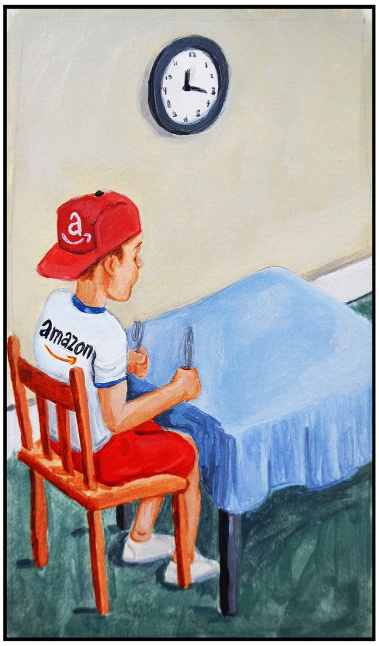
MVAM Newsletter

'Marshmallows' September 2017



AND YOU THOUGHT THE SOUFFLÉ TOOK A LONG TIME!

Is the secret of successful investing all about eating, or not eating marshmallows?

In 1972 a Stanford professor, Walter Mischel, published a famous study, based on an experiment carried out on over 600 children, aged c.4 years old. Each child was left in a room alone and given a choice to eat one marshmallow immediately or two after a fifteen-minute wait. Some gave in at once, others cracked during the interminable wait, while one third held out for the reward of double rations. In simple terms, self -control paid off for the minority. However, the most interesting part of the research has come through over the next 40 years, with the subsequent follow up studies on the participating children. Those that showed the restraint, in the expectation of higher rewards later, have been more successful in life overall, suggesting that the ability to delay gratification is an important characteristic for all of us to embrace in our lives, both socially or at work.

So, is the marshmallow study relevant for successful investing? Every portfolio manager buys a share believing it to be undervalued, based on a number of factors. From then on, every day there is always the option to take a profit (or even the occasional loss!). Like the 4-year olds, does the investor book a gain (eat the marshmallow) and search out the next investment opportunity (hope Mum or Dad offer another marshmallow from the pack), or demonstrate that great quality of self-control and have confidence that the share will at some future date reach a higher fair value (more marshmallows)?

Amazon is maybe the best example of where the greatest rewards came from avoiding the temptation to sell over the past 20 years. The share price has risen from under $2 in 1997 to a peak of $1000 this year. This rise has not been for the faint hearted, with extreme periods of volatility. It was possible to lose some 90% over the millennium and 60% during the 2007/08 financial crisis. In reality Amazon was at the forefront of a secular change in the retail industry, which had the management to execute a successful strategy to lead the revolution. The economic cycle was not the key factor.

While Amazon is an extreme example of patience paying off for the investor, it does highlight the common failing across the investment industry, with too much focus on short term returns and short-term performance. This encourages portfolio managers to lock in profits, especially if ahead of the benchmark, rather than having the confidence to sit on an investment which is expected to prosper over the longer term. Of course, circumstances may change for an individual share, undermining the reasons to hold, whether it be a change in the business model (the marshmallow changes shape or colour) or a failed drug trial for a pharmaceutical company (the marshmallow explodes in your face). However, if the reasons for the original investment case have not changed and still appear valid, then sticking with the share may well be the best investment strategy. The second marshmallow will appear.

Mole Valley Asset Management Ltd.

Website: www.mvam.com

Tel: 01306 776999

Email: enquiries@mvam.com