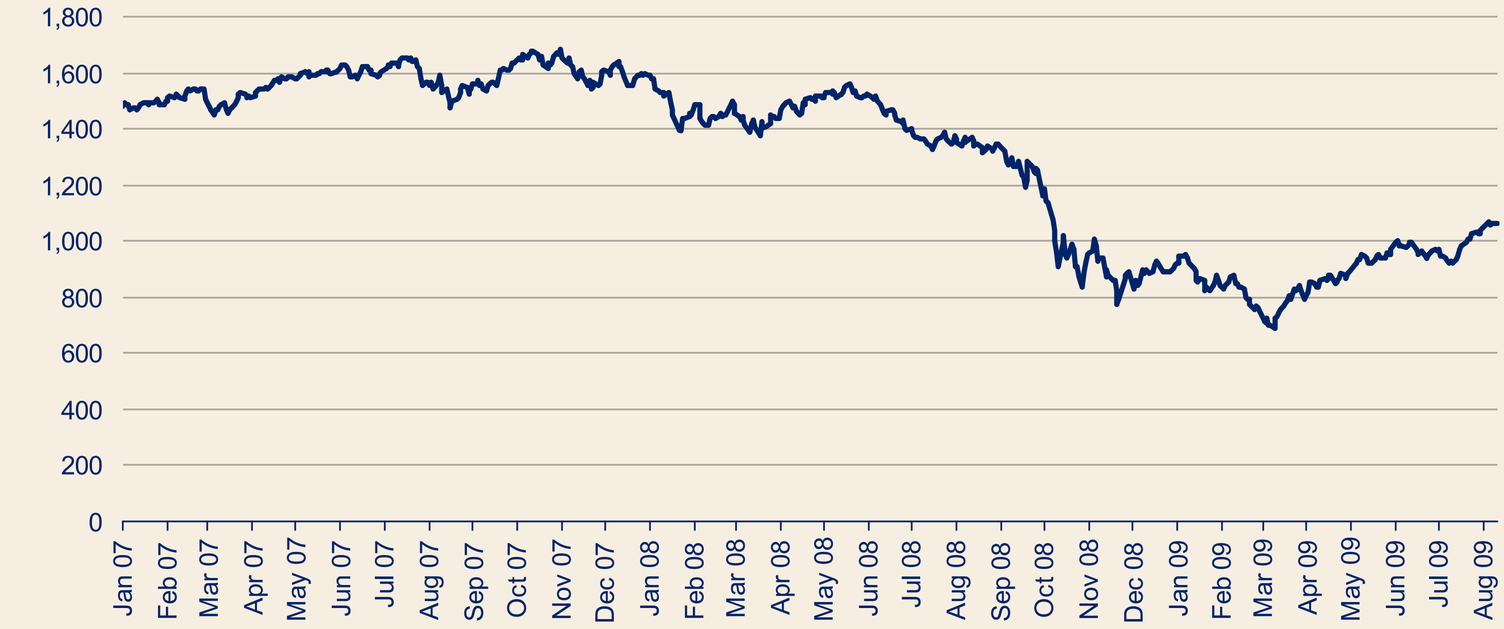
Q. Is it different this time?

A. No

"The fact that people will be full of greed, fear or folly is predictable, the sequence is not predictable."

Warren E Buffett
CEO Berkshire Hathaway

MSCI World Index – 2007 to date



- From peak to trough the world index fell nearly 60%
- In February 2009 the FT ran a week long article on the ‘Future of Capitalism’

Source: Bloomberg, Aug 09

Dow Jones Index – 1925-1934

- Was this the end of Capitalism?
- Index fell just shy of 90% from peak to trough

Source: Bloomberg, Aug 09

Keep it simple

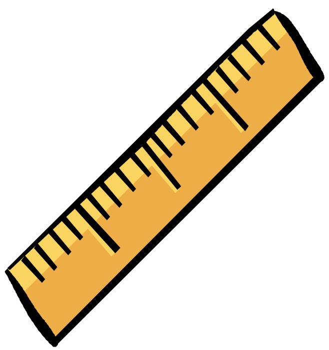
- What is the objective of the fund manager?
  - Invariably to outperform some benchmark as agreed with client

What is a benchmark?

