

## ➤ The Investment Perspective – February 2025

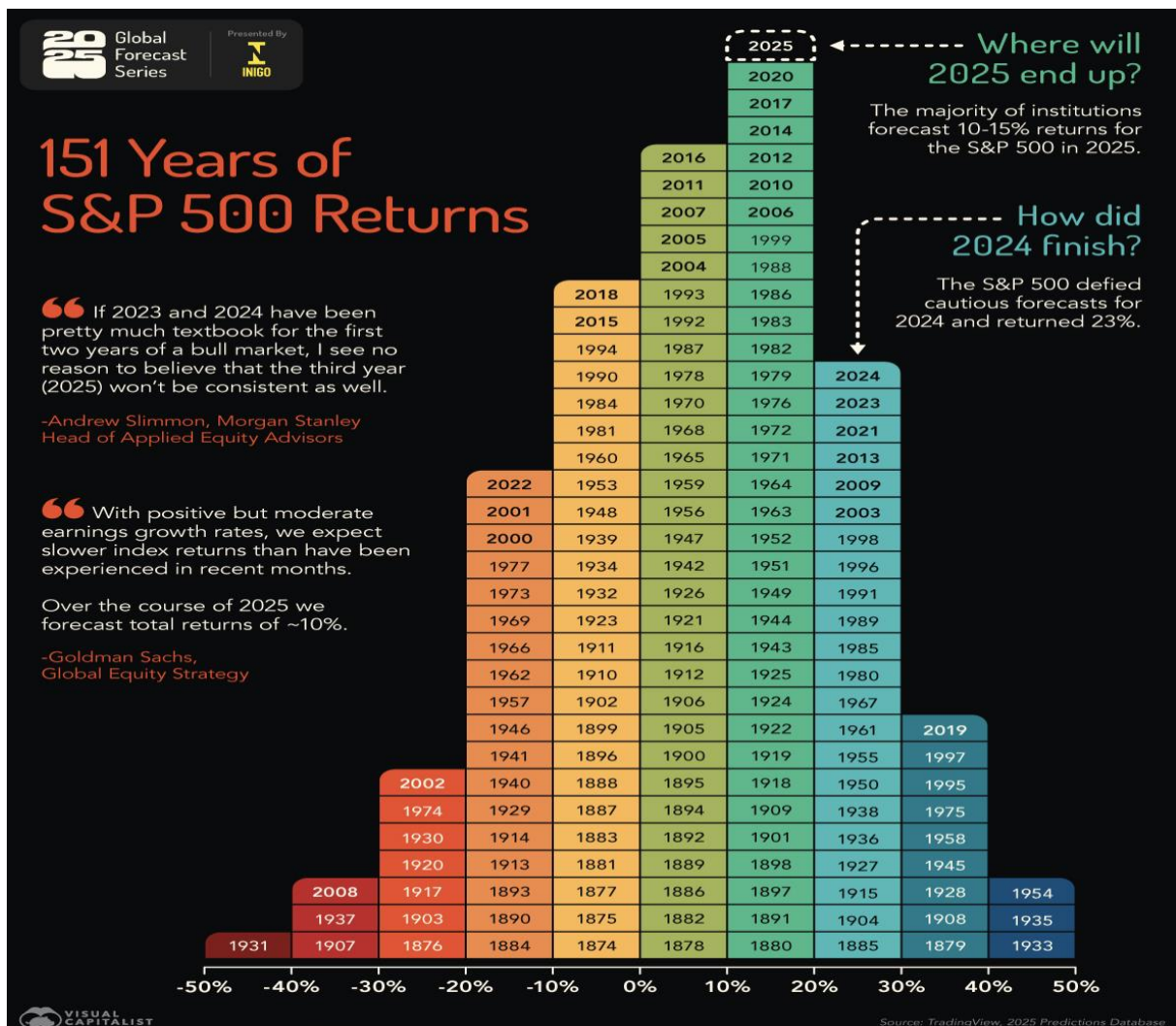


*"Wealth is not primarily determined by investment performance, but by investor behaviour."*

-Nick Murray

Peter Flannery CFP FA

### *Markets, returns and targeting growth*



The infographic above (sorry it is a bit squished!) shows the movement in the S&P 500 each year over the last 150 years, categorised by annual change in the index (up or down).

Markets move up and down because of market sentiment, especially in the short term.

You may recall that in August 2024, when the US unemployment number unexpectedly spiked, the market sold down sharply, thinking that the likelihood of recession had just increased a lot. The market was wrong in this instance.

The market is not always wrong but highlights the point that signals from the market are not always reliable.

## ***Rear vision mirror investing***

This refers to the tendency for some investors to take their signals on where to invest by looking at past outcomes.

Go back to the run-up to the 1987 share market correction. Markets seemed to rise more each year. FOMO takes hold...

Same for 'the 2000 tech wreck' and a number of other market corrections.

