

The Underappreciated Value of a Long-Term Orientation

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"I ask everybody not to think in two to three-year time frames, but to think in five to seven-year time frames." -Jeff Bezos

Amazon is a remarkable enterprise that was built in part on an unwavering long-term orientation. Founder Jeff Bezos doesn't care about quarterly earnings because he knows the near-term earnings simply reflect the actions and initiatives Amazon took years ago. He is always thinking about the direction of Amazon five to seven years out, rather than what is happening today. Such a perspective is highly unusual in the corporate world, but far more likely in founder-run firms.

It is also important in the investment world. Thinking long term impacts how you plan and where you allot energy, time, money and resources. While we try to navigate the near-term twists and turns of the market, we keep three long-term considerations front of mind.

1. The great 35-year interest rate cycle probably bottomed in 2016

Interest rates are likely headed up, possibly trending higher for a long time. As we speculated in our fiscal year-end commentary [last year](#), this big news didn't make any front-page headlines, but could have profound long-term implications on asset values and investment strategies. When great cycles turn, there are usually multi-year, if not multi-decade, consequences for investors.

Just ask Bill Gross, the former superstar bond manager of PIMCO, how much fun it can be to get the big cycle right and ride a secular wave for decades. Of note, Gross' and PIMCO's success coincided within an epoch of credit expansion – a period where those who reached for carry, that sold volatility, that tilted towards yield and more credit risk succeeded. What if zero -bound interest rates, that define the end of a total return epoch that began in the 1970's, accelerated in 1981 and came to a mathematical dead end for bonds in 2016 and commonsensically for other adjoined asset classes as well?

We suspect many strategies that worked well over the last few decades may not work as well going forward, no matter how compelling the rear view mirror looks (we are looking at you, "bond proxies", as noted in our July 2016 note [Utilities – Reward-free risk?](#)). In any case, fasten your seat belts – we are about to find out.

2. Disruptive periods like today change the opportunity sets

Many, if not most, industries are in the process of being reshaped by the disruptive forces of technological change. We believe one of the great lessons in microeconomics is to discriminate between when technology is going to help you and when it's going to hurt you. We're seeing this broadly as legacy companies struggle to match the agility and scalability of born-digital competitors like the FANGs (Facebook, Amazon, Netflix and Google), while keeping their cost structures competitive. Perhaps the most instructive case study is Sears vs Amazon with important lessons for other industries that are impacted by disruptive business models and technologies that are changing consumer behaviour.

A major disruptor purchased across multiple Fund mandates in early 2017 was Baidu, frequently referred to as “the Google of China”. We generally do not delve deep into our individual holdings externally, but Baidu was a rare exception written up last year [here](#), which we believe was hiding in plain sight as a misunderstood and unloved megacap.

Another name in this category that we added in 2017 is TripAdvisor, the world’s largest travel site. We bought the stock initially last July and we doubled down following a sell-off in November. TripAdvisor’s solid reputation among travellers for reliable advice on hotels, restaurants and attractions had made it one of the largest and fastest growing online properties in the world. Yet, it remains very under monetized. In a nutshell, we believe either management will fix this issue, or it will be sold off to a strategic buyer at a premium relative to our entry price. As long as TripAdvisor’s many properties continue to grow unique monthly users, which feed its powerful network effects, internal value should continue to build at a healthy pace.

Ultimately, we believe this represents latent monetization and foreshadows significant potential upside as a standalone company, or a bigger premium as a takeout. Just consider Facebook after its IPO almost six years ago when management successfully pivoted from their desktop-centric model to a mobile-first strategy. The potential rewards for monetizing a massive and growing engaged user-base can be truly breathtaking. The stock has been a ten bagger since bottoming in August 2012.

Read more on the disruptive forces of technological change in this [blog post](#), including comments on Syntel (SYNT) and Discovery (DISCK).