Benchmark

1. A mark or stone or other permanent feature at a point whose exact elevation and position is known: used as a reference point in surveying

2. A criteria by which to measure something; standard; reference point



Benchmark position

- A public service job used for comparison with a similar position, such as a position in commerce, for wage settlement

The World benchmark – The MSCI AC World Index

- There are 46 countries in the MSCI AC World index
- There are 35 different currencies
- This equates to 46 x 35 = 1,610 decisions to get right and predict every year
- There are 1,693 companies in the MSCI World Index
- Would it not be easier to analyse and invest in relatively few companies that you understand and know well?
- Following a benchmark strategy equates to running a momentum driven portfolio

Source: As at June 09

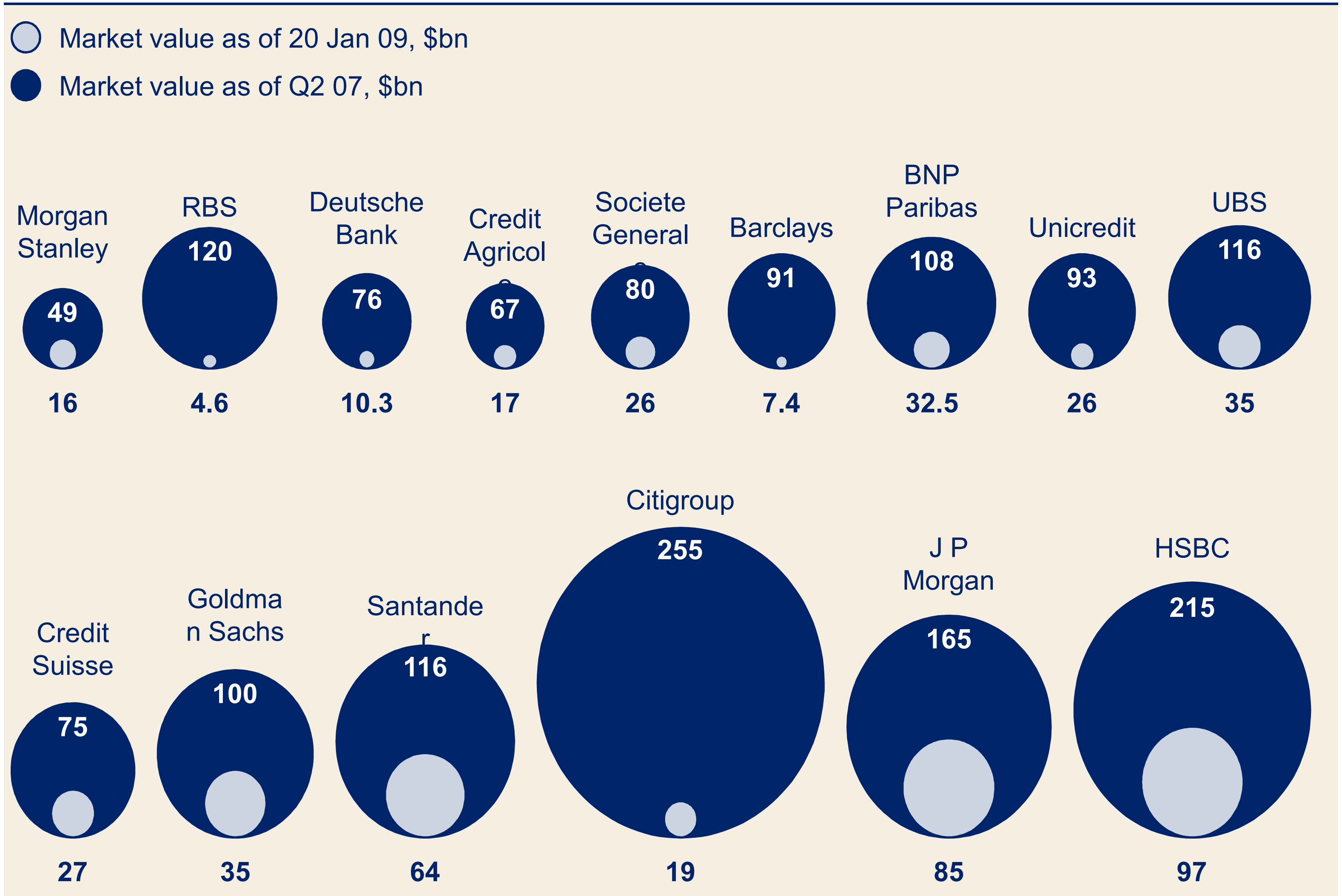
Top 15 stocks by market cap by weight in FTSE All-Share

