**Global Equity Team**

Dr. Ian Mortimer, CFA

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**Funds managed**

**Guinness Global Equity Income Fund**

Invests in profitable companies that have generated persistently high return on capital over the last decade; we believe these companies are well placed to pay a sustainable dividend into the future.

**Guinness Global Innovators Fund**

Invests in companies benefiting from innovations in technology, communication, globalisation or innovative management strategies; we believe innovative companies in any industry can improve productivity and grow their profits.

# To meet or not to meet

## Some thoughts on company management

*"It's not what you don't know that kills you, it's what you know for sure that ain't true."*

Mark Twain

**One question we are often asked by investors is, how important is meeting management of the companies we invest in?**

Generally we do not consider meeting management as a high priority, and we certainly don't consider it a prerequisite for investment, as some do. We much prefer to focus on the objective metrics of a company such as long-term profitability, balance sheet metrics, valuation etc. There are two main reasons for this. First, it is impossible to assess the impact of management or quantify the degree of success or failure that should be attributed to management in any objective way. Second, meeting management can put your objectivity at risk.

There are various questions which we have to ask ourselves, such as how well can we assess management of a company? Can we measure it? Do we have the skills to do so, and if we do, what level of certainty could we muster from any conclusion? What makes good management? Are we any good at sifting out the good from the bad? Do we have the time to do it?

The first thing we have to consider is how much influence do senior management (essentially the CEO and CFO) have on the future prospects of a company? Intuitively it seems likely that they are very important. After all they are the people responsible for setting the goals and strategy for the company and ensuring its implementation. They make significant decisions about how capital is employed, the level of employee headcount, which growth opportunities to pursue etc., which can all have a significant bearing on the future prospects of a company.

Given that management are the public face of the company, people often attribute company successes and failures to management. The media love to praise management when the company is performing well and criticise them when the company is performing poorly. However, there are clearly many other factors, be they macro, industry-specific or company-specific that could, individually or in combination, have a stronger effect on the prospects of a company than the decisions of management.

Management could make what you might consider to be all the right decisions, yet over time factors outside of their control have negative consequences for the company. Equally management could make what you might consider all the wrong decisions, yet over time factors outside of their control have positive consequences for the company. In practice what you often see is management blaming factors outside their control when things are going poorly, and taking credit when things go well, independent of what the real causes are. This asymmetric attribution by management, and people's conflation of management with the company as a whole, ignores the reality, which is often grey, fuzzy, uncertain and difficult to determine.

There is also a problem with definition. What is an objectively good decision? So often good decisions only appear to be good decisions when you look back with hindsight. It is a lot harder to define an objectively good decision ex ante when the future is uncertain.

Therefore, we think too much emphasis is often attributed to management decisions.

Even so, can we actually measure the influence management is having on one company to the next? Can we take a quantitative approach and look at some key financial metrics over the tenure of the management team and see whether management have improved the profitability of the company, produce higher returns on capital, strengthen the balance sheet etc?

The problem with this approach is that, by looking at these metrics, you are assessing all the factors that affect a company at once. Mathematically it's impossible to isolate the degree of impact that management has on financial metrics and show causation. Other macro or industry or company specific factors are at play, which are potentially more important, such as an improving economic backdrop, a favourable foreign exchange environment, weak competition etc.

Even if we did have a suitable metric we could use, what would be the appropriate period over which to assess performance and when should it begin? Many of the big capital budgeting decisions that management make will not have a noticeable effect for perhaps a year, two years or more. Therefore, arguably we wouldn't be able to objectively assess management without a considerable time lag.

So perhaps we can't quantitatively deduce the degree of success or failure of a company that should be attributed to management. But perhaps we could make a qualitative assessment of the absolute quality of management? Should we research the backgrounds of the management team and try to find out as much as possible about them? What is their approach, what is their style, what are their successes and failures? How are they viewed by other professionals?

But first, what is good management?

Lots of books have been written which profess to define what the key tenets are that make a good manager. They tend to be based on studies that show that most of the senior managers they analysed shared X number of skills or characteristics or areas of focus, therefore to identify good management you have to identify the people who have these X number of skills etc. These characteristics will likely make sense because they support one's existing notions of what makes a good manager. Bold, visionary, shrewd, decisive, good under pressure, organised, level headed etc.

At the same time lots of biographical books have been written that attribute successful businesses to individuals, perhaps the maverick who did everything differently to the commonly held idea of good management. They explain the effect their childhood, culture or some other personal experience had on their business philosophy. They discuss the key people that influenced them and why. They explain important decisions they made to which they attribute their success. The books are often packed with proverbs, aphorisms and insights that are all interesting and intuitively make sense.

However, what these books really provide are simply good stories: stories that appeal to the way our brains function. They provide clear, rhetorical, definitive arguments, often stated as "facts" or truths. They may appeal to our existing beliefs creating emotional resonances which confirm the "truths" we already know.

Much of the role of management when they meet investors is that of a salesperson. They are trying to sell us a good story about the company. They will attempt to provide us with the elegant, persuasive, optimistic, appealing story that will resonate with our way of thinking to convince us that they are in control of the company's destiny, they are improving the company, they are going to reach their goals, the value of the company will increase and therefore we should buy their shares. They aren't going to provide us with the highly complex, conflicting, uncertain, uncomfortable reality, that there is much outside of their control. Who would want to buy that?

We have to be very careful about listening to what management tell us. We need to be clear what is fact and what is opinion. What is an expectation or forecast and what is real and present.

