"Buy good companies, don't overpay and do nothing."

Terry Smith (founder & CEO of Fundsmith)

Investment adviser, Robert Kirby, once recalled a client he had in the 1950s:

> *I had worked with the client for about ten years, when her husband suddenly died. She inherited his estate and called us to say that she would be adding his securities to the portfolio under our management. When we received the list of assets, I was amused to find that he had secretly been piggy-backing our recommendations for his wife's portfolio. Then, when I looked at the total value of the estate, I was also shocked. The husband had applied a small twist of his own to our advice: He paid no attention whatsoever to the sale recommendations. He simply put about $5,000 in every purchase recommendation. Then he would toss the certificate in his safe-deposit box and forget it. Needless to say, he had an odd-looking portfolio. He owned a number of small holdings with values of less than $2,000. He had several large holdings with values in excess of $100,000. There was one jumbo holding worth over $800,000 that exceeded the total value of his wife's portfolio and came from a small commitment in a company called Haloid; this later turned out to be a zillion shares of Xerox.*[1]

It's an interesting concept. We know that activity is the enemy of returns due to frictional costs (transaction fees and tax on realised gains). The more we trade the less we have to invest in the first place. And we are hard wired to act in exactly the wrong way at exactly the wrong time – to zig when we should be zagging, to buy when we should be selling and sell when we should be buying.[2]

Kirby went on to coin a term for the "hold forever" approach to investing. He referred to it as "the coffee can portfolio".

> *The Coffee Can portfolio concept harkens back to the Old West, when people put their valuable possessions in a coffee can and kept it under the mattress. That coffee can involved no transaction costs, administrative costs, or any other costs. The success of the program depended entirely on the wisdom and foresight used to select the objects to be placed in the coffee can to begin with.*

How should this inform our behaviour? There are two thing we need to remain focused on if we want to emulate the style (and returns) of the coffee can portfolio.

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[1] Robert G Kirby, "The Coffee Can Portfolio", *Journal of Portfolio Management* (Fall 1984)

[2] Between 1977 and 1990 Peter Lynch managed Fidelity's Magellan Fund and racked up an average annual return of 29%. But, when Fidelity later analysed the returns of investors in the fund over that period, the average return was just 7% pa. People had bought units when markets were buoyant and sold them when they were despondent. It's a dynamic that's replicated in a lot of top-performing funds.

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The first is quality. The businesses in the portfolio should be of the highest quality. If we are going to hold them forever we want them to have minimal capital requirements, good margins, excellent return on capital (equity and debt) and, above all, great management and a great culture. Great companies tend, over time, to surprise on the upside much more (and much less on the downside) than poor ones do.

The second is an unwavering focus on the long-term. As Warren Buffett observes, “Time is the friend of the wonderful business, the enemy of the mediocre.” The effects of compounding are often not all that noticeable over months or years. But over decades they can be overwhelming. To reap the rewards of this approach we need to curb the temptation to abandon holdings in the face of short-term volatility, such as we have seen at various times over just the current year, and may see again before the year is over.

Incidentally high-quality businesses are also generally more focused on the long-term than the short-term. They are less concerned with making the numbers in a particular year, than in strengthening the business’ long-term competitive position.

One of the side-effects of this approach is that it is likely to deliver a very lop-sided portfolio. We might see one or two business failures, a large proportion of the holdings with moderate returns, and one or two with stellar returns. It is worth keeping in mind that just a single holding going up ten-fold would offset ten business failures, let alone the one or two you might reasonably expect in such a sample.

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