Company	Sector	31 Dec 07 Wgt (%)	Return in 08	31 Dec 08 Wgt %
Royal Dutch Shell	Oil & gas	7.4	-14.5	9.0
BP	Oil & gas	6.4	-14.5	8.1
HSBC Holdings	Banking	5.5	-21.4	6.5
Vodafone	Telecom	5.4	-26.0	6.0
Glaxosmithkline	Pharmaceuticals	3.9	0.4	5.5
Rio Tinto	Materials	2.9	-72.0	1.2
Royal Bank of Scotland	Banking	2.5	-86.7	0.8
Anglo American	Materials	2.3	-49.8	1.7
BG Group	Oil & gas	2.1	-16.8	2.6
Tesco	Food retail	2.1	-24.6	2.3
BHP Billiton	Materials	1.9	-16.3	2.3
Barclays	Banking	1.8	-68.7	1.0
Astrazeneca	Pharmaceuticals	1.7	29.7	3.3
British American Tobacco	Tobacco	1.6	-8.4	2.9
Diageo	Alcohol beverages	1.5	-11.0	2.0
		49.0		55.2
FTSE All Share return			**-29.8**	

- Top 15 names at end of 2008 account for 56.8% of the index, up from 49% at end of 2007

Source: Aberdeen Asset Management

Changes in market capitalisation of major developed country banks



Source: JP Morgan; Bloomberg, Jan 09, not to scale

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Summary on benchmarks

- Benchmark indices are backward focused and tell you very little about the prospects for any country or company looking forward
- Benchmark indices can create a fear culture! The fear of underperforming can encourage taking ‘benchmark positions to reduce risk’
- In order to add alpha, it is the ability to move away from the benchmark that is important
- Benchmark strategies are momentum strategies
- In short, forget everything you know about the benchmark, focus on the individual companies and their prospects

