the art of boring™

EP 147 | Global Equities: Moneyball, Weighing Decisions, and Finding an Edge

[00:00:00] Rob Campbell: On today's Art of Boring, Manar Hassan-Agha, co-manager of our Global Equity strategy. Most of our conversation takes place through the lens of our Moneyball process, which is designed to help us evaluate past decisions. And the big lesson, as I heard it: it pays to "be right and sit tight."

[Disclaimer]

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[00:00:56] Rob Campbell: Let's just jump right in. Manar, welcome, and a very happy New Year to you!

[00:01:00] Manar Hassan-Agha: Yeah, Happy New Year, Rob! I apologize if my voice sounds a little hoarse here. I'm just recovering from a cold where I lost my voice. But on the plus side, my wife says I've never been a better listener. So, there you go.

[00:01:13] Rob Campbell: Very good. Well, it sounds like you celebrated pretty well over the holidays then. But hey, a new year—a chance to both look backwards and reflect. Also a chance to look forwards. I'm actually hoping to ask you to do a bit of both over the next few minutes. So, if you wouldn't mind, let's start with looking back. I wanted to ask you about our Moneyball process.

We've talked about it a little bit on the podcast over the last few years, but can we start there? Can you remind us what that is and maybe share some of the more interesting insights that you've gleaned from that as it pertains to the Global Equity strategy? And some of the investment decisions that we've made over the past year.

[00:01:47] Manar Hassan-Agha: You know, Rob, I'm always excited about the new year. I'm just anxiously waiting for the Moneyball statistics to come out, 'cause it's such a great example of the continuous improvement at Mawer. A few years ago, it was an experiment run by Justin [Anderson] and The Lab team. And today it's, you know, a consistent process that we use to kind of help evaluate our decision making. And I think it's a real testament to the decentralized and evolutionary model that we have for ideas at the firm.

So, for the benefit of the audience, what is the Moneyball that we do at Mawer? You've probably seen the movie, right? With Brad Pitt and Jonah Hill? You know, a baseball team starts using these statistics systematically to draft players and evaluate their decisions.

[00:02:29] Manar Hassan-Agha: Instead of kind of the old school, conventional "eye tests" that the scouts used to deploy, right? "Oh, I'm telling you, he has a good swing!" And as a result of that, they're able to spend a lot less money. I think if I recall correctly, the Oakland A's had a budget three times less than the Yankees. And they kind of outperformed—this team of misfits. In a similar way that we look for mispriced risk.

Moneyball for us is, every year we make these buy and sell decisions and they're ranked by the dollar alpha that they contribute to the strategy and the portfolio. And a few things I've just mentioned that, you know, we're conscientious of when we look at these statistics, one is Annie Duke talks about this great concept of "resulting," where we have this dangerous heuristic of assessing the decision quality by the result. So, good result means good decision, bad result means bad decision.

And the problem we have here is that the future is uncertain and probabilistic. So, at the time of the decision, the odds could have been in your favour, so you made a good bet, but you had a bad result. Or vice versa. And so you might overfit the decision quality with the outcome.

[00:03:38] Manar Hassan-Agha: Then your feedback loop gets distorted and you're learning kind of the wrong things. And another thing I want to just consider here is in the context of being long-term investors, the shorter, the timeframe you look at, the more noise it starts introducing. So, we start to get a lot more signal when we look at five years plus.

Let me give you an example. In 2019, we bought Couche-Tard, a boring convenience store operator, number two position in the U.S. in a very fragmented kind of landscape of convenience stores. And if I transport you to 2019 and we open up the Moneyball stats, what you'll see is if you go all the way down to the bottom, the fourth worst contributor in dollar alpha was Couche-Tard in 2019.

[00:04:21] Rob Campbell: You're saying when we initiated in the position off the bat, it didn't go so well.

[00:04:25] Manar Hassan-Agha: Exactly. I mean, so you get the Moneyball stats from beginning of 2019 to the end of 2019, who started was the 4th worst contributor with negative alpha to the portfolio. Fast forward to 2023. You go back to that 2019 sheet, but in 2023, you see it's actually the fourth most positive contributor in the 2019 decisions we made in terms of contribution to the portfolio from a dollar alpha perspective. So, sometimes great investments have this short-term negative momentum going against you.

I'll keep going here a little bit with some other patterns from Moneyball. A lot of the large contributors to the strategy were really consistent with our philosophy. For example, we bought Microsoft in 2019, and if you transport yourself back to 2019, [Microsoft] was far more boring than it is today. It was a good business with a good management at a good price, but it was not the largest company in the world with sexy AI behind it or emerging at the forefront of cloud in a big way.

[00:05:26] Manar Hassan-Agha: Or how about Novo Nordisk in 2020? Back then it was pretty boring. It was the number one insulin and diabetes manufacturer; super focused on the molecule, on the research; great engaged owners with Scandinavian governance. But obesity was just an optionality that got realized over time, right? But it was super boring at that time.

