

## THOUGHTS ON COMPOUNDING: *Not Knowing Where To Go, But Knowing How To Get There!*

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In *The Lion Tracker's Guide To Life*, Boyd Varty recounts an amazing day on the beautiful Londolozi Game Reserve. While tracking the apex of African predators, the lion, the three trackers showcase the power of observation, problem-solving, adaptability and patience. More fundamentally, the book contains some powerful introspective observations about finding joy along the path of discovery. As we read the book, we could not help but wonder whether equity research requires the same skills as lion tracking—minus the life-threatening encounters, of course. Hop into the Land Rover and let's explore.

A successful lion tracker has three essential skills:

1. Observation skills and pattern recognition
2. Open mindedness
3. Curiosity combined with action

### Observation skills and pattern recognition

**"You can easily miss this information if you don't know how to see. Track awareness is how attuned you are to what is around you. It is recognizing a track when it appears."<sup>2</sup>**

Experience matters to be a successful lion tracker. Countless hours apprenticing and walking the savanna observing, are essential. Observing animal behaviour, observing animal habitat preference, and observing changes in the landscape. Patterns emerge and are remembered. It is these elements that allow the lion tracker to not only *find* the track, but more importantly, to stay on the track. For the investment analyst, the basics of accounting, finance and strategy can only take you so far. Countless hours of apprenticeship and experience doing fundamental research are required to 'track' a cash flow compounding company. Observing what and why makes a company successful or unsuccessful builds on these foundations. Then, after many repetitions ("reps") of company analysis, patterns begin to emerge. The analyst begins to "see" what makes a cash flow compounding company. Through strong observational skills combined with pattern recognition earned through 'reps', the analyst is often able to spot small changes in the business environment that can lead to investment opportunities or awareness of rising risks that could impair capital.

### Open mindedness

**"I understood him to mean find the first track, then the next first track, then the one after that. He does not set out into the unlikely chance of finding a lion in the future. He works with what he has now, in the moment... In the bush and in life, we don't get trails fully laid out. We get tremendous unknowns and, if we are lucky, first tracks. Then next first tracks."<sup>3</sup>**

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The lion tracker keeps an open mind. He or she does not impose their beliefs of where the lion should be and immediately head there but, rather, they observe the environment around them for evidence of the lion. Find the lion's track and follow the lion's track. Like the lion tracker, it is essential that the equity research analyst keep an open mind. An open mind makes the unbiased gathering of facts possible. However, this is easier said than done. Investment research is an intellectual pursuit, meaning we rely on the human mind to reason. There is a long list of biases that burden our ability to make rational decisions.<sup>4</sup> The best research analyst pursues evidence in an unbiased search for objective truth. Some evidence along the track proves the thesis, some disproves it. At Cidel we deploy a research framework with four criteria to guide our analysts on their research journey of identifying cash flow compounding companies.<sup>5</sup> However, we are all aware of the risk of confirmation bias and therefore our research framework is not intended to be a four-page passport to be stamped with visits to countries that support the thesis. Similarly, one can imagine the lion tracker eating the yellow marula fruit and declaring all the woodlands of southern Africa to be a never-ending bounty of fruit. No, you're merely standing under a marula tree in-season. Therefore, the investment research analyst is on a journey, the facts lead the journey and often the destination is unknown at the outset. Whether the facts discovered validate or invalidate a thesis, it is the discovery that matters. We put luck on our side by investing in many, many journeys of discovery, none with a pre-determined outcome. Like the lion tracker who enjoys the time on the track almost as much (or more) than discovering the lion, the investment analyst must enjoy the path of research discovery as much (or more) than discovering the cash flow compounding business.