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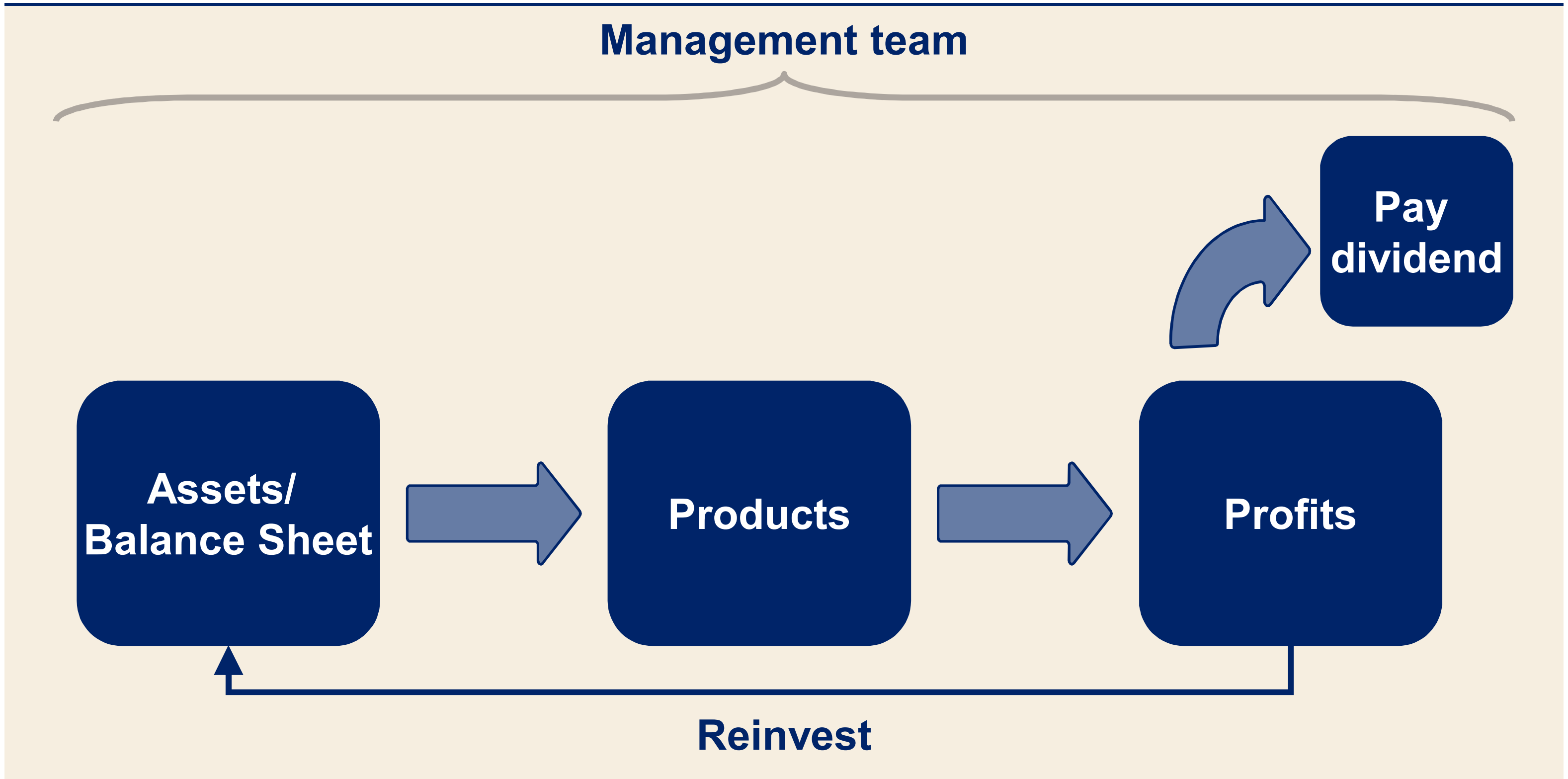
Complex world – focus on the companies

- Calling market directions in the near term is a game of Russian Roulette
- Keep it simple – focus on the basic building blocks – Companies
- Know these companies well and utilise market volatility to your advantage rather than becoming a consequence of it
- Drive layers of diversification on an absolute basis
- Make your own decisions

