QUARTERLY COMMENT II 2012

The erratic happenings in financial markets over the last year have made the stock market investor an increasingly endangered species. While individual institutional investors face growing regulatory restrictions and enormous career risk by taking on too high allocations, retail investors often lack the necessary insight to feel comfortable to take on contrarian positions. So, it warrants the question who is the right stock investor to cope with an unpredictable political and macroeconomic environment and who can still make sense of the benefit of being engaged in the fortunes of companies? These are the times that really set hands-on company investors apart from asset allocators. The superimposing media noise reduces investment convictions. People with high levels of information on particular companies not only keep faith more easily but can also take advantage of it particularly during times of market dislocations. And they do.

Volatility is not a bad thing per se although many institutional investors define it as risk and admittedly, we humans do not bear volatility easily. However, as long as there is no permanent loss of capital, volatility actually offers us an opportunity and should be understood as such. It is the market offering the opportunity to sometimes buy in cheaply and sometimes sell out dearly. The proviso is that one has a clear understanding of value vs. price and the factual risk herein lies in an analytical misjudgment.

As with volatility, the correct approach to uncertainty can also provide investors with opportunities. Uncertainty about a business outlook might not be a bad thing per se either but can keep you from sleeping well (maybe that might be already a reason to shun a company's stock). But again, if one gets the fundamental drivers right and feels comfortable with the possible range of outcomes, a situation of uncertainty can offer tremendous opportunity because many others are not willing to take advantage of it. As a matter of fact, among the most attractive investment opportunities turn out to be businesses with high uncertainty but low risk in terms of permanent loss of capital. Usually stock market participants punish companies with uncertain outlooks by collapsing their stock prices and adore companies with low uncertainty through high trading multiples. The latter category of companies promises little return, yet the former category of companies provides for above average rewards if one can control for risk. The concept of a favorable risk-reward ratio has been central to Barius' investment philosophy.

We are certainly experiencing uncertain times in the Eurozone. But do we also face a loss of capital through equity investments that can never be recovered? In some individual cases this risk might be real. Most other companies will be in a position to recover from a potential downturn. The question also needs to be seen in light of the underlying investment time horizon. In any instance, the question remains rhetorical for a long-term investor. Nevertheless, uncertain times bring the benefit of a favorably tilted risk-reward ratio on longer-term time lines. And in the smaller companies segment this effect is magnified. Right now, there are wonderful individual investment opportunities – but only for the entrepreneurial-minded investor.

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