3. Just about everything is cyclical

As the saying goes, stocks aren’t usually cheap and popular at the same time. We often begin our search for opportunities in companies and industries we understand that are having problems. The stocks of such companies are more likely to be mispriced. We attempt to discern the source of consensus pessimism in such situations, and occasionally take the other side of the trade when we either have a variant view to the market, or we believe other important attributes are being overlooked by investors. These situations often take time to work out, but we prefer to remain patient as long as the firm is building internal value and improving their competitive position, even if the stock action is unfavourable in the interim.

Sometimes we make a mistake and our patience is misplaced. Either the facts change or our investing thesis is just plain wrong. In such cases, it’s best to sell and move on (Altisource Portfolio Solutions, sold in 2017, was a recent example). But often we find our mistakes are related to timing, particularly when the idea is a [Compounder](#). Ultimately such businesses will grow in value and eventually bail out investors who timed their purchase poorly.

Bruce Flatt, the CEO of Brookfield Asset Management, recently penned another terrific letter that included some lessons learned by the management team. As it relates to this topic, Flatt wrote, “the single greatest way to dig ourselves out of mistakes is to be patient with investments and, in most cases, double down. This is the best way to recover losses, although it requires conviction as well as availability of the necessary capital. This is particularly important when we have acquired a good business, but our timing was poor. Doubling down in this case is virtually always the answer. However, one has to be careful because if the business is just a bad business, it only serves to compound the pain. But, generally we have found that in the absence of technological change in the extreme, doubling down and being patient is the most proven way to turn around an investment.”

Likewise, we endeavor to remain patient (or double down) with good businesses during periods of adversity when they are having problems – we have found that cyclical headwinds usually become a

tailwind again. Some examples of top Pender holdings purchased during periods of adversity that went from “dogs” to “stars” and sold in the past year include [Panera Bread](#), Wynn Resorts, KKR and [Whole Foods](#). They were all founder-run firms which delivered exceptional returns to unitholders over our holding period.

“The time to buy is when there’s blood in the streets.” –Baron Rothschild

As such, we bought South Korean-based steel maker Posco in late 2014 as a deeply cyclical [close-the-discount](#) opportunity. Statistically speaking, we originally bought the stock at a very attractive valuation. The only prior period that Posco traded at lower levels since it started trading in the U.S. in 1994 was a small window during the 1997-1998 Asian financial crisis. The stock’s subsequent rebound was dramatic — a four bagger in less than two years. However, as we quickly (re)learned, every situation is different.

The year following our original purchase, the steel industry went through one of its most challenging cycles in history, crashing Posco to record-setting low valuation levels. The stock went from trading near the trough valuations relative to its past 20-year record, to setting new precedents for all-time lows that future generations will no doubt use as “worst case” historical examples (similar to how we referenced the Asian financial crisis as a “worst case” scenario). This excruciating period required us to draw upon our deepest reserves of patience and fortitude in late 2015.

As long we believe there is no fundamental impairment to the underlying business, we try to keep in mind, the time to buy is when there’s blood in the streets. We added to our position during this downdraft because of our conviction that Posco, as the world’s most efficient steel maker, would be a survivor. If the world’s manufacturing and construction industries required steel in the future, Posco would still be around to pick up the pieces after less efficient peers went belly up. Since then, operating conditions materially improved, non-core assets were either sold or restructured and debt was paid down meaningfully. Not surprisingly, the stock has been repriced and became one of Pender’s top performers in both 2016 and 2017 (we have been trimming our position during the run up).

In hindsight, our initial timing on Posco was less than ideal. However, because we added to our holdings during the downturn, we were able to generate a reasonable return for investors over our holding period. Importantly, the return on the incremental capital invested has been extraordinary. The moral of the story here is that as long as the facts remain at your side, one should always consider buying when there’s blood in the streets – even when it is your own blood.

Read more on taking advantage of cycles in this [blog post](#), including comments on Liberty Global (LBTYA), Liberty Latin America (LILA), Platform Specialty (PAH) and Colfax (CFX).

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