"Be aware that the market does not turn when it sees light at the end of the tunnel. It turns when all looks black, but just a subtle shade less black than the day before."

Jeremy Grantham, March 2009

Much more important than trying to predict the future direction of the market is being prepared for whatever that future delivers. We believe that being mindful of four basic criteria will prepare most investment portfolios for whatever the future dishes up.

Investing in businesses that have management with high standards of integrity is the first and most important factor to consider. You wouldn't go into a business partnership with someone you didn't absolutely trust so why become a partner in a listed business (where you wield virtually no influence) if you don't trust that the board and management have your (the shareholders') best interests at heart. There is no law that says you have to deal with bad people so we generally choose not to.

A wise man once said that debt was the only way an intelligent person could go broke. What we have seen emerge from the recent Opes Prime and Storm Financial debacles bears this observation out. If you have no debt you are unlikely to ever be a forced seller. There has been an awful lot of forced selling over the past year, which creates opportunities for rational buyers. Debt is also an issue at the corporate level. There are many businesses that, if they had resisted the institutional imperative to gear up their "lazy balance sheets", would be steadily going about their businesses today. Instead their primary focus is now on coming to acceptable agreements with their bankers rather than getting on with their business.

No matter how attractive a business is, if you pay too much for a share in that business it can be a poor investment decision. The best way to avoid paying too much is to have a very clear and rational view of what the value of that business is. It is then easier to resist the temptation to jump aboard the latest "market fad" and only invest when value is apparent. (It is probably worth observing at this stage that the latest market fad appears to be cash, which is currently paying the low yield common to most such fads.)

A reasonable level of diversification - without succumbing to "diworsification"[*] - can help protect a portfolio from industry or sector specific downturns. A portfolio of a dozen securities spread across different sectors without significant correlated exposures will generally provide sufficient diversification for the average investor. This is the final consideration and really a continual overlay after the previous factors have been used to construct the portfolio.

If we can keep these four factors to the fore when making investment decisions we believe that we will withstand the worst of what the market delivers.

March 2009

---

[*] "Diworsification" is investing in the 13th to 50th best ideas so as not to be too concentrated in the 12 best ideas