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Top Ten Investment Lessons Learned

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I was recently asked to give a brief presentation on an investment-related topic. What follows is my list of the top ten lessons I have learned throughout my years of working as both a portfolio manager and analyst. Each cycle feels a bit different, but the time-tested principles I describe below have shaped my investment decision-making and have proven to be fruitful over the years. I would like to think I have learned from my winners and maybe even more so from the ideas that did not work out as well.

10. To truly invest with conviction, you must do your own work and formulate a thesis that is grounded in facts and empirical evidence. I believe there is no substitute for good fundamental work, and there are few shortcuts that can be taken in the equity research process. The development of an investment thesis must consider all of the risks inherent to the opportunity, it must be well-documented, and it must have key performance indicators (KPIs) that can be tracked throughout the investment's lifecycle. It is critical to ensure opinions and personal bias do not get in the way of the investment thesis. All of this should set one up to purchase at the right time, hold the idea long enough to let fundamental progress contribute to total shareholder return, and then to sell, when appropriate.

9. Return On Invested Capital (ROIC) is the single most important metric driving stock returns over a long-term time horizon. Many believe Earnings Per Share (EPS) is the most informative metric in determining the direction of stocks, but I have found that this is really just a shortcut for ROIC improvement. Many companies can grow EPS over the short term, or even for years at a time, but we believe growing earnings at a level that is ROIC-accretive over the long term takes skill, vision, leadership, and most importantly, thoughtful and carefully vetted capital allocation. ROIC assesses how efficiently a company is allocating investors' funds to generate a profit. This is very much related to the strength of a company's management team, which leads me to the next point.

8. The importance of a strong management team cannot be understated. Human errors and greed can manifest in poor capital allocation such as unwise acquisitions or balance sheet encumbrance. These are among some of the most consistent thesis spoilers. If you pay attention, it is not hard to spot the worst of the capital allocators. Management incentives are often underappreciated by investors, and while simple, this is something we pay attention to and use to our investors' benefit at Crawford.

7. Forget about commodity price forecasting. At Crawford, we do not rely on forecasts for natural gas, oil, or interest rates, but instead we focus on the strength of an underlying business and management team. While we do not believe we can get an edge by producing commodity forecasts, we invest in companies with management teams that have a clear understanding of commodity risks and can take advantage of ebbs and flows within more commodity-sensitive industries such as Energy, Financials, Real Estate, Utilities, and Materials. These businesses, steered by enlightened industry experts, may be hard to find, but they tend to be good ones to hang onto.

6. Benchmark weightings are important, but only to a limited extent. In all Crawford portfolios, we are careful and intentional when considering key underweightings and overweightings relative to a benchmark. Understanding exposures on both an absolute and relative basis is important, as is the differential relative to a benchmark. Inaction or a benchmark alone should not dictate portfolio positioning.

5. Every investment needs at least a comparative (preferably a competitive) advantage. It is crucial to make sure every thesis has an argument for what the competitive advantage is and how it will play out over a reasonable total shareholder return horizon. Valuation by itself does not constitute a solid thesis for investment.

4. Many of the best investments are out-of-favor, high-quality stocks with a catalyst for reversion to the mean in valuation. A short-term controversy or temporary dark cloud over a business can create a once-in-a-decade buying opportunity, but again valuation by itself is not a solid thesis for investment. I look for companies with strong business models, sustained competitive advantages, and/or a new management team ready to drive the competitive advantage. While you should not shy away from valuation opportunities when they present themselves, you must also ensure you do not invest before the temporary issues have been fully realized by the market. In other words, don't be too early. Successful investors are patient with the purchase and then patient again as they wait for fundamentals to improve.

3. Hiring decisions are of the utmost importance. A new hire can impair a well-functioning and collaborative environment, or it can expand the expertise and functionality of a team. While this applies very much to the C-suites of the companies in which we invest and is something we are very cognizant of, it also applies to our equity research team at Crawford. We have been very thoughtful in making hiring decisions, seeking to be conscious of philosophical consistency and team dynamics while at the same time expanding the expertise of the team.

2. Be careful with losers. Some investors say you should not add to a losing position under any circumstances. I tend to believe that if you do, you should have a good argument. At Crawford, we believe the theses and fundamentals of companies experiencing poor performance should be carefully scrutinized.

1. As a famous investor once said, "There's never just one cockroach in the kitchen." After I find the first "cockroach" and the stock resets nicely, I prefer to wait at least a couple of quarters to make an investment decision. I like to allow the market to work itself into a bearish lather before we step in. This gives me plenty of time to do the fundamental work and observe management before deploying meaningful capital. One of the most important lessons, however, is that after doing all of the work to develop a thesis, sometimes the right decision is to pass entirely or continue to wait.

While these are my personal lessons learned, many of them are shared among members of our equity research team at Crawford. Moving forward, our research team intends to invest according to these lessons learned (and more) with quality as our North Star. We continue to refine our fundamental, bottom-up process and create best practices as it relates to both security selection and portfolio construction, and we do all of this in the spirit of creating successful outcomes for our investors.