AORIS

The paradoxes of investing

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Aoris International Fund

Aoris Investment Management

Aoris is a specialist international equity manager founded in 2017. We are a focused business and manage a single international equity portfolio. Our investment approach is conservative, fundamental and evidence-based.

The Aoris International Fund

We own a concentrated portfolio of high-quality, wealth-creating businesses run by prudent and capable management. Owning a maximum of 15 companies allows our quality criteria to be unusually demanding and permits us to be discerning on the price we pay. We aim to deliver a return of 8–12% p.a. after fees over a 5–7-year market cycle.

The paradoxes of investing

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Introduction

The great American novelist F. Scott Fitzgerald, author of *The Great Gatsby*, wrote that **'The test of a first-rate intelligence is the ability to hold two opposed ideas in mind at the same time and still retain the ability to function.'** While Fitzgerald was writing about his own identity crisis, his insights are strikingly relevant to the field of investing.

Investment decisions are rarely clear cut. Investors often need to make decisions with imperfect information and while reconciling between multiple beliefs. Learning to navigate these tensions thoughtfully is what separates a good process from a lucky outcome.

At Aoris, we commonly need to make decisions in the face of five such investment paradoxes:

1. Confidence vs. humility
2. Patience vs. urgency
3. Trust vs. scepticism
4. Insights vs. information
5. Diversity of thought vs. decisiveness.

In this feature article, we share how we manage these tensions to make the best possible investment decisions.

1. Confidence vs. humility

While it's important to be confident in the companies we own, we also need to remain humble and willing to recognise when we're wrong.

Successful investing requires a delicate balance between confidence and humility. Veering too far in either direction can lead to poor investment outcomes. We don't want to be confident to the point of arrogance and blind belief, nor do we want to be humble to the point of self-doubt.

To be able to own our portfolio companies for a long time and stay the course through the inevitable periods of poorer fundamental or share price performance, we need to be clear and confident in our ownership hypothesis. What helps us develop this confidence is giving ourselves at least a year to understand a business and how well it's managed before considering it for the portfolio. With time this confidence can deepen as we continue to analyse the business, follow its financial performance, and interact with its representatives.

But no matter how confident we are in our investment views, we must always remain open to the possibility we're wrong. We need to be on the lookout for any disconfirming evidence to our existing belief set on a business, and to think about what we might be missing. We might be wrong about the quality of the business to begin with, or the assumptions underlying our valuation. Perhaps the environment in which a business operates has become structurally less favourable. Or perhaps management aren't taking the actions necessary to make the business better.

These are some elements of our investment process that help keep us humble:

- We rewrite our investment cases for portfolio companies every year from scratch, which is an opportunity to re-test our thinking.

- We conduct an adverse-event checklist when faced with materially negative developments for a business. This is a series of questions that help us think through the situation as rationally as possible, rather than letting our emotions take over.
- We regularly revisit businesses we've passed on, recognising we may have misappraised their qualities in the first place.
- We hold biannual investment team offsites, where we reflect on our mistakes and what we could have done differently.

While it's important for us to be confident in the companies we own, we also need to remain humble and willing to recognise when we're wrong. This mindset has helped ensure that when we have inevitably made mistakes, their severity and impact on investment returns have been low.

2. Patience vs. urgency

Investors need to strike the right balance between patience and the urgency to act when the facts change.

Another tension in our decision-making relates to timing, and knowing when to wait and when to act.

We aim to be patient, long-term owners of great businesses. We want to be patient in taking the time to get to know a business and whether it satisfies our demanding quality criteria, rather than getting excited and rushing into an investment we don't fully understand. We also want to be patient once we do own a business, recognising that every business will eventually endure tougher times and go through periods of share price underperformance. To benefit from the long-term compounding in value of a quality business, we must be able to stay the course.

But we can't let our patience devolve into inaction or inertia. We need to be willing to sell an investment with urgency as the facts change. In particular, through periods of share price volatility, we also need to be able to take advantage of price dislocations that can be short-lived.

At the end of 2020, portfolio company S&P Global announced a large acquisition that we felt diluted the quality of its existing franchise and introduced material integration risks. Even though we had only owned the business for three months at that time, we didn't hesitate to sell our investment the day after the acquisition was announced.

On the other hand, in hindsight we took too long to exit our investment in IT reseller CDW after we first recognised the company's waning customer relevance. There was a cost to this inaction in underperformance, as well as the opportunity cost of what other business we could have owned instead. This experience has heightened our vigilance and responsiveness to signs of structural weakness in a business.

To grow and protect our clients' capital over the long term, we need to strike the right balance between patience and the urgency to act when the facts change.

3. Trust vs. scepticism

We need to balance our trust in management teams with a healthy degree of scepticism.

Just as our clients entrust us with their capital, we need to be able to trust the management teams of our portfolio companies to allocate their capital sensibly and make the right decisions to strengthen their competitiveness.