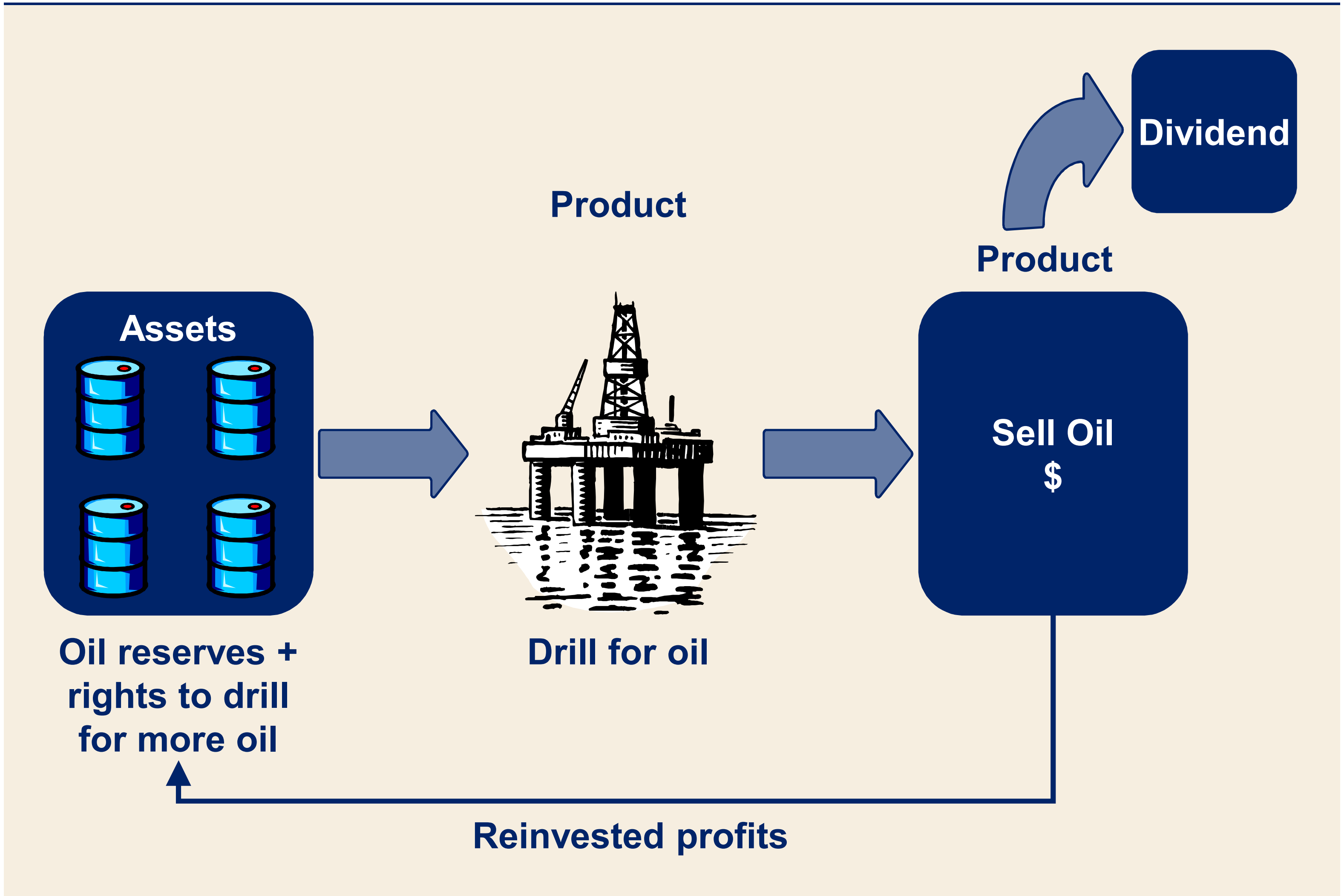
What is a company?



"When a management with a reputation for brilliance tackles a business with a poor reputation for fundamental economics, it is the reputation of the business that stays intact."

Warren E Buffett
CEO Berkshire Hathaway

eg An oil company



What to look for in a good company

- Quality at an attractive price
- Management track record
- Competitive advantage
- Barriers to entry
- Brand strength
- Strong financials

Portfolio risk

- Investing in a poor quality company
  - Irrespective of benchmark weight
- Paying too much for a company

Make your own decisions

- Do your own research
- See the company from the same perspective as the company
- Take a close look at management – whites of their eyes
- Be conservative with your estimates
- Within your circle of competence

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The danger of following the crowd

- Follow the crowd, get crowd returns – ie benchmark
- But less because you are paying active fees

Three decisions in investment

- Buy, sell and do nothing
- The latter is the hardest, but usually the most constructive over the medium to longer term

‘practice inactivity, not hyperactivity’

Warren Buffett

Helping to create corporate wealth. Long-term investors can engage with the management of companies in their portfolios, and encourage them to favour long-term wealth creation strategies. Ideally, this should lead to capital being deployed more efficiently.