Proverbs are an interesting example to illustrate this point. A proverb is defined as "a short well-known saying that expresses an obvious truth and often offers advice". For example:

1. *If at first you don't succeed, try, try again*
2. *Nothing ventured, nothing gained*
3. *All good things come to those who wait*
4. *Look before you leap*

We have all heard them and they all make sense. But here are another four that state the opposite "truth" to each of the above in the same order.

1. *Don't flog a dead horse*
2. *Better safe than sorry*
3. *Time and tide wait for no man*
4. *Strike while the iron is hot*

When we hear any individual proverb in isolation they seem true. Yet when we read the numbered pairs of these proverbs we are hit with an awkward feeling. We "know" both proverbs are "true", yet they state opposite "facts". In reality proverbs are not "truths" or facts they are simply phrases which we associate with truth.

This is an incredibly important and somewhat uncomfortable realisation: in many instances when analysing aspects that affect the future prospects of a company, not just management, all we can genuinely conclude is, "we don't know". We can't rely on predictions and forecasts, we can't rely on an elegant, optimistic story that "makes sense". Whilst uncomfortable, it is vital to realise this, and it focuses the mind away from what we think we know towards what we don't know, i.e. away from attempting to make predictions and forecasts based on unprovable qualitative factors but instead towards the risks of our decisions. It makes us prefer a strong balance sheet today over expectations of earnings growth in the future, diversified established product offerings over hot new products, cash over earnings, and companies that have been successful in most economic and industry scenarios.

There is a reasonable chance that, rather than read what we have written above, you would have preferred us to have written something more positively deterministic about management. Perhaps something along the lines of:

"We won't invest in a company until we have met management. We want to press the flesh, look in to the whites of their eyes and understand what they are doing and why. We believe this is one of the ways that we really can add value and attribute a significant proportion of our good performance since we launched the fund to our ability to weed out mediocre management from the great."

Evidence suggests that all of us as have a human psychological bias towards confident statements over balanced statements, certainties over probabilities, simplicity over complexity. Just look at the types of people the media tend to interview: they make strong assertions, condense complex issues into bite-size chunks, and make clear conclusions. This makes it easier for our minds to understand, remember and make sense of the world. Our minds naturally use stories to make sense of our world in any situation where there is conflicting information as our way of dealing with what psychologists term Cognitive Dissonance (for a fascinating example of Cognitive Dissonance in action, see Leon Festinger's book, When Prophecy Fails). Conflicting information is everywhere when you are trying to decide whether to invest in a company – arguments both for and against. We need to be aware that our mind's natural desire to resolve cognitive dissonance towards a certainty can be an obstacle to making good decisions, and meeting management won't help us maintain our objectivity.

As Mark Twain said, "It's not what you don't know that kills you, it's what you know for sure that ain't true."

**Dr. Ian Mortimer & Matthew Page**

Co-managers,
Guinness Global Equity Income Fund
Guinness Global Innovators Fund

## Guinness Global Equity Income Fund

- Providing investors with global exposure to dividend-paying companies.
- Managed for income and capital growth, and invests in:
    1) **profitable companies…**
    2) **that have generated persistently high return on capital over the last decade…**
    3) **and that are well placed to pay a sustainable dividend into the future.**

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|---|---|
| **Benchmark** | MSCI World Index |
| **Asset class** | Equity (long-only) |
| **Geographic focus** | Global |
| **IA sector** | Global Equity Income |
| **Fund launch** | 31.12.2010 |
| **Dividend payments** | July (interim) & January (final) |

## Guinness Global Innovators Fund

- Invests in companies benefiting from innovations in technology, communication, globalisation or innovative management strategies.
- We believe innovative companies that develop competitive strengths will deliver the key factors behind superior shareholder returns:
    1) **Higher than average return on investment**
    2) **Persistent growth over a business cycle**
- Managed for capital growth; holds a concentrated portfolio of large and mid-sized companies in any industry and in any region.

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|---|---|
| **Benchmark** | MSCI World Index |
| **Asset class** | Equity (long-only) |
| **Geographic focus** | Global |
| **IA sector** | Global |
| **Fund launch** | 31.10.2014 |
| **Strategy launch** | 01.05.2003 |

## Fund managers

**Dr. Ian Mortimer, CFA**, joined Guinness Asset Management in 2006. He co-manages Guinness Global Equity Income and Guinness Global Innovators Funds. Prior to joining Guinness, Ian completed a D.Phil. in experimental physics at Christ Church, University of Oxford, and graduated in 2006. He graduated from University College London with a First Class Honours Master's degree in Physics in 2003, is a CFA charterholder.

**Matthew Page, CFA**, joined Guinness Asset Management in 2005. He co-manages Guinness Global Equity Income and Guinness Global Innovators Funds. Prior to starting at Guinness, Matthew joined Goldman Sachs on the graduate scheme in 2004 working in Foreign Exchange and Fixed Income. He graduated from New College, University of Oxford with a Master's Degree in Physics, and is a CFA charterholder.

## Guinness Asset Management

Guinness Asset Management provides a range of long-only actively managed funds to individual and institutional investors. Founded in 2003, Guinness is independent and is wholly owned by its employees.

We believe in in-house research, intelligent screening for prioritisation of research and well-designed investment processes. We manage concentrated, high conviction portfolios, with low turnover and no benchmark constraints. At heart Guinness is a value investor.

Since our establishment we have developed a variety of specialisms in global growth and dividend funds, global sector funds and Asian regional and country funds.

The Guinness funds sit within an Irish-listed OEIC. They are managed alongside a range of mirror SEC-registered funds offered to US investors by our US sister company, Guinness Atkinson Asset Management Inc.

We also offer Enterprise Investment Schemes and Inheritance Planning investing in UK renewable energy projects and AIM-listed companies.