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Is It Possible To Be A Long-term Investor?

By: Peter de Auer

About 15 years ago, I wrote about the 'Tyranny of Numbers' for **Benefits and Pensions Monitor**. The question then was 'how to choose a **pension** fund manager who looked beyond a conventional decision-making philosophy centered on short-term performance?'

The question today is 'will the market, defined as those who establish performance requirements in the **pension** fund industry, allow long-term **investing**?'

The issue was raised by Gwynn Morgan in a recent article in the Globe and Mail which discussed the desirability of management running companies with a long-time horizon, rather than the more prevalent quarterly results in mind.

This article attempts to bridge the gap between the two concepts: portfolio managers using long (say 10 year) hold periods to **invest** in companies they have identified as 'true' growth companies – that is with long time horizon managements – and the industry's desire for 'stable,' shorter time frame **investment** performance.

Two Aspects

There are two aspects to the question:

- identifying superior companies
- translating these into a winning stock market strategy

Identifying such companies is no easy task because the only winning criteria is superior management. The industry in which companies find themselves is important, but their life cycle is usually under the 10-year criteria, so management has to be able to change direction to continue along a superior growth path.

This does not necessarily mean transforming the company into entirely new lines of business. However, it does mean at least making sufficient adjustments to provide superior growth prospects.

Morgan's former company, Encana, probably qualifies in this respect. It is an oil and gas company with one of its two mainstays (natural gas) having been out of favour for a few years while the other, oil is doing exceptionally well. Encana is now switching direction by reducing significantly its emphasis on oil and using the proceeds of disposals to increase its dependence on natural gas.

Time Constraints

The transition could be painful in the short run, but it is likely a winning strategy long term. The problem for a portfolio manager is that holding Encana shares through the transition could result in fourth quartile performance in the short term, before resulting in first quartile as time unfolds.

Another example is Bombardier. The company originally positioned itself into what was thought of as three growth businesses – recreation, public transit, and small airplanes. Arguably, these were 'growth' cyclicals rather than true growth, but longterm growth nevertheless. The outcome is well known: flameout and renewal (sans recreation), a tribute to management.

Another example of an attempt at longterm strategy is Thomson, which has transformed itself from a newspaper company into a futuristic, electronic transmission of financial information pipeline and content firm. The company has been successful in achieving this corporate goal, but investors had to put up with nearly 10 years of profitless wait.

How long would trustees accept underperformance during these transition periods?

However, success can be achieved. Witness the transformation of Western Financial Group from a single property and casualty insurance brokerage office to a fully-diversified financial services company over a 10-year time span.

And there is always the example of Power Corp.*

Requirements for Success

This money manager's answers to the question posed by this article are as follows.

First, a money manager needs to select clients with a long time horizon, such as pension funds, with a positive cash flow for a considerable period of time. Further, such funds' trustees should be prepared to commit to support periods of underperformance in exchange for the prospect of truly superior results in the long run.

Second, the money manager should be prepared to conduct fundamental research into corporate strategies and be able to quantify the 'drivers' which will support successful long-term investing. The author has worked on this investment philosophy for some time and is hopeful of being close to identifying the methodology needed for success.

It can be done, but it won't be easy. ■

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