Watson Wyatt

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Low turnover tends to produce better returns

- Performance of US mutual funds over various periods by net portfolio turnover

Turnover (%)	Annual return (%)			
	1 year	3 year	5 year	10 year
< 20	27.0	23.9	17.2	12.9
20 – 50	23.1	21.9	16.6	12.5
50 - 100	21.8	21.8	17.0	12.6
> 100	17.6	19.8	15.0	11.3

- Over ten years, low turnover funds beat high turnover funds by 1.6 percentage points per annum, equivalent to $170,000 on an investment of $1 million
- Even over one year, performance of low turnover funds is superior
- Principle: Look after the long-term and the short-term often looks after itself

Source: Morningstar, Inc, 7 Sep 97

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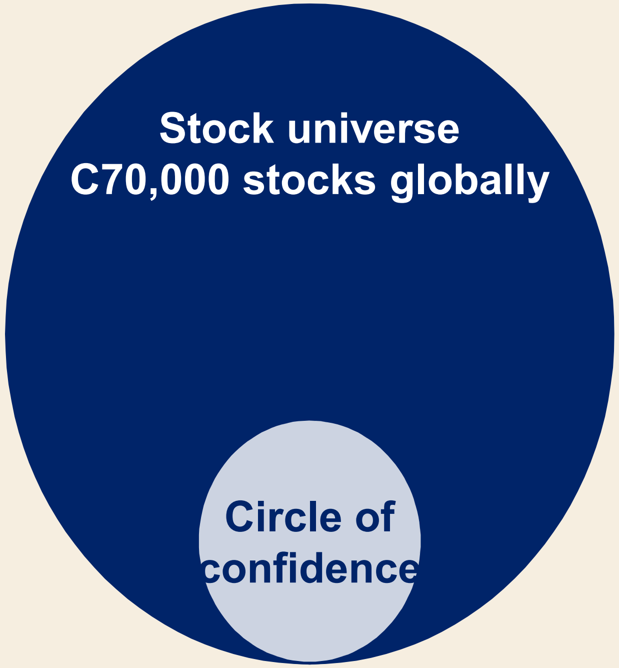
"For some reason, people take their cues from price action rather than from values. What doesn't work is when you start doing things that you don't understand or because they worked for somebody else. The dumbest reason in the world to buy a stock is because its going up."

Warren E Buffett

CEO Berkshire Hathaway

The importance of discipline and sticking to what you know



- It is important to know what sort of companies you want to own and stick to your circle of confidence
- If you can't understand a company, you can't value it. If you can't value it, you shouldn't invest in it

