GRAYISSUE

# Avoiding the overwhelming bias for action

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In life, we have a natural bias for action. From a young age, we are told stories about heroes who overcame great odds and many setbacks to do something great. Sportspeople, entrepreneurs and leaders are all lauded for their actions. 'Watching and waiting' are rarely considered valuable. However, there are times when the most valuable thing you can do is to wait for the right opportunity. In the face of the relentless pressure to do something, waiting patiently is often extremely difficult to do. This same scenario holds true in the world of investments.

**Corporate managers' effectiveness is measured by what they get done**

Corporate managers are often under pressure to constantly take action to be considered effective. Managers, after all, are considered to be 'agents', and agents must act. Business schools tell future leaders around the world how they can be more effective at getting things done. In the first chapter of their book 'A Bias for Action' (2004), Bruch and Ghoshal say that 'management is the art of doing and getting done'.

While managers are busy trying to fight fires and take their companies forward, they are also bombarded by advisers, pressuring them to take action. In many industries that are driven by transactions, if there were no deals, the industry would starve. Examples of professions that are influenced and driven by activity include accountants, investment bankers and lawyers.

When we meet with management teams, we are often struck by their unwavering desire to simply do something. It is an institutional imperative for most companies. For example, resources companies tend to always want to drill the next hole, even if the economics of doing that are only marginally positive. Instead of drilling the hole, a prudent company may reserve the cash for a truly compelling opportunity or even give it back to shareholders. Many resources companies have done that in the past – develop a resource, hand back money to shareholders when the cash starts coming through, and then ask for more cash if a new opportunity arises. In recent times, such prudence is less common.

Management teams from many other industries are also tempted by the desire to do something. Often their actions take the form of acquisitions, however, they very rarely truly create value for shareholders. This does not seem to stop optimistic managers and boards from pressing ahead.

**Managers who act on selective opportunities create value for shareholders**

When managers stick to what they do best and optimise what they have, they can create enormous value for their shareholders over the long term. A great example of this is ALE Property Group (ALE), which is listed on the Australian Securities Exchange (ASX) and held in the Allan Gray Australia Equity Fund and the Allan Gray Australia Opportunity Fund. This company's management have been disciplined in sticking to what they do well: managing a portfolio of land on which there are pubs and liquor stores.

The main tenant is a Woolworths-controlled joint venture. ALE has let expensive acquisitions pass them by. In doing so, they have been very good custodians of shareholder money. This is reflected in the returns that ALE has generated for our clients over the years.

Furthermore, the underlying properties themselves are probably under-rented (the current or passing rent is lower than the estimated rental value). This means that earnings could still grow significantly from today's levels.

**Many fund managers are also restless**

Fund managers are not immune from the bias for action. Many managers will shuffle their portfolios and buy and sell stocks on a daily basis. They will cut losses early when they are dissatisfied or if things haven't gone as planned according to their often short-term investment thesis.

Some fund managers believe the appearance of doing something may alleviate client fears after a period of underperformance. They therefore see their restlessness as a benefit. However, the costs of this continuous action are very clear. The only people guaranteed to benefit are the people who take a percentage of the transaction and that percentage has a direct impact on returns.

**Successful investing is about considered decisions and letting mediocre opportunities pass**

We are not saying that managers in corporations or fund managers should sit back and do nothing – the important thing is to choose when to act and when not to. The choice not to do something should always be considered a valid – and potentially value-creating – alternative. It is about considered choices. In the background, managers must always do the required homework so that they are ready to act when needed.

At Allan Gray, we strive to be patient and to wait for the right opportunities to eventually arise. We only act when there are significant deviations from 'normal', and only buy when a stock's price is significantly below what we think is 'fair value'.

Having a patient approach is one of the reasons that our portfolios have a low turnover. Why transact unnecessarily, and bleed value, when the long-term prospects of the companies in which we invest don't change significantly from one day to the next? Investing by exception means that our portfolio will often look very different to the index we use as a benchmark.

This scenario is similar to the best batsmen in cricket. They watch, wait, and then strike only when a good opportunity (in the form of a poor delivery) presents itself. Successful investing is as much about letting mediocre opportunities pass by as it is about taking a considered and active decision to buy or sell a stock. Over the long term, we have seen that this style of investing is rewarding for our clients.

*This article was first published by Allan Gray Australia. Investors can access the Allan Gray Australia Equity Fund and the Allan Gray Australia Opportunity Fund via the Allan Gray offshore investment platform, or directly through Allan Gray Australia. These funds are approved to be marketed in South Africa in terms of Section 65 of the Collective Investment Schemes Control Act. For more information about these funds, please visit www.allangray.com.au*

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