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A Life Well Lived

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Woody Allen famously said "I don't want to achieve immortality through my work; I want to achieve immortality through not dying. I don't want to live on in the hearts of my countrymen; I want to live on in my apartment". Having celebrated his eighty-eighth birthday last week, he's giving it a good go.

Sadly, one character who is now only going to be immortalised not only for what he achieved, but also for his wit and wisdom, is Charlie Munger, who died last week tantalisingly close to his hundredth birthday. Munger is often referred to as the faithful number two to legendary investor Warren Buffett (himself a mere spring chicken at ninety-three), but I think that does him a disservice.

Many credit him with updating Buffett's investment strategy from deep value (which has been described by Buffett himself as "cigar-butt" investing) to something that we might describe today as "growth at a reasonable price".

Many books have been written about Munger, often utilising aphorisms from the man himself as the springboard for greater insights. One of the better known is "The Tao of Charlie Munger", with commentary by David Clark. As my own tribute to the great man, I thought this week I would lift a few of those quotes and give my own perspective, either in terms of a longer-term investment strategy or with reference to more immediate market concerns.

I hope this will have a longer shelf life than mere market commentary, even if November's returns turned out to be fantastic for both bond and equity investors. In a nutshell: inflation prints were lower than expected; hints of a pause in the interest rate cycle from central bankers cemented the idea that "the peak is in"; growth is not collapsing; the potential for an "immaculate disinflation" is alive; investors ran from one (bearish) side of the boat to the other (bullish), pricing in quite a punchy level of interest rate cuts next year despite protestations to the contrary from central bankers. It's probably gone a bit too far too fast for its own good in the short term, and the level of rate cuts predicted seems improbable without greater economic weakness.

Back to the main event. The Tao is a collection of 138 quotes. Deciding on just a few was difficult. My first pass through them offered twenty-five possibilities. In the end, I decided to take a few to illustrate certain key themes that Munger reiterates.

My third quarter client webinar was entitled "Patience will be rewarded". It acknowledged the frustration clients are experiencing of limited investment returns for the last two years. The Tao kicks off with a classic: "The desire to get rich fast is pretty dangerous." The fact that it happens sometimes makes it seem even more aggravating when it doesn't. But I would be inclined to say that the speedy accumulation of wealth is most usually associated with luck, a misperception of risk or following an unsustainable trend. Even today's winner in the AI stakes, Nvidia, was created as long ago as 1992 and listed on the stock market in 1999... before becoming an "overnight sensation" in May this year. How many waited that long for the big pay-off? "It's waiting that pays off as an investor, and a lot of people just can't stand to wait".

And so, patience is a key character trait for a successful investor, in Munger's eyes. Allied to that belief is the power of compounding. "Understanding both the power of compound interest and the difficulty of getting it is the heart and soul of understanding a lot of things". From our perspective, we see the power of compounding through two mechanisms. First is the ability of successful companies to compound returns through investing returns above the cost of capital back into their own businesses. Then there is the successful investor's ability to reinvest their returns (dividends or capital gains, for example) back into their portfolios.

I remember learning the story about the king who acceded to a sage's request to be paid in rice equivalent to doubling the number of grains received from one on the first square of a chess board. It turns out that two to the power of sixty-three is a number beyond most people's comprehension*. I can't say I really took this lesson on board when I was still in short trousers, and probably insufficiently when I had graduated to long trousers, but if I had to impress one thing onto somebody early (and even later than that) in their investment journey today, this is it.

- My colleague Simon Lapthorne reminds me that he used this in a tech presentation a few years ago – he says it's enough to stretch from earth to Alpha Centauri and back - even if it's short grain!

I could also add that interest rolling up on debts can have an extremely detrimental effect as the liabilities spiral higher. Most busts that follow booms succumb to this force. The US mortgage market in the build up to the Great Financial Crisis was a case in point, as many homebuyers stretched their finances to the limit by taking on mortgages where no cash interest was paid; instead, it was rolled up into the principal amount... and then interest was charged on that too. We all know how that ended. There is a similar reckoning playing out currently in China's real estate market. We also note the increasing popularity of "Payment in Kind" bonds (PIKs), where the annual coupon is rolled into the amount owed and no cash is paid out. We tend to stay clear of this sort of investment "opportunity".

As for making those investments, Munger definitely had a bias towards quality, a bias that we share. "View a stock as an ownership of the business and judge the staying quality of the business in terms of its competitive advantage". The last two words encapsulate the concept of the "moat", the safety barrier around a business that has been paramount to most of Berkshire Hathaway's successful investments. No doubt there is a degree of subjectivity in assessing the width of a moat, and this is where investment skill comes in. But we are acutely aware that in a world of accelerated disruption, moats are there to be bridged, and so we remain vigilant on the ramparts.

And what do you pay for such a business? One of Munger's most famous lines is "A great business at a fair price is superior to a fair business at a great price" (this one has been attributed to Buffett as well – it's such a good one that they probably both said it often). It's hard to resist the allure of a company that looks "cheap" on a headline price/earnings, price-to-book ratio or high dividend yield. But will it have the ability to compound great returns into to future? Probably not, in most cases, unless it can transform itself.