We do have some new ideas in late 2021 that haven't gone so well. Two years later, I would say we're still in the early phases of being able to talk about them—

[00:05:56] Rob Campbell: Maybe let's just stop there. So, it sounds like one of the real insights that Moneyball provides relative to more traditional—call it prints and attribution—would just be the ability to decompose decisions by vintage. So you can separate your shorter term decisions from the longer term decisions.

[00:06:11] Manar Hassan-Agha: Absolutely.

[00:06:13] Rob Campbell: But another aspect of Moneyball, I think, is this ability to distinguish between, "Okay, a decision to do something, versus a decision to do nothing." And I wonder if you have anything that really came out of the past year that fits into that camp.

[00:06:25] Manar Hassan-Agha: Yeah, that's beautiful. That's another interesting thing we do, Rob, is we have all these different states of the portfolio that we can benchmark against. And you can think of it as kind of having these alternative histories to assess our decision making. And my favorite one is, "Hey, what if you just did nothing?" Like, what if you just went to Mexico, laid on a beach, just sat on your hands?

And it's always humbling when you underperform that alternative history, which is, "just don't touch it." And we have in the past. In a few years, we've underperformed that history. And we do that in different variations. You can do it kind of starting at the fund weights or doing it like "Hey, what if we equal weight, but you did nothing in the beginning of the year." And that's also pretty humbling because if you underperform the equal weight, which means your position sizing might be a little bit off, or you're not really creating a lot of edge in your position sizing.

One interesting observation in 2023 was that this was the first time since we started doing this exercise in 2019 where our portfolio outperformed every possible state that we contemplated in the Moneyball strategy.

[00:07:29] Rob Campbell: So, coming into the office this past year was a good decision. [Laughter]

[00:07:30] Manar Hassan-Agha: It was a good decision, which, thankfully, because it justified my job for one year. But it may be luck or just randomness, Rob, but I do think we've made an intentional and considerable effort this year and increasing the hurdle rate when we make decisions, we often talk about inactivity being kind of an intelligent behaviour.

[00:07:50] Rob Campbell: That's sort of a weird thing that Moneyball is suggesting, right? It's saying that, "Hey, if you had just done nothing, you would have been better over the last few years than what we did." But I don't think that's the full picture, right? Because the strategy has still outperformed its benchmark over various periods of time. And so it's those initial decisions to stick with things in the first place that are driving value.

I just wonder if you can shed some light on that aspect of it. Because I think a lot of it just comes back to the philosophy itself.

[00:08:18] Manar Hassan-Agha: Yeah, absolutely right. I think Peter Lynch said it kind of well when he said that the most important organ in our body is our stomach, not our brain. The big profits really come from owning great businesses and not really trading them. And we don't want to confuse action and motion with progress.

So, sitting on your hands is probably the toughest part. And I'll give you one example, tying it back to Moneyball. Here's a boring company for you—Wolters Kluwer, a professional publisher with these workflow solutions and databases for professionals like accountants and tax, health professionals, lawyers for reference so they can reference case law. And that's a stock we held nearly seven years. And it's undergone this transition from print to digital over time. So, it's a really boring company, nice sticky kind of subscription revenue. And you go back to our 2017 vintage in Moneyball and you see that it was a top contributor in terms of dollar alpha contribution to our strategy.

And again, a lot of the money is made by "being right and sitting tight." The *Reminiscence of a Stock Operator*, Edwin [Lefèvre], talks about that. It's not your thinking that makes the big money. So, we had the stomach to hold that for a longer period of duration. And I think that's our intention.

[00:09:29] Rob Campbell: I want to go back to something you mentioned briefly, because I know we're also at a time a year when you're reflecting back as part of our postmortem process and thinking about things that went wrong, stuff that you've learned.

You mentioned some decisions in late 2021, if I heard that correctly, that haven't played out yet the way that we hoped. Can you talk a little bit more about those and are there specific postmortem learnings from this past year that tie into those?

[00:09:54] Manar Hassan-Agha: There's two points I'd say to this Rob. One is we typically shy away from businesses with poor balance sheets, but our mental model is we don't want to take both operational and financial leverage. So, you don't want a business that's volatile on an operating leverage perspective *and* has financial leverage. That's a double whammy. That mixture is nay nay for us.

[00:10:16] Rob Campbell: Pretty toxic.

[00:10:17] Manar Hassan-Agha: Pretty toxic mix there. So, the businesses that we bought like Organon or Dun & Bradstreet, they had leverage on the balance sheets. But both businesses, if we think of Dun Bradstreet… really recurring subscription revenues, very sticky, high retention rates, 96 percent plus.

[00:10:36] Rob Campbell: This is the commercial credit company, right?

[00:10:35] Manar Hassan-Agha: Yeah, that's the number one commercial credit bureau. And then you have Organon, which kind of had this branded, off-patent portfolio in niches of drugs, as well as innovative women's health and biosimilars part of the business. So, not growing much, but a portfolio of assets that [seem] pretty resilient to defensible when you think of drugs and pharma.

