Why taking a long–term view is key to successful investing

Anet Ahern

Anet has 30 years' experience in investment and business management. After starting her career at Allan Gray in 1986, where she fulfilled various roles in trading and investment management, she worked as a portfolio manager at Syfrets, and later BoE Asset Management, where she was CIO and CEO. She also spent six years at Sanlam, where she was the CEO of Sanlam Multi Manager International, with assets totalling R100 billion in local and global mandates. Anet joined PSG Asset Management as CEO in 2013.

The desire to act on short-term concerns is a basic human tendency

On a recent visit to New York, I came across a quaint music shop in the West Village. It is little more than a tiny upstairs-downstairs cubbyhole. I could easily have missed it, if it weren't for the owner, Jeff, who was polishing an old sitar in the early spring sun outside his store. Inside, there is a jumble of old instruments, comic books and vinyls, mixed with the sounds of wannabe musicians trying out instruments from the compact downstairs space. Jeff has been running this shop for 59 years in what must have been one of the fastest-changing, competitive industries and cities. He has a table set up with a kettle where you can make really bad coffee, and leaves you to browse. While vinyl has made a big comeback, I'd imagine that over the past 35 years he must have had many sleepless nights worrying about the appearance of large CD chains and eventually the increasing threat of online shopping for music and musical instruments alike. There must have been times when he strongly considered selling the shop and taking the easier way out by just going to work for someone else.

Similarly, investors may have had sleepless nights over the past year about the ability of so-called growth investments to ever show positive returns again. They may worry about how they are going to protect and grow their savings. Fund managers who apply a proven valuation-based approach have also had their investment beliefs tested. Like Jeff, these managers must have been tempted to sell out and go with the crowd by buying into what was popular and comfortable. Indexing gained popularity once more as active managers struggled to beat the narrow market indices.

Investment strategies need time to deliver optimal results

Many investment gurus, experienced advisers, professionals and adverts remind us about the time it takes for a strategy to work. Yet, when the market dislocates and hits us with volatility, we become very short-term focused. We digest every bit of bad news as if our lives depended on it and we obsess over it, projecting the bad news into the future. It fuels our dinner conversation and compels us to take action. This is often unnecessary.

The following three points summarise why it's important to take a long-term view:

1. **Periodic volatility is inevitable.**
   If we go back in history, we find that periods of extreme volatility occur at least once a decade, as shown in Graph 1. We should therefore not be surprised when it happens – although such a reaction is only human.
2. **Uncertainty creates pessimism. Pessimism creates opportunity.**

