LINDSELL TRAIN

Seven Pillars of Wisdom

September 2011

A friend asked my advice about his financial affairs, having recently come into a pot of capital. My first thought – which indeed I acted on - was to direct him toward the capable hands of any of Lindsell Train's valued counterparties in the Private Wealth Management industry.

However he was insistent that I express some opinions – if only to provide context for his future discussions. "OK", I said, "So long as you acknowledge that I'm not professionally qualified to advise you – indeed, LT's regulation means that I'm specifically barred from giving you any advice – so long as you recognise all that: here are my seven pillars of investment wisdom."

These are seven propositions – appropriate for private, individual investors - which I try and remember before considering what to do with my own cash (before I give up and just buy more shares in Finsbury Growth & Income Trust). I long ago gave up seeking the "answer" to the investment challenge and my seven propositions certainly don't add up to even an attempted answer. I just find that if I ruminate on them my eventual decisions feel less impulsive, better founded.

1. The purpose of investment is to preserve the real, post-tax purchasing power of capital, in the least risky way.

This may seem a truism, but it's always important to set out on any endeavour with a clear objective. What's more, it may seem an unambitious target – though protecting capital over time from the twin ravages of Inflation and the Taxman has not proven a trivial challenge. But what proposition 1. really achieves, though, is to inoculate me against over-reach. One of the most sobering, but refreshingly realistic, financial headlines I ever saw read as follows – "It is unlikely that God's plan for the universe involves making you rich." Sad, but true. So, let's now get on with achieving a realistic investment objective.

2. Invest your age in fixed interest. Or not.

I apologise for the fudge here – but this one is really crucial and really tricky. It used to be said, admittedly decades ago, that you should invest your age in gilts. In other words and for instance, a 10 year-old child, whose grandparents are saving for her, should have no more than 10% of those savings in fixed interest. She has a lifetime ahead of her to make back any setbacks in her Equity holdings. Whereas a 75 year-old, more or less dependent on investment income, might as well as have 75% of his wealth in government bonds. Carpe diem. You can't take it with you. Spend and enjoy.

With increasing life expectancy, however, it is clear that this rule of thumb no longer holds. Inflation can pauperise you quicker and when you're more vulnerable (i.e., when reliant on a fixed income) than our wisest forebears could conceive. We need to hold more Equity for longer — particularly when one can invest in some very decent companies offering starting dividend yields above gilt yields, as now.

3. Never consume more than 4% of your capital every year – whether you take it as capital gain or income – if you want to maintain the real value of your wealth.

No worries if you don't care about preserving real value of capital, but don't kid yourself. Long term real returns on shares are circa 5% pa and that includes reinvested dividends, taxed at the standard rate (an element of index return unavailable to most of us). In the real world peeling off more than 4% of capital a year, or trying to earn much more than 4% annual income from higher risk instruments will erode your stash over time (and perhaps quicker, if the junk bond market crashes and burns).

4. Don't let anyone tell you that capital preservation and "Growth" are possible at the same time.

They're not.

5. If you need to make money - concentrate your investments. If you want to preserve capital – diversify.

Big returns require successful big bets. Diversification may not make you rich, but it lessens the potential for unpleasant surprises.

By the way, Mrs. Train insists that the Train family fortune is not yet even remotely sufficient. For this reason LT's UK and Global strategies, where I invest, are run in a concentrated fashion. We willingly take this risk, because we know it offers the best chance for the exceptional returns Mrs. Train insists on. But I'd be mortified if any of our clients invested in these vehicles without eyes wide-open and without adequate diversification relative to their own objectives.

6. Most professional investors will do worse than the benchmarks over time, largely because of fees and transaction costs.

As Anthony Hilton of the Evening Standard wrote last year – "Remember, the only difference between investment professionals and investment amateurs is that the professionals make their mistakes with your money, not their own."

I don't table proposition 6. just to advertise Index Funds or ETFs, though it's hard to argue with the cumulative effects of their inexorable mediocrity - long periods of average performance, relative to benchmark, push you up the long term performance tables - rather to demystify the investment profession. Smart suits and smooth patter will almost certainly not compensate you for 150bps of annual management fee.

7. Time, not timing, is the key to investment success. The best time to invest, therefore, is NOW.

You've got to be in it to win it. Don't believe anyone who claims they know where prices will be next week, month or year. If you need to earn a return, then invest for that return today – and let Capitalism do its steady work.

Be optimistic.

Nick Train, Portfolio Manager
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LTL 000-104-9 5 September 2011

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