We can't expect perfection – after all, management are only human and have their own biases. So when executives do make mistakes, we assess the severity of the impact, whether they're taking the right corrective actions, and look for evidence they've learned from the mistake so it's unlikely to be repeated.

But the allure of the narrative can be compelling. Just because an executive is a polished speaker doesn't mean they're an effective leader. We need to remain sceptical about whether we're being given the complete picture or just being told what we want to hear. Management's messaging needs to be supported by clear actions and in the financial outcomes. We often ask ourselves: **Does this make sense?**

Thinking by inversion, another question we ask ourselves is: **What are we not hearing?** We can't assume that just because something was true when we first looked at a business, it's still true today. If management have stopped talking about something, it's likely because it's no longer as important to them. We value consistency in management's messaging over time and across different representatives from the company.

Our recent sale of Atlas Copco was influenced by the absence of meaningful commentary from management about what they're doing to make the business competitively stronger and to reinforce its entrepreneurial culture.

The priorities and performance of any business can occasionally diverge from their norm. We need to constantly balance our trust in the management teams of our portfolio companies with a healthy degree of scepticism when their messaging deviates from our expectations.

4. Insights vs. information

Investing is more about insight and judgements than knowledge, and requires an active effort to focus on the things that matter.

Today's investors have access to more data than ever: real-time stock prices, financial news, earnings transcripts, expert networks, social media, and even satellite imagery of retail store parking lots. Paradoxically, this glut of information is more likely to cloud one's judgement than to result in better investment outcomes. Investors need to work out the few key issues that matter to the long-term prospects of a business, and what's just noise.

The overconsumption of irrelevant information can have a materially detrimental impact on investors' psyche and returns. It can lead them to overestimate their understanding of a business, to sell an investment prematurely in response to negative press, or to become indecisive in a never-ending search for the next piece of marginal data.

At Aoris, we try to tune out the noise as much as possible. For starters, managing an international equity portfolio out of Australia allows us to assess information and make decisions outside of the pressure of live market trading in the US and Europe.

We've chosen not to receive research from sell-side analysts, who often focus on the short term and exhibit herd mentality. We'd rather form our own judgements.

When we conduct research, speak with a company or hold discussions as a team, our emphasis is on uncovering real insights rather than fact-finding. We work hard to keep our meetings purposeful, to not get drawn into the periphery, and not feel like we have to contribute to every interaction if we have nothing of importance to add.

We build our own financial models based on the source documents from the company, and we try to keep them as simple as possible. A handful of variables determine the economics of a business. We'd rather be roughly right with our simple models, than precisely wrong with a 1,000-line model. The more variables introduced into a model, the more mistakes can be made.

Investing is more about insight and judgements than knowledge. Two investors armed with the same information could come to drastically different conclusions. It requires an active effort for us to tune out the noise and focus on what matters most to the long-term prospects of a business.

5. Diversity of thought vs. decisiveness

Our investment process is collaborative, while also embedding the decisiveness that investing requires.

Our investment team is deliberately collaborative. We recognise we all have our own blind spots, and that collectively we can benefit from each other's diverse backgrounds and ways of thinking. We can help sharpen each other's thinking by encouraging respectful dissent and a meritocracy of opinions.

We need to encourage healthy debate to benefit from our team-based approach and diversity of thought. Groupthink is a sign that ideas aren't being challenged robustly enough. We have an obligation to our clients and our colleagues to speak out where we feel differently, provide honest feedback to one another, and help each other learn and improve.

Any time we meet with a company or make a key investment decision, every member of the investment team records their individual views in our internal document system. This highlights any differences of opinion and helps each of us feel accountable for the decisions we make as a team.

But we can't allow differences of opinion to paralyse our decision-making. There's a point at which the discussions must end, and decisions have to be taken. Inaction can have a meaningful opportunity cost in investing. For this reason, we have clear guidelines around the degree of consensus needed to make portfolio decisions.

We work hard to keep our investment team collaborative and bring out a diversity of views, while at the same time our process embeds the decisiveness that investing requires. Being a small team helps us make decisions nimbly and without getting bogged down in peripheral views.

Conclusion

To make the best possible investment decisions we need to:

- Have confidence in our views, as well as humility and a recognition we could be wrong.
- Be patient, long-term owners of great businesses, while remaining vigilant for signs of weakness and acting with urgency once the facts change.
- Trust in the management teams of our portfolio companies while asking ourselves if what we're hearing from them matches with what we expect.
- Focus on insights that matter most to the long-term prospects of a business, and manage the constant flow of information we're exposed to every day as investors.
- Collaborate respectfully as a team and remain decisive.

We believe our disciplined investment process and collaborative team structure have helped us strike the right balance between these paradoxes.

Portfolio companies

accenture

Amphenol

COMPASS GROUP

Copart

Halma

experian

GRAINGER

DIPLOMA PLC

jack henry

L'ORÉAL PARIS

Microsoft

RELX

SHERWIN-WILLIAMS

VISA

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