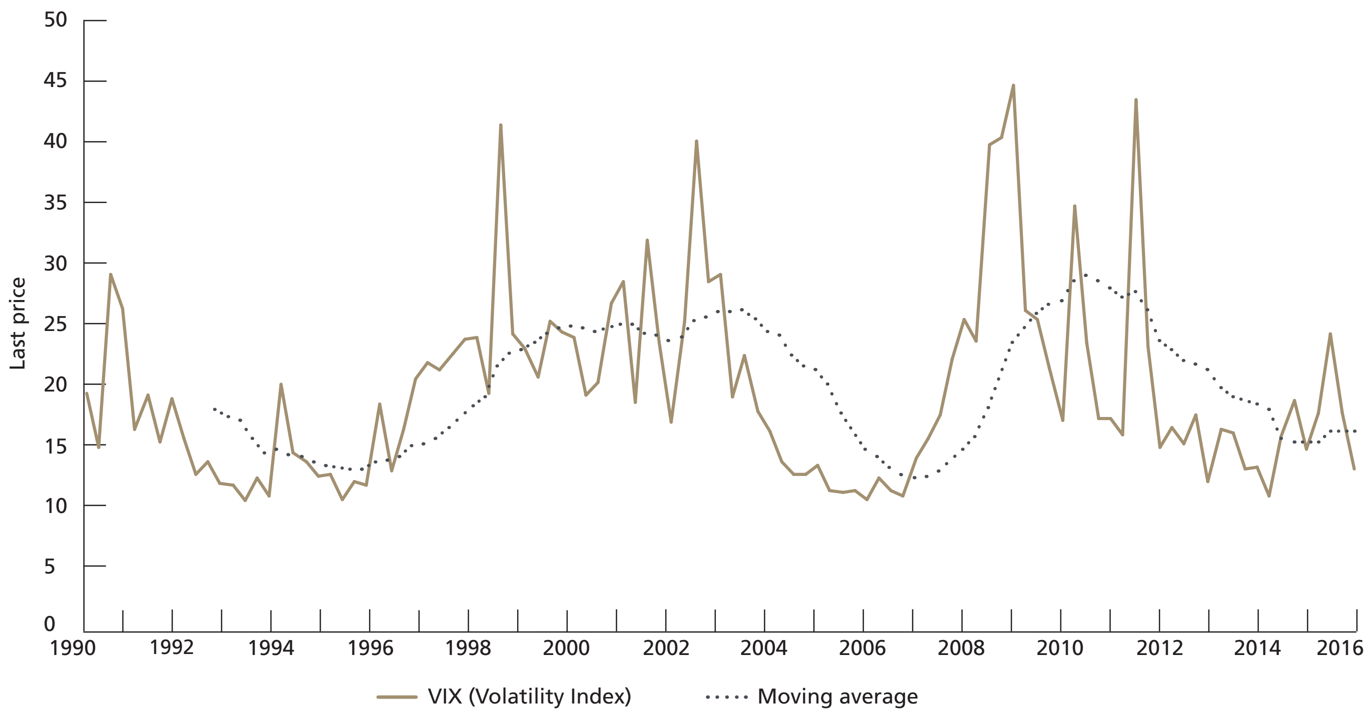
   > 'The most common cause of low prices is pessimism – sometimes pervasive, sometimes specific to a company or industry. We want to do business in such an environment, not because we like pessimism but because we like the prices it produces. It's optimism that is the enemy of the rational buyer.'
   > Warren Buffett,
   > Berkshire Hathaway's 1990 Chairman's LetterWarren

   Buffett summarises it really well in this quote. The marvel of the investment market is that it swiftly discounts what is going on in the investment environment, and often overreacts. If you are able to take a step back and think longer term, there can be some really good investment opportunities. Recent examples of opportunities arising from pessimism in our portfolios include buying Capitec and Capitec paper during the African Bank debacle, as well as Super Group.
3. **To think long term, you have to look beyond the noise – this gives you a better chance of success.**

   > 'If the past, by bringing surprises, did not resemble the past previous to it (what I call the past's past), then why should our future resemble our current past?'
   > Nassim Nicholas Taleb, Fooled by Randomness:
   > The Hidden Role of Chance in Life and in the Markets, 2005

   When fund managers have faced difficult markets and came through them with lessons learnt, it is not a guarantee that all their future decisions will be right. However, it will stand them in good stead when it comes to thinking more clearly and taking the emotion out of investment decision-making.

Graph 1: Volatility Index (1990 - 2016)



Source: Bloomberg

The three questions our fund managers always ask

Our fund managers have three questions they ask in response to the question, 'What is going to happen to the market?' (We however always refer to the investments we have in our clients' portfolios and not to the market.)

1. Is the company in question likely to be around in five years' time? This often refers to the first M of our 3 Ms investment philosophy, moat. It questions the strength of the company's business model.
2. Is the company likely to make money at some point in the next five years? This is partly a question about our second M, management. We often forget that a good management team responds better to a poor environment and often creates a more robust company for the next upturn, however mild it ends up being.
3. Given the answers to the first two questions, is the company likely to be trading at a higher price-earnings ratio at some point in the next five years? This refers to the third M, margin of safety.

If the answer to all of these three questions is 'yes', then our clients are very likely to get a good return from the investment. This approach considers the time period and the factors that can give us insight when we've done in-depth research. However, no amount of in-depth research can help predict the short term.

History provides evidence of the merits of a long-term focus

Some of the most admired investment businesses have been built over 30 years or longer. When you review their histories, patches of volatility, uncertainty and hardship will be evident. Yet, the ones who stuck to their well-proven process lasted and flourished, and their clients were well served. Any long-term investment strategy will be tested over time. It is the investor who partners a long-term view with good advice and the fund manager who takes a long-term view when making investment decisions who will have the best chance of success.

At PSG Asset Management, we unashamedly take a longer-term view. It may not always be comfortable, and it is seldom popular. However, we believe it is the best way for us to look after our clients' money.