20 years ago or so, a fund manager called Bankers Trust (BT) was the number one performer in New Zealand in almost every fund category and every time period. That was until their star analyst, Kerr Neilson, departed to set up his own range of managed funds, Platinum International. His performance was good for a while, although it seemed to taper off as the years rolled by.

BT was eventually purchased by Westpac Bank, a shadow of its former self and basically disappeared off the investment landscape in New Zealand

Milford Asset Management looks like the new BT, although watch this space. Brian Gaynor (who sadly passed away in 2022) was one very smart analyst, rare.

This brings us to Berkshire Hathaway and Warren Buffett. Warren Buffett has repeatedly stated that the returns he and Charlie Munger achieved for decades are unlikely to be repeated. Different times (perhaps), but Berkshire Hathaway is a victim of its own success. The scale of the company now makes it difficult to 'move the needle' in terms of significantly changing investment performance.

This scale of their operation (because they have been unusually successful) limits their options. There are not that many great businesses that fit their model at the size and price they need (to move the needle). Not so for you and I, though 😊

## **19.8%**

Berkshire Hathaway achieved a 19.8% compound average annual return from 1965 to 2023.

Two things:

1. The amount of that average return
2. The significant timeline (decades)

How many others have achieved this?

So, it is becoming increasingly difficult for management at Berkshire to continue to perform at that level. By the way, a totally different situation to the others I mentioned earlier.

The point is that 'rear vision mirror investing' can be the default position for some because there is minimal research and analysis required. It works... until it doesn't.

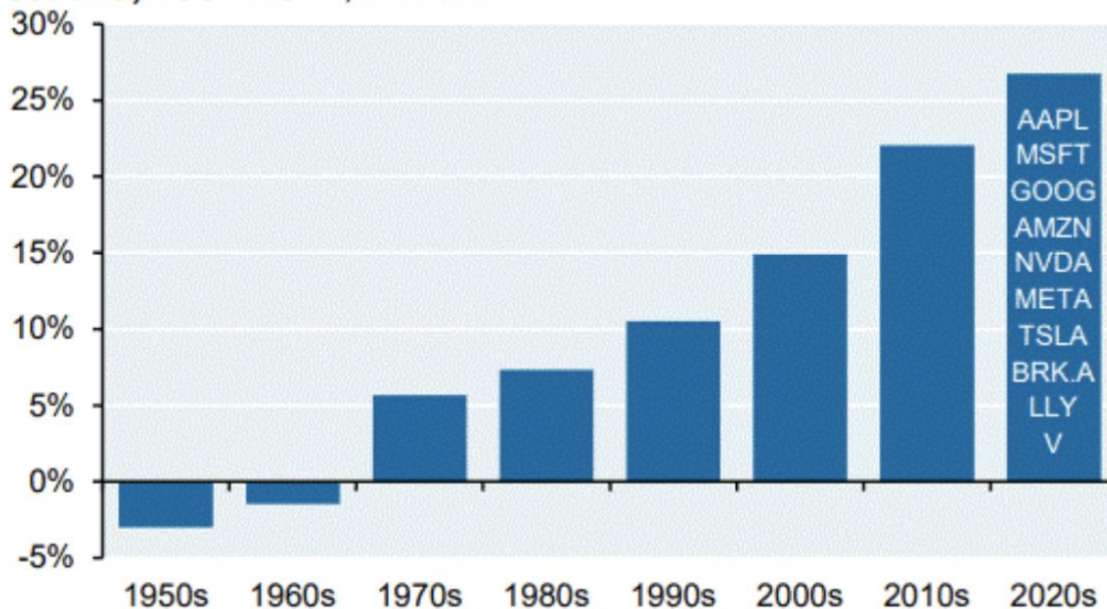
## OK, so what do we do then?

Fortunately, BRK will continue to provide acceptable returns for the foreseeable future but with materially less risk than many other options. [That has a lot to do with the quality of the underlying businesses – THANK YOU Charlie Munger.](#)

We are unlikely to replicate their success. However, their methodology is to some degree, transferrable. We can have reliable growth on our portfolios over time and be confident about it, regardless of short-term market conditions.

For example, the focus on the quality of the business (not the analysis of the stock or the fast rising share price) is 'the secret sauce' that Charlie Munger gave to Warren Buffett before he even became a shareholder - and to you and I.

### Free cash flow margins by decade for the ten largest stocks, 1952-2024, Percent



Source: Empirical Research, September 2024

*The graph above shows increasing levels of free cash flow each decade.*

Free cash flow is not the only indicator of a quality business, but a key metric. It shows how efficiently management utilise profit.

Note in the graph above (the company's listed in the bar on the right of the graph), the number of technology companies. Who else do you see as well in the list of companies?

*“The investor’s chief problem — and even his worst enemy — is likely to be himself.”*

**-Benjamin Graham, [The Intelligent Investor](#)**

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