Morgan Stanley

Acres of Diamonds

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One of the fundamental rules of investing is KISS, also known as "Keep It Simple, Stupid". There are many ways to apply this mantra in one's quest for financial independence. For most investors, KISS should come in the form of selecting low-cost index funds to serve as the foundation of a portfolio. It means avoiding things you don't understand.

However, there are other ways to accumulate wealth in a simple manner. **Simple yes, easy, no**. The simple is, don't overlook what is right before your eyes. The "not easy" is to really see what is before you.

Don't Overlook the Obvious

IN THE CONTEXT OF ACQUIRING OWNERSHIP in individual businesses via stocks, it includes avoiding a tempting trap: Namely, overlooking the "tried and true" companies that rarely change, are highly profitable, and pump out ever-increasing sums of cash flow for owners.

SEVERAL UNIQUE BUSINESSES exist with above average returns on capital, high barriers to entry and vast geographic diversification. To some owners, shares are intended to be passed on as future inheritances to grandchildren. Some think of these shares as "family money" in the same way you would a cherished farm or grandmother's wedding ring. As long as the core economic engine is intact, they want to enjoy a bit of the profit generated by every unit of product sold.

More Than a Logo

ONE OF THE APPEALS of owning shares in one of these dominant companies is that it's often not just one or two lines of business or products for which they are so well known. Often times these global franchises have multiple brands that generate billions of dollars in annual revenue. Additionally, they often have unrivaled distribution across continents and customer loyalty dating back decades approaching centuries. In some cases trademark protections and a limited number of global competitors makes the business model akin to having an early broadcast licenses. Charles Mizrahi called these early broadcast rights "a license to print money."[1]

Consistent Cash Flow

Typically, companies with these characteristics have strong consistent cash flow. With some of the more mature companies, the majority of the free cash flow goes right back out the door to shareholders, either in the form of share repurchases or cash dividends. In many cases the total shares outstanding declines and the dividend rises. The boards of directors often increase the annual dividend, and in some cases, the increase has become routine – for decades.

YET, WHEN GIVEN THE CHOICE, it seems that very few individual shareholders prioritize the acquisition of shares of theses "diamonds" for the long-term. You hear people talk about buying shares of crypto-currencies, electric cars or solar panel startups; a new social media network that could hit pay dirt or the next "unicorn". It seems it's all about getting rich quickly, rather than building wealth steadily.

Bore Me, All the Way to the Bank

WHEN WAS THE LAST TIME you heard someone excitedly exclaim, "I am going to expand my holdings in the world's largest and most profitable (FILL IN TH BLANK) industry, which I'll someday leave to my grandkids"? It doesn't happen frequently. For whatever reason, most investors aren't wired to think of common stocks like they do office buildings, antiques or art, which, in the case of those assets, they understand has utility that extends far past one lifetime.

THERE ARE NOT A LOT, but certainly more than a few, of these amazing long-term holdings. These are companies that have similar economics and competitive advantages. These special companies are rare enough that I truly don't understand why people don't systematically add them to their holdings as an addition to the family's collection of assets that generate income.

Maybe the Tortoise was Right

THE MORAL OF THIS STORY isn't that one should buy shares of one specific company. Rather, it is to remind you that the next time you are tempted to buy into something that promises excitement and rapid payoffs, to over-leverage or take more risk than you should; consider, instead, looking to one of the couple dozen incredible businesses that are highly probable to maintain their market dominance well into the future. Slow and steady wins the race.

SOMETIMES, THE SMARTEST COURSE of action is to stop chasing excitement and, instead, buy shares of a great company and wait. With enough diversification, the chances of permanent loss can be greatly reduced. This leaves a whole lot of upside to enjoy decade after decade, generation after generation. Even though most people don't invest this way, you can be different. Dare to insist on boring, exceptional holdings rather than what is in vogue at the moment.

What to Take Away

Some readers are expecting a list of "can't miss" stocks. That is not going to happen here. However, knowing what to look for is the first step. Accumulating those holdings over time is the second. The third, that's easy – enjoy the dividends and give the shares to your heirs.

The question is: What are *you* doing in *your* life right now – *today* – to make sure that *your* family is in that favorable position 40 to 50 years from now? My suggestion: Start picking up the acres diamonds that are hidden in plain sight.

About the Author

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[1] "Getting Started in Value Investing", Mizrahi, John Wiley & Sons, 2011