

Nils Herzing Sums Up His Investment Philosophy

This article is authored by MOI Global instructor Nils Herzing. Nils is an investment professional at Active Ownership Capital, a partner-managed investment company that acquires significant minority stakes in publicly listed, undervalued small- and mid-size companies in German-speaking countries and the Nordics.

This Investment Philosophy frames the general thinking about investing and describes my investment style. It is not a fixed set of rules, it is more an evolving collection of thinking patterns.

The aim of my investing is to generate long-term outperformance (over a time period of more than 5 years). Thus I don't aim for a low volatility or other fancy things; the sole goal is to maximize the performance in real money terms.

I don't believe in efficient markets, as I think that markets are "Voting Machines" in the short-term but "Weighing Machines" in the long term. I believe that the highest irrationality in stock prices, especially in the short run, exists in small- and mid-capitalized enterprises which have a low free float. Furthermore, I believe that an undervaluation in the long run can occur in large-caps, as most investors only think within a timeframe of 3 years. By taking a long-term investment approach which exceeds 3 years and thinking in time frames of 5, 10, or even 20 years, you are able to outperform the market even in large-caps.

I don't believe in over-diversification, or in holding more than 20 stocks as it doesn't add value and destroys performance. On the opposite, I believe that it is possible to get an investment edge via the two following ways:

a.) Informational edge - More information than every normal market participant has. This means doing field research, visiting companies and speaking with customers and competitors.

b.) Behavioral edge or "longer time horizon" - by taking a time horizon of more than 3 years, investors can see the value of long-term growth and are able to go against short-term pressure / noise / "pain".

To participate from short-term irrationalities, it is necessary to have an investment process which is focused on the long-term value creation of a company, thus the value of growth is essential for my investing approach. To pursue this type of investment strategy, it is necessary to find long-term capital and co-investors who think like owners.

The only possibility to increase my returns towards a level of above 15%, which I would like to achieve in the long-run, is in my opinion:

a.) Have a less diversified portfolio of only 8 to 15 companies.

b.) Avoid a permanent loss of capital, which can be achieved by using quality filters such as good management, strong balance sheets and the use of "Owner Earnings".

c.) Use a higher discount rate and thus have fewer potential investment candidates.

d.) Shorten the time frame of value realization, e.g., until the undervaluation is uncovered and the market price reaches the fair valuation of a business

e.) Take a long-term view of more than 5 years and invest in real compounders, which have an outstanding management / capital allocator, really early in their life.

Last but not least, I would like to achieve this goal by investing in an ethical and sustainable manner. I believe so, as I think that sustainability and ethical thinking is equal to a rational view on the long-term time axis.