CEO Point of View

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by Glenn Carlson, CFA

The start of a new year often prompts reflection. I want to underscore a recurring theme in Brandes Investment Partners' communication with clients – the benefit of a long-term perspective. We believe focusing on long-term objectives is a critical element of investment success. And yet...

We regularly report quarterly results and performance attribution for your portfolio, which we see as very short term. For example, in each quarterly commentary, we discuss what helped and hurt returns over a single quarter's 92 days, which included approximately 63 business days – or about 400 hours of market activity.

We recognize that many of our clients expect quarterly reports. In addition, these reports satisfy contractual or compliance obligations. Thus, we provide the information as requested or needed. Keep in mind, however, we believe reporting on quarterly performance represents frequent communication on a process that transpires over, and requires, a much longer time frame.

Why do we believe evaluating a portfolio over one quarter is too short term to be of much value for a long-term investor, and may be counter-productive? In our company-focused research, we consistently observe business cycles typically ranging between three and five years or longer. We are concerned with one fundamental question – how the stock ultimately contributed to the long-term performance of your portfolio. Consider that the progress of a firm with a 5-year business cycle would encompass 20 quarterly commentaries.

Another reason we caution placing too much emphasis on quarterly commentaries is that they may lead to false conclusions about portfolio holdings. Consider the late 1990s, when many of our portfolios, as a result of our company-specific research, had much more exposure to the insurance industry than the respective benchmarks. Amid concerns about overcapacity and a lack of pricing power, there were quarters when we reported that our insurance holdings adversely affected absolute and relative performance. Indeed, some of our largest positions looked, well, "stupid" in the short term. Some interpreted these price declines as validating their concerns about these stocks.

However, we remained focused on our assessment of each company's fair value. Often, we responded to short-term price declines by adding to positions. We were excited and enthusiastic. We believed the market was presenting us an opportunity to purchase these companies at even larger discounts to our estimates of fair value.

An investor relying on quarterly commentaries would learn only that holdings in the insurance industry weighed on performance for that quarter. However, ultimately, our positions in this industry registered significant capital appreciation over the next few years and were sold after notable gains. While not every issue that we purchase works in your favor, there are many examples of periods when short-term losses were eclipsed by gains over the long term. This is why our long-term results have been compelling. And although past performance is not a guarantee of future results, we believe this will continue.

Finally, you may have read in a previous commentary that our firm has a “100-year vision” guided by key principles. In this context, three month’s time seems like the blink of an eye.

So how would our ideal quarterly commentary read? You might not find us very stimulating.

> *“During the quarter, we continued to apply our disciplined investment process, just as we have since our inception in 1974. Some stocks went up, as their prices moved toward what we believe to be their fair value. Other stocks declined, trading at even further discounts to what we believe to be their underlying value. Regarding the stocks that appreciated during the quarter – we didn’t get them ‘more right’ than the stocks that went down. In fact, we’re excited to add to existing positions that fell to even lower prices. All stocks in your portfolio were bought for the same reason – their discounts to our assessments of their fair values. We can’t say with precision when or if the market will recognize a stock’s fair value. In our portfolios, we have found this often occurs between three and five years, on average.*
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> *Over the past 33 years, the reversion of stock price to the fair value of the company has often created compelling returns for our clients. We are confident this result will endure, as we continue to apply the same disciplined investment process.”*

With little modification, this commentary could well serve as our quarterly commentary in perpetuity.

To make the commentary even more appropriate to our perspective, we would include performance only for the trailing 3- and 5-year periods. We would still invite clients to review performance each quarter, as long as they remained focused on the relevant trailing 3- and 5-year periods.

Our comments are not meant to sound arrogant, or indifferent to client requests. We place a high priority on communication with our clients. Our perspective reflects our belief that our disciplined investment process, long-term perspective, and willingness to be different are the key elements that have accounted for our historical performance – not how one industry, or company, fared over a quarter or similar short-term time frame. We remind you of the need for long-term focus as we reflect on the prior year and look with confidence toward the years to come.

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