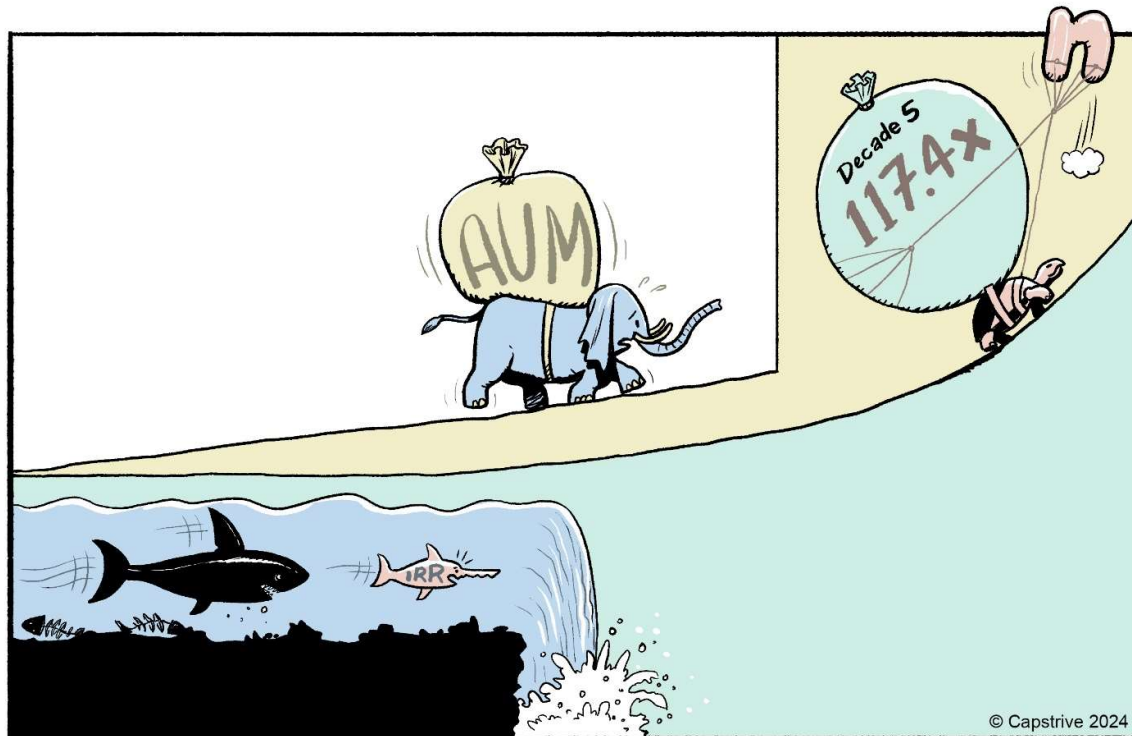


"Adopt the pace of nature: her secret is patience."

–Ralph Waldo Emerson



Solve for what?

One of the Late Stephen Covey's suggested habits was to "begin with the end in mind".

Expressed another way, what are we solving for?

This question can be asked in the context of being an individual investor of your own capital, or as an investment fiduciary managing the capital of others.

In preview, what follows is an invitation to emulate nature and to get rich slowly. You have probably received more appealing invitations. Bear with me. This is an invitation worth accepting.

Investment managers mostly profess to solve for high risk-adjusted returns. In practice, incentive driven revealed preferences frequently solve for maximum assets under management ('AUM').

The return chasers (the sharks) chase the "IRR hall of fame", while the AUM maximisers (the elephants) seek the "AUM hall of fame".

There is another approach however, and that is to act like nature and solve for staying in the game for the longest possible time, i.e. solve for duration (the tortoises). Do this and you may find your way into the "money multiple hall of fame".

In the compounding formula, where 'r' is the rate of return:

$$(1 + r)^n$$

'n', otherwise known as the exponent, or the number of years, does a surprising amount of the heavy lifting in the later years.

If you start with \$10,000 and compound at 10% per annum, your money multiple at the end of each subsequent decade is exponential.