Sometimes, market conditions do offer unexpected opportunities, such as when certain investors are forced to sell owing to liquidity issues, for example. Sometimes it might be that impatient investors are reading too much into short-term or one-off problems and the shares fall well below their long-term intrinsic value. That is when Berkshire can back up the truck.

Munger was not short of life lessons either and he had almost ten decades during which to accumulate them. We are often dealt hands in the stock market (and life) that are not pleasant. "I think that one should recognise reality even when one does not like it; indeed, especially when one does not like it". There can be a tendency either to bury one's head in the sand or to take inappropriate actions in tough times or when an investment goes sour. We need to be more realistic.

In a similar vein: "I don't think it's terribly constructive to spend your time worrying about things you can't fix". There are plenty of things that impinge on my own life over which I have very little or no control, ranging from income tax rates to train cancellations; from that inconvenient rainstorm on the day that I had booked off to play golf to the guest who knocked over a glass of red wine onto a white carpet at the weekend. I allow myself a few well chosen swear words to vent my frustration and move on. (The red wine did respond to immediate treatment with salt, water and, finally, carpet cleaner, so they will be invited back... to drink white wine!)

I am also completely aligned with both Munger and Buffett when it comes to learning. "Warren is one of the best learning machines on this earth. [His] investing skills have markedly increased since he turned sixty-five". There is hope for all of us! Furthermore: "I constantly see people rise in life who are not the smartest, sometimes not even the most diligent, but they are learning machines. They go to bed every night a little wiser than they were before they got up, and boy, does that help, particularly when you have a long run ahead of you."

Nobody could complain today that there is a dearth of learning material in the world. If anything, the choice is overwhelming. Sometimes I read books or articles or listen to podcasts that one could take reams of notes from. On other occasions it seems that I have panned through a massive pile of dross to reveal a tiny nugget, but it's always worth the effort. Or one can just take a shortcut thanks to the accumulated wisdom of others. Thanks, for that, Charlie! May you rest in peace.

Economic Commentary

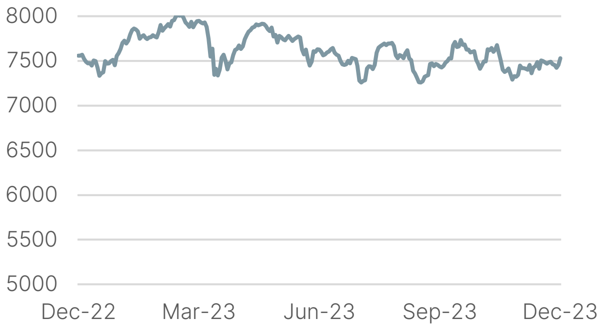
FTSE 100 weekly winners

Rolls-Royce Holdings plc	14.8%
Smurfit Kappa Group PLC	12.7%
Fresnillo PLC	12.2%
Rightmove plc	8.4%
JD Sports Fashion Plc	8.2%
B&M European Value Retail SA	8.0%
Mondi plc	6.0%

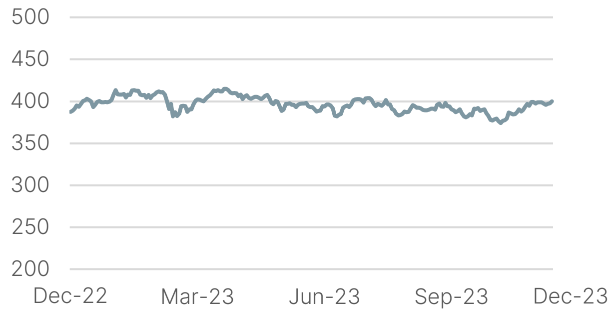
FTSE 100 weekly losers

Rentokil Initial plc	-6.0%
Entain PLC	-5.9%
Prudential plc	-5.7%
Pearson PLC	-5.0%
Just Eat Takeaway.com N.V.	-4.5%
Severn Trent Plc	-3.4%
Abrdn plc	-2.8%

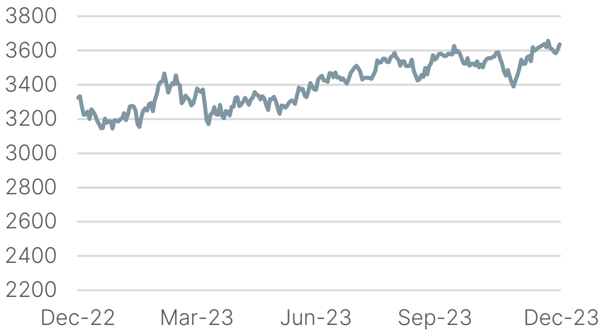
FTSE 100 index, past 12 months



EuroStoxx 600 index, past 12 months



S&P 500 index, past 12 months



All data shown in GBP.

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