What about diversifying and correlations

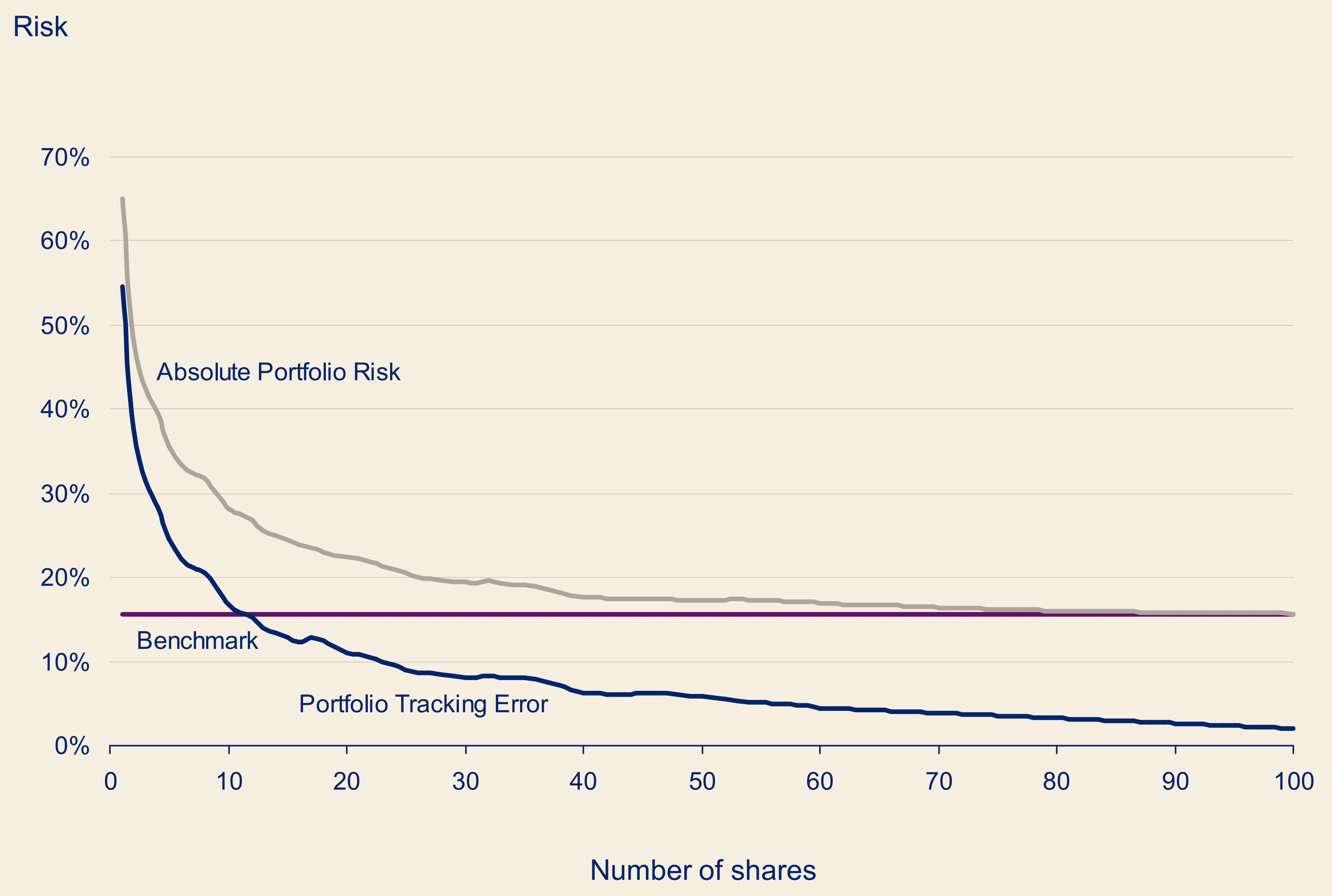
"We believe that a policy of portfolio concentration may well decrease risk if it raises, as it should, both the intensity with which an investor thinks about a business and the comfort-level he must feel with its economic characteristics before buying it. In stating this opinion, we define risk, using dictionary terms as "the possibility of loss or injury."

"We think diversification, as practised generally, makes very little sense for anyone who knows what they're doing. Diversification serves as protection against ignorance. If you want to make sure nothing bad happens to you relative to the market, you should own everything. There's nothing wrong with that. It's a perfectly logical approach for someone who doesn't know how to analyse business."