### Curiosity and Activity

**"As paradoxical as it sounds, going down a path and not finding a track is part of finding the track. Alex and Renias call this "the path of not here." No action is considered a waste, and the key is to keep moving, readjusting, welcoming feedback. The path of not here is part of the path of here."<sup>6</sup>**

We all enjoy a good narrative, and the narrative arc in *The Lion Tracker's Guide to Life* is wonderful. The book contains the heroes' journey from start to finish, including timeless insights, nicely wrapped up in one day. What the book does not include is a description of what happened the day before or the day after. Without too much imagination, one can visualize a situation where the three protagonists set out to find a lion only to apply their tracking skills and come up empty. This does not make for a good narrative: set out from camp with high hopes, found lion track, lost lion track and returned to camp with no lion sighting. The day-to-day equity investment research process can (unfortunately for our behind-the-scenes movie aspirations) often resembles the same narrative: construct a promising investment thesis, set out into the research world, lose the track by discovering evidence that voids the original thesis, return to camp with no high-quality investment sighting.

One of the more interesting counter-intuitive messages from the book is recognizing the value from losing 'the track'. For the tracker, even if the track is lost, the environment can still provide valuable information. For the equity research analyst, there are often occasions where the research is providing 'signs' that one is well off the path of identifying a high-quality business. While recognizing that no company is perfect, we will often abandon further research on a company if the signs point to a business that does not meet our quality standards.<sup>5</sup> We at

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Cidel expect this to occur. Often. Not every thesis or investment idea results in the company being included in the portfolio. As noted above, if a thesis on an investment idea is proved false – this is still valuable information. To understand (and document) what makes a lower quality business helps us to improve our investment research skills and processes much like the lion trackers would sit around the evening fire and discuss what happened during the day. The equity research analyst, like the lion tracker, *gets better every day by doing*. For both, experience means learning and the more of it the better, even if the results do not always achieve the intended goal. Being on the “path of not here” is a valuable learning experience, because it provides clarity on what doesn’t work. For us as equity investors walking away from a bad investment idea is a valuable outcome given the presence of both opportunity costs and the potential for capital drawdowns. Unlike the lion tacker who starts each day ‘fresh’, we, as stewards of capital, want to first protect the existing asset base. Therefore, avoiding investment mistakes goes a long way in helping to compound wealth over the long term (see *Compounding Without Catastrophe*<sup>7</sup>).

We hope you have enjoyed our metaphorical Land Rover journey to the investment savanna to appreciate better the commonalities in skills between the seemingly disparate activities: that of the lion tracker and that of an equity research analyst. There is one notable difference though between the lion tracker and the investment analyst: the lion tracker is encouraged to go barefoot, whereas Cidel analysts are given their choice.<sup>8</sup> Wash up and dinner will be in the mess hall at 6:30 pm.

### Notes

1. Varty, Boyd. *The Lion Tracker’s Guide To Life* (p. 49). HarperCollins
2. Varty, Boyd. *The Lion Tracker’s Guide To Life* (p. 35). HarperCollins
3. Varty, Boyd. *The Lion Tracker’s Guide To Life* (p. 49). HarperCollins
4. For an excellent discussion of biases see Charlie Munger’s *The Psychology of Human Misjudgment* <https://fs.blog/great-talks/psychology-human-misjudgment/>
5. Cidel’s equity investment team focuses on four fundamental criteria to identify high quality businesses that can compound their cash flows: 1) sustainable competitive advantage, 2) predictability, 3) high return on capital with reinvestment opportunities, and 4) strong financial position. For more details, see *How we Invest at Cidel*: [https://cidel.com/downloads/Newsletter/Q3\\_2022/How-We-Invest-At-Cidel-MB%2811-2022%29.pdf](https://cidel.com/downloads/Newsletter/Q3_2022/How-We-Invest-At-Cidel-MB%2811-2022%29.pdf).
6. Varty, Boyd. *The Lion Tracker’s Guide To Life* (p. 68). HarperCollins
7. [https://cidel.com/wp-content/uploads/2024/07/Thoughts-on-Compounding\\_Q2-2024-.pdf](https://cidel.com/wp-content/uploads/2024/07/Thoughts-on-Compounding_Q2-2024-.pdf)
8. For greater clarity, Cidel’s Dress Policy is “Dress is to be business casual and in keeping with an office environment and proper business dress attire is expected at all Company client events.”