How To Outperform The Index-Part One

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Our McComb Value Basket has outperformed our index, the S&P TSX, for 17 years. We are beating it in all time frames- 1 year, 3 year, 5 year, 10 years and since inception. This was the case before the pandemic and it is the case now. This track record has taken hard work, an open mind to learning from mistakes and it has been a journey that has been both fascinating and difficult. I follow a money manager, Gavin Baker, on Twitter. He is a former portfolio manager at Fidelity and now has his own firm Atreides Management. He tweeted the other day that he thought the best portfolio managers were between 50 to 70 years old. Since I now fall in that category it may be of interest to discuss my methodologies. We will start with investment time frame

There are many factors involved in successfully managing money. One of the most important is our time frame or investment horizon. To achieve a good outcome, investors need to move away from day to day and month to month fluctuations in their investments and focus on the 3 year plus results. This may mean looking stupid for a while but you eventually get used to it. My kids do it to me all the time.

To maintain conviction in your stock picks you have to understand the company. At National Bank Financial we have an excellent research department that covers most sectors and both large, mid and small-cap companies. Along with our inhouse capabilities we have outside researchers that can often offer a differing view or confirmation of our thesis. This analysis needs to be filtered by the portfolio manager (that is my job). Researchers are experts in their specific sectors and areas. Their ideas need to be put in context of the broader market and economic situation. Not every great company is a good investment. That lesson can take years to fully sink in.

All this company and industry research needs to be filtered and put in its proper setting. This can decades for a money manager to get up to speed on. You need to listen to company earnings calls, listen to the analyst's discussions, read the research and eventually you will be able to pick up anomalies and patterns in the information flow. This is when you begin to have confidence in your decisions. Remember, after that initial investment is made in a security it may very well go lower. Actually, it almost always goes lower; picking the bottom is nigh on impossible. Hence the appearance of looking stupid. But if you have done your homework , the companies balance sheet is ok and there is no management fraud (that happened once to me) then you can ride out the volatility with peace of mind-or as close as you can get to it in this business.

The world of investing is very focused on the short term. And this is not going to change any time soon. Traditional news reporting has always been an inch deep and a mile wide. Now, with Twitter, Reddit etc. and the shortening of everyone's attention span this day to day focus is just getting worse. So, trying to take advantage of short-term moves is very risky if not a fool's errand.

There was a time when short term traders could make money by watching for daily opportunities. Strategies like arbitraging companies that traded on both the US and Canadian exchanges, or watching for large institutional orders that would move markets or playing index rebalances, or closed end fund redemptions, or failed bought deals, etc. could all offer quick gains. But the advent of algorithms have made most of these strategies obsolete.

I will use an example of how experience and research work together to enhance returns. I grew up in a steel town. I have seen three major steel cycles. They are boom or bust. The companies come out of a recession with clean balance sheets (no or little debt) and then the economy starts booming. The demand is there so they begin adding debt for new blast furnaces, hiring more people etc. Then a recession hits and demand slows down and suddenly this debt is an albatross. It can't be paid back, bankruptcy or restructuring occurs, and they are ready for the next cycle. So, when Stelco, the large Canadian steel company in Hamilton ON came out of bankruptcy and was back on the stock market three years ago we started a position in it. When the pandemic hit it fell dramatically, we continued to buy it, comfortable that the balance sheet was in good shape. Our average cost is just over 13 dollars a share and it is now over 35 dollars.

So, go where the crowd isn't. A long-term outlook, combined with confident decision making is an essential part of outperforming. Do your homework or hire someone that does.