QUARTERLY COMMENT – II 2015

Greece – exit or not? Nothing has dominated the media and to some extent financial markets more in recent weeks. The potential uncharted territory of a Grexit has unnerved many investors but more so the political elites of the Eurozone. At stake are purely geopolitical ramifications rather than economic implications. Greece accounts for less than 2% of the Eurozone's GDP, so there is no economic reason for shuffling such high aid packages southeast. To the contrary, with debt levels already unsustainably high, stacking up another EUR 80 to 100bn – although some funds will just be used to repay former loans – can be only be labeled a one-way transfer to Greece. In return, both the ruling Greek government and the majority of Greek people clearly stated that they don't want to embrace necessary reforms. How then should the necessary adjustment of the Greek economic fabric towards European and global free market regimes occur? The unbelievable behavior of the ruling Greek government has provided Eurozone politicians with a unique opportunity to solve the situation for good. But fear of the unknown has never been a good advisor. So, the can gets kicked further down the road and we experience a classic case of escalation of commitment by the Eurozone throwing good money after bad. Current politicians have just passed the task of sorting out the mess on to future politicians who will have to deal with this matter again (and probably again).

So what does this mean for our target investment universe of smaller companies? Essentially not much, unless market participants lose their heads again. Yet, politically induced volatility does not usually last too long and economic forces once again take over. Hence, why should European companies without tangible Greek business exposure be concerned at all? Aren't then any short-term market value contractions welcome entry points?

This leads me to the concept of time arbitrage in investing. Generally speaking, the past year or even the past three years are statistically insignificant when evaluating an equity investment strategy. Yet, most people base their decisions on these too-short-time-frames. It is almost impossible to determine ex ante how market participants will value a stock in say three or six months. This is purely random because way too many market variables will impact this outcome. The better questions to ask are what will the company likely be worth in five years' time? And why? By trying to answer these questions one has to take into consideration fundamental business factors like a company's business model and how it will fare against competition as well as how its underlying market will probably develop. Even though these answers will not be black and white and will certainly also be subject to market imponderabilities. Nevertheless, due analyses can improve information for decision taking on the probability of certain outcomes.

Taking these expectations of mid-term outcomes and contrasting them to current market perceptions can offer time arbitrage opportunities. Short-term oriented investors could get exploited by long-term oriented investors. And long-term investors get rid of a common pitfall – known as market timing. Short-term investors always have to decide when to be "risk-on" or "risk-off". History has shown that value appreciation in stocks usually occurs in short bursts. If an investor is not invested at that time, he or she can miss a potentially important value contribution.

So whenever there is a politically induced market dislocation, I get very interested in exploring the situation further for opportunities. Moreover, looking through a five-year lens can sometimes provide astonishing perspectives in terms of what "normal times" look like. On this premise I have established a portfolio of companies that have proven to outperform competition for years. Often this success was based on a combination of sustainable competition advantages and superior management teams.

Hunting for short-term performance is a hopeless rat race. In contrast, I'd rather keep sticking to attaining long-term performance based on outstanding smaller companies.

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