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Simplification

"We have a passion for keeping things simple." **– Charlie Munger, Vice Chairman, Berkshire Hathaway**

An Internet search on the subject of "ways to simplify your life" offers up hundreds of articles, reports and books on the seemingly popular topic. Many of these pieces are penned by so-called life gurus, and recommend solutions such as "declutter your house", "remove toxic influences", "take control of your finances" and the very popular "reduce your social media use". The philosophy behind this simple mantra is that everything in our daily life takes up space – mental space, physical space, calendar space – and we only have so much personal capacity. In theory, simplifying one's life should provide us with more time, space and energy to devote to the important tasks and ideally get more enjoyment out of them. All very logical and easier said than done.

The basic concepts of simplification transfer well to the world of investment management, and have been the core of investment philosophies of some of the industry's most successful and esteemed investors, Warren Buffett included.

"(We) have not learned how to solve difficult business problems. What we have learned is to avoid them. To the extent we have been successful, it is because we concentrated on identifying one-foot hurdles that we could step over rather than because we acquired any ability to clear seven-footers…in both business and investments it is usually far more profitable to simply stick with the easy and obvious than it is to resolve the difficult." – Warren Buffett

To the layperson, the investment world can be a complicated space of esoteric product structures and inconspicuous security risks, which if not fully understood, can lead to painful, loss-incurring outcomes. Poor outcomes, however, are not solely the domain of the amateur investor. Professional investors of all stripes have felt the sting of failed investments resulting from misunderstood business models and underappreciated risks. When investing in stocks, risks are unavoidable. However, knowing and understanding the risks can prove invaluable when it comes to avoiding the pitfalls. Unfortunately, risks can be hidden under a convoluted business structure and minimized by management teams that have mastered the art of obfuscation. If a solid grasp of the complexities of a business proves elusive, closing the books and moving on to the next investment idea may prove the best course of action.

As professional investors, we often think back on our most successful outcomes in an effort to carry forward the common denominators of those winning moves. In doing so, we would be remiss to exclude from those reflections the situations that were purposely avoided due to a lack of understanding of the inherent risks in the business model. In investing, sometimes it's more about what you didn't own in your portfolio rather than what you did. Avoiding the investor minefield of disasters helps preserve investor capital, and by default, contributes to the achievement of above-average returns over the long term.

Walking away from a seemingly enticing and well-promoted investment opportunity due to a lack of full comprehension of the underlying business model and/or the associated risks, is not something we regularly see portfolio managers detailing in their quarterly reports. Yet these can prove to be the wisest of investment decisions.

"There are things that we stay away from. We're like the man who said he has three baskets on his desk: in, out, and too tough. We have such baskets – mental baskets – in our office. An awful lot of stuff goes in the 'too tough' basket." – Charlie Munger

While successful investing requires an understanding of the underlying business and the inherent risks, there are often only a few integral pieces to the puzzle that an investor needs to uncover and understand before moving forward. The 19th century American philosopher William James said, "The art of being wise is the art of knowing what to overlook", words that translate well in the world of investment research. The investment research process can often leave one swimming in a sea of information – knowing what is important and what is irrelevant is key to prioritizing and simplifying the entire process. Understanding which facts were vital and which were incidental was key to the art of detection in the fictional world of Sherlock Holmes, unsurprisingly this rings true in the investing world as well. An unfocused and exhaustive search for more and more information can inject paralysis into the decision-making process, and the result isn't necessarily a better decision. Making fewer decisions can allow for more thought into each one, ideally resulting in better decisions overall.

Staying within one's circle of competence is an oft mentioned piece of investment advice, usually handed down by someone who has experienced conditions outside of the "circle". The concept in its simplest form states you should only invest in those areas/businesses that you clearly understand; to do otherwise increases the risk of costly mistakes. Within the circle are the things you know well. Outside of the circle are the things you think you might know but really don't, and all the things you definitely don't know. Understanding those boundaries is key to this simple concept. Or put another way, a key element of staying within one's circle of competence is knowing what you don't know. This is simplification in its most effective form.

"*Acknowledging the boundaries of what you can know – and working within those limits rather than venturing beyond – can give you great advantage.*" – Howard Marks, Oaktree Capital

The simplification strategies highlighted thus far have related primarily to the investment research process and individual stock selection; however, the concept is also relevant when thinking about portfolio construction. If making fewer and better decisions can improve one's chances of success (because it forces us to spend more time thinking about each decision), then running a focused or concentrated portfolio should ideally result in a portfolio comprised of high-conviction ideas and one that is better protected from unknown risks. Logically, it should be easier to stay abreast of the individual businesses within a 30-stock portfolio than it is within a 60-stock portfolio. The greater the number of holdings under one's watch, the less the individual will likely know about each one – it really is that simple.

Keeping things simple has clearly worked for legendary investors such as Warren Buffett and Charlie Munger; and it is a concept that resonates well across large swathes of the investment management industry – Sionna included! Unfortunately, simplicity in approach can sometimes be viewed as lacking and perhaps out of touch, whereas elaborate and complex approaches can at times appear brilliant and progressive. This is of course not to say that complex and elaborate approaches cannot be successful if the risks are well understood and managed accordingly, but history has shown that even the most brilliant minds in the room have limits to their circle of competence.

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