Warren E Buffett (1993)
CEO Berkshire Hathaway

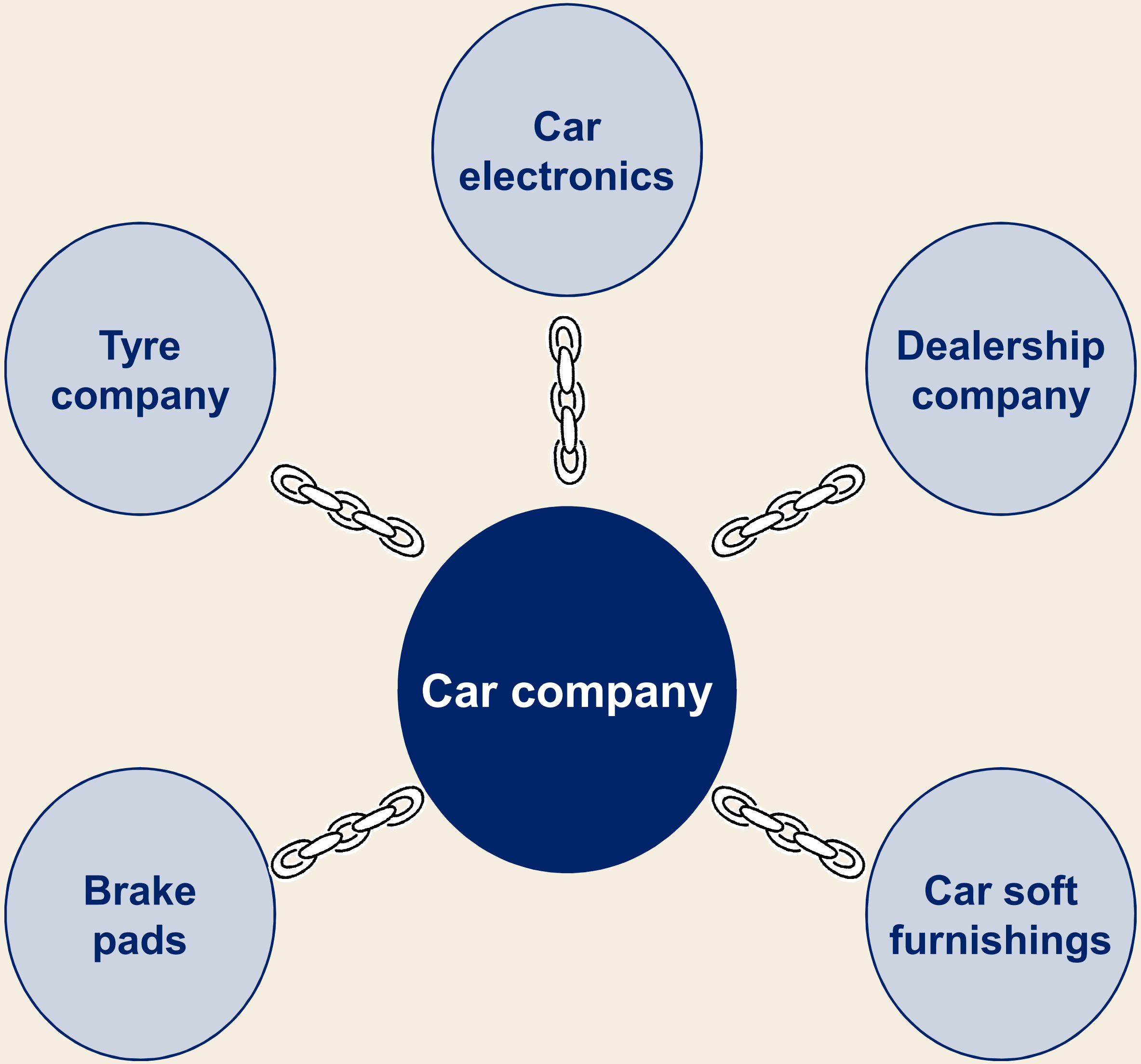
Risk diversification requires no benchmark – More is less

MSCI World in comparison to a same-weighted portfolio of single stocks



Source: Aberdeen Asset Management, 2007

Avoid investment chains



Summary

- When investing in companies, take a long term view (3 year minimum)
  - The people running them certainly do
- Be patient
  - A good stock at a high level of valuation can lose you money in the same way that a poor company can
- Be prepared to underperform
  - Going with the crowd will give you crowdlike returns. A crowded trade is not the place to be ie think long term and contrarian
- Have courage of your convictions
  - Look beyond the noise!

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