Money Multiple on \$10,000 earning 10% p.a.	
Decade One	2.6x
Decade Two	6.7x
Decade Three	17.4x
Decade Four	45.3x
Decade Five	117.4x

The benefits of staying in the game for each incremental decade are simply staggering. Very few money managers have multi-decade track records. Simply surviving as a competent investment manager for multiple decades puts one in the rarified company of people like John Templeton, Peter Lynch, Warren Buffett, T. Rowe Price, Joel Tillinghast, Ron Baron, Chuck Akre and Bill Nygren.

Rather than becoming a boring tortoise why not be a shark and solve for the highest returns? Afterall, why get rich slowly when you can do it quickly? The main reason is that being in a hurry to get rich increases the risk of getting dealt out of the game. Navigating nature is a delicate affair.

From Entropy to Eternity.

Nature operates on a systematic level, aiming for the long-term survival of the whole, often at the expense of the individual components. Nature is solving for eternity. Crucially it does so in the full knowledge that ongoing major shocks are inevitable.

For investors, the challenge lies in not becoming roadkill in the relentless march of collective progress. This challenge is daunting due to the natural inclination towards entropy or increasing disorder and decay. Businesses must continuously adapt, safeguard, and enhance themselves to sustain their value and avoid dissolution or acquisition by those more adept at navigating these conditions. Portfolio managers need to be prepared for the future equivalents of the tech bust, the GFC, the Euro crisis, covid. Investing is meant to be hard.

Movement and adaptation are essential for survival, as demonstrated by sharks' constant motion to avoid decay. However, mere activity doesn't ensure safety; not all environments are equally rewarding, especially in the context of irreversibility of time, where you don't get the chance to undo a prior action.

Consider I offer you the following bet. We toss a coin and if it comes up heads, I pay you 50%, if it comes up tails you only lose 40%.¹ Should you take this bet? The answer seems obvious, of course you should as it has a positive expected value of 5%. Despite a positive expected return per toss, the reality of playing over time reveals a different picture. Due to the disproportionate impact of losses, continuous play results in a gradual depletion of wealth, because a loss of 40%, followed by a gain of 50% only gets

¹ Mathematician Ole Peters has explored this thought experiment in detail in his work on ergodicity.

you back to 90% of your original value, highlighting what I call “the miserable math of mistakes”. What looks like a good bet in isolation, played over time ultimately results in financial ruin.

Durable by Design

There is wisdom in the motorsport adage; “to finish first, you must first finish”.

Nature is durable by design. Enabling characteristics include:

- Self-repair and adaptation.
- Efficiency and resourcefulness.
- Diversity and redundancy.
- Scalability and integration.

Reducing errors, or minimising the impact of errors seems mundane, but it is the key to survival. If we want compounding to work its exponential magic, we simply need to make sure we survive long enough. Indeed, if the ‘n’ is long enough, ‘r’ doesn’t matter so much. A single dollar compounded at 2% from the birth date of Jesus would exceed all the wealth in the world today.

Management teams that emulate nature seek to build businesses that are durable by design. Such businesses typically share the following characteristics:

- A culture of long-term thinking over short-term profit maximisation.
- No/low leverage.
- Large and improving consumer/customer surplus.
- Heightened sensitivity to threats/risks (think Andy Grove’s dictum “only the paranoid survive”).
- Prioritise flexibility, stability, and optionality over optimisation.
- High returns on capital employed earned through a durable, and preferably widening, competitive advantage.

The Tortoises Diet

If as investors, we are solving for duration, then we need to be thoughtful about our information diet. We should choose the timeless over the topical, or to put it another way, the cumulative over the cyclical. More time spent reading annual reports, less time on daily ‘news’. More time studying business models, less time on the latest Model T. More time studying base rates, less on trying to divine the path of interest rates.

Conclusion

While, as individual investors, we can’t solve for eternity, we can design for durability, first and foremost through error avoidance. Error avoidance begets resilience which when combined with optionality most closely resembles nature’s relentless productive path.

That said, duration has a price. Compared to the sharks and the elephants, which will at times respectively be famous or visible, the duration seeking tortoise will be neither, spending countless years in obscurity in the investment wilderness (especially in bull markets). It’s a price worth paying.

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