But the leverage in that environment didn't work very well. And despite having this mental model, I do think that we've put a bigger emphasis on their balance sheets. We're a little bit too off side. It's one of those lessons you know, but you do it anyway. So, in hindsight, it's recalibrating that again and mak[ing] sure you're conscientious of that balance sheet.

It reminds me of how lessons can be so fallible. I mean, Stanley Druckenmiller, you know, famous investor/trader (however you want to classify him), but he talks about how he learned nothing from investing at the peak of the dotcom bubble, because he says, "you know, I already knew it was stupid. I already knew it was folly," but he did it anyway.

[00:11:34] Manar Hassan-Agha: And so a lot of times the enemy of our client's capital is really our own emotion, Rob. So, it's not what we know, but it's what we do and how we act. And so that's one perspective.

And the other perspective is in the desire to move off of some of the higher duration names, we may have made more decisions than we intended to. We were more active. You know, typically the constraint or the bottleneck is the other side of the trade. So, sometimes it's better to lean into your existing ideas and say, "Hey, you're always swapping one risk for another. When you do a buy and sell decision." When you sell something, it means you're buying something else and you're swapping risks of just being more mindful of leaning into something instead of going away from it.

And so that's really where having more inactivity, I think, has been, really, a motto for us in increasing the hurdle weight.

[00:12:21] Rob Campbell: Got it. Manar, I want to stay sort of on the subject of portfolio construction and risk, but I want to shift to looking ahead here. And I think last time you were on the podcast, you talked about various ways in which you and the Global [Equity] team are slicing the portfolio to evaluate the balance and the risks that are there.

In the past, you talked about economic sensitivity, you talked about alignment, skin in the game. One that I heard you talking about internally a little bit more lately, was asset intensity. Can you describe why that's so important in a risk management process and what the portfolio looks like from that perspective?

[00:12:56] Manar Hassan-Agha: Rob, you know, if a monkey can see it, then there likely [won't] be much value add. So, Nassim Taleb calls this "statistics from the cookbook." And so, you're kind of just getting this plain vanilla, already-calculated-for-you-to see, it's a correlation or a P/E or whatever it is. And you kind of superficially look at that number and you make a judgment from that.

But the key is in our risk management process; it's very dynamic. So, we try to do new exercises. The key is to have this criteria that's not visible at first glance. You can't just look at the portfolio and say, Oh yeah, X amount of your portfolio has this asset intensity. Or skin in the game that requires a little more deeper dive into the portfolio and some judgment.

And that's where we think judgment can lead to an edge. The outcome of that exercise was our portfolio biases towards asset-light companies. And this is consistent with our thinking. Roughly 90 percent exposure of our portfolio. And again, this is my subjective opinion on the strategy, or our subjective opinion on the strategy—[that it] had no, to little, to average asset intensity relative to the universe.

[00:14:04] Rob Campbell: Do you have a sense how different that is than kind of the broader universe? With more and more technology, has the universe shifted that way as well, or is this really differentiated the way we've got the portfolio?

[00:14:15] Manar Hassan-Agha: I think in part, the world has shifted there, particularly in the U.S. It's a more service-based economy. And you can see that. I do think that our philosophy, which emphasizes wealth creation, does create a selection bias which is intentional. Which is that businesses that don't require a lot of capital to grow. Well, who knew it tends to be more wealth creating and they don't have to reinvest a lot of money to maintain their revenue base.

So, in an inflationary environment that's also quite positive because as your maintenance expenditure goes up with inflation, you have to spend more and more just to reinvest, just to maintain your revenue base. So we like businesses that don't have a lot of capital to grow, and that tends to be more wealth creating. But I do think there's a structural shift in particularly the developed economies towards a more service based, But not everywhere. I mean, I think it's particularly acute in the U.S.

[00:15:05] Rob Campbell: One last question for you, which again, is in the forward-looking category. You know, we've got a platform here to speak to folks who are invested in the [Mawer Global Equity] strategy. What are you thinking about the most, and what message do you want to leave with clients as we look forward to what's always an uncertain year?

[00:15:22] Manar Hassan-Agha: What's the name of this podcast going to be?

[00:15:26] Rob Campbell: [Laughs] Okay, expecting a predictable response then.

[00:15:29] Manar Hassan-Agha: Play the plan, Rob. We'll continue to be boring and play the plan. No, look, "being boring" to us is making repeatable good decisions, over time, with a really well-defined investment philosophy and process. And that tends to lead us to boring, defensible, resilient companies. And we're a special bunch of people because we find boring exciting. That's the message that we're going to continue to be consistent with.

[00:15:53] Rob Campbell: Okay. Well, Manar, your voice sounds just fine. I'm glad you're fully recovered and many happy returns for the year ahead.

[00:16:00] Manar Hassan-Agha: Thanks, Rob. Appreciate that.