New Year's Resolutions

The New Year is upon us. The world didn't end (at least as far as we know), the rapture has yet to take place and the good folks at Reaves Asset Management are again adjusting to their road warrior New Jersey commutes and long work hours. Many have come back with new goals to do things like lose weight, drink less coffee (as if that's a good thing), be more productive, etc. and I certainly hope the best for them all.

I too came back with some resolutions. And against the advice of some of my colleagues, I've decided to share a few with you.

Pay less attention to news headlines!
But if I don't pay attention to news, how can I possibly do a good job reacting to it? [Please insert the sounds of crickets chirping here.]

When I consider the mistakes of 2012 all too often they were the result of reaction to market and industry conditions that proved temporary. Of course, those conditions didn't seem temporary at the time. On the contrary, they seemed like the brimstone-charred end of the world. I felt immense pressure to do something, sure that if I didn't my clients could lose money. Images of investors left destitute, their retirement savings dearly departed, their children in State rather than private schools, dinners paired with only domestic wines (and not from Napa) filled my mind. Closely watching the news only reinforced my alternating sense of doom or euphoria.

Fortunately, these temptations were mostly held in check by the people who work here and by a research and management process that requires discussion before action. The debates were fierce. It is certainly a testament to the founders of the firm and architects of our process that such a failsafe exists. Without it we might cause many more unnecessary tax events and lose positions that more often than not recover throughout the year.

Paying too close attention to news and to prices is like willingly joining the heuristic of a computer matrix. You become one of the tongue dragging cows in the herd, stampeding back and forth, lost in a dirt cloud of confusion with only the rump in front of you as your guide. I find it very difficult to be independent and dispassionate when I'm too close to current events. They become the starting point for my thinking and I become reactive rather than proactive. Also, in an age where computer algorithms are intelligent enough to interpret and trade on headlines, it is increasingly difficult to add value by trying to be the quick one to trade on new information. Thus it's more important than ever to focus just on the really important stuff. Most news is not that.

In fact, I may go one step further than simply paying less attention to news. What if I were to read corporate press releases only one full month *after* their release? That way I'd be paying attention to the release when the electronic herd is focused elsewhere on the crisis de jour. I wonder if doing so would lead to better investment decisions…maybe I'll try that in 2014.

Pay less attention to my portfolios!
Dear clients: I hope you will not panic, but this year I fully plan to pay *less* attention to our portfolios than I did last year. I'm kidding, of course. However, I will pay less attention to the day-to-day price swings.

About a year ago a friend of mine purchased a copper pot still. He lives in a place where making your own liquor is legal (but assault rifles are not – a very strange place, indeed). I happened to spend some time with him and had a good mental chuckle over how similar whiskey making is to investing. Just as whiskey has to mature in order to taste its best, investments need time to come to fruition. Once the whiskey is in the cask (or aging jars, in this case), stressing, fretting or frequently changing things generally will make the outcome worse, not better. The finished product is a function of all the work and planning that goes into it *before* the spirit is jarred. Once in the jar, there is not much benefit to second guessing the process. And if you have some experience in the field, you should have a pretty good idea when it is time to open that jar and start enjoying the whiskey.

I've found that the same is true for investments. Our best results generally happen when we do good work before a purchase is made and then stick with the investment game plan, deviating only when something spectacular or catastrophic happens. It's not too different from a private equity investment except that we have the liquidly and flexibility to take action when that truly horrible event occurs. I find that when I enter investments with this sort of long-term psychology it compels a more strategic and countercyclical investment approach. Management quality takes on more importance because I know I will have to trust these people to create value even in adverse conditions. Also, because I know markets are volatile and short-term business cycles or company specific events can cause gyrations in price, it leads to me to constructing portfolios imbedded with natural hedges. For instance, if we decide to purchase a commodity producer that can benefit from rising prices, we also may consider a low-cost consumer of that commodity. While the consuming company may be hurt by rising input costs in the short run it should be able to take market share from higher cost competitors in the long run.

We (our hard-working research team) have a very rigorous research process. We come up with a thesis, a timeline, a list of catalysts, as well as action plans in the event of full valuation or fundamental negative change. So will it add value if I obsessively watch our investments worrying about every daily price move, trying to "manage short-term volatility", or storming the offices of my colleagues with a frantic need for answers when some headline moves the market? As much as it makes me feel like I'm being productive by watching our portfolios so closely, I suspect that the opposite is generally true. There are certainly times when action is required and it is important to get the big stuff right, which is exactly what an independent research process and sensitivity to valuation is all about. But it is equally important not sweat the noise.

Spend less time in the office!
If I could get away with it, I would only come to the office two or three days a week. I've honestly never been a big fan of Jersey City anyway, so I wouldn't miss it much. There are too many people with moustache's here. Alas, my partners are a bit parochial and prickly about the idea of me trotting the globe looking for investments while they are chained to their desks like Gregorian monks. Why should I have all the fun? So, rest assured, I will be here should you need some assistance or want to talk about something (other than news, of course).

But spending less time in the office has big benefits. First, it means paying less attention to the news, and to short-term swings in the market and our portfolios. Second, it means doing more primary investment research, meeting more companies, getting answers to qualitative questions that Excel models won't give us, and, most important, improving our global contact network so that we become better global investors.

Fresh perspectives are the lifeblood of strategic thinking. Routines are often the killers of fresh perspectives.

I'm actually not a big fan of travel – wasting hours in airports, being stuck on runways or waking up at four in the morning due to jetlag - but it's becoming clear to me that the global opportunity set is growing and should not be missed. While our firm has a history of investing in foreign companies, I've generally been the odd man out on the topic. I never got with the diversification push by them or by the academic community because of my fierce patriotism and distrust of foreign accounting, regulation, and business institutions. For the most part, that inclination has proved right. However, my opinion is changing.

Many of the trends that have proved so profitable in the U.S. over the past ten years such as Shale Gas and the need for associated infrastructure are starting to be global phenomena. The U.S. is far from the only place in the world with great energy reserves. Also, many emerging markets are capital consumers. Since capital generally comes with lots of terms and conditions that force better accounting and regulatory frameworks, investability has generally continued to improve while residual fear about 2008-style contagion has kept valuations attractive. As always, any new idea will receive the customary due diligence and team vetting, all of which takes a lot of time and work. However, I wouldn't be surprised to see more international investments in our portfolios over the next few years.

So there you have it. Those are my new year's resolutions. Since I'm already thin, good looking, have exemplary hygiene and have absolutely no intention of decreasing my caffeine consumption ever, under any circumstances; I'm left with tackling the big stuff. Wish me luck!

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