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“Efficient market hypothesis is a load of tosh”

By Taha Lokhandwala

Fund managers love quoting their heroes when describing their investment philosophy. One name that often comes up is of course legendary investor Warren Buffett. The American and his company Berkshire Hathaway are renowned for his style of investing – being the first to coin terms such as ‘economic moat’ and developing a stock screen that is revered.

One fan, a super fan perhaps, went a step further. Rather than simply quoting Mr Buffett to demonstrate knowhow, Keith Ashworth-Lord recreated the investment style and was entirely open about it. With a hat tip to its founder, Mr Ashworth-Lord launched the IC Top 100 Fund**CFP SDL UK Buffettology** (GB00BF0LDZ31).

The philosophy is simple, he says: “It’s all about finding the best companies at the right price and holding them forever, ideally.” The difficulty is in finding the best companies. He starts back at the definition of 'economic moat'. These are companies that have built a commercial strategy around them that allows continued excess profit. This moat could take the shape of a patent, or a brand, or anything in which another business cannot come along, copy and eat away at returns.

“The first rule of capitalism is that excess returns get competed away. If you can beat that, you have something special,” he says.

Mr Ashworth-Lord’s fund has taken this strategy and focused it towards the lower end of the UK stock market. The fund has around 37 per cent in small-caps and a further 30 per cent in micro-caps, with around 12 per cent in large-caps. Despite focusing on the lower end of the cap scale, the fund is relatively concentrated, holding only 30 companies with big weightings to the top holdings.

At the end of October, this meant a 5.6 per cent weighting to FTSE 250 darling **Games Workshop** (GAW) – a company he first bought back in 2011, when he launched the fund. **RWS Holdings** (RWS), another top 10 holding, has also been included from day one.

Such a strategy has reaped rewards. Since launch in April 2011, the fund has returned 209 per cent, versus 65 per cent for the FTSE All-Share and 107 per cent for the FTSE Small Cap index. The average return from a fund in the Investment Association UK All Companies sector was 67 per cent.

More recently, the fund has held up well despite rocky markets. Over one year the fund has returned 9.8 per cent, versus a 1.2 per cent fall in the FTSE All-Share and a 9.1 per cent fall in the FTSE Small Cap index. Over three years the fund returned more than double the FTSE All-Share and triple the FTSE Small Cap, with a 51 per cent return.

Despite the simplicity of the ideology, and the stellar rewards on offer, Mr Ashworth-Lord says logic and fundamental analysis is what makes the strategy. "You must know where the business will be in 10 years' time – it cannot be vulnerable to disruption. It should have growth potential, but not explosive as that's hard to manage, and should be in an industry that's growing while also growing its market share.

"I then look at 10 years of accounts and I read all the reviews, the operating story and the financial story; follow what the company has been doing. I am looking for any repeated issues. What have they promised and what have they delivered," he says.

Mr Ashworth-Lord studies each company based on the business model Porter's Five Forces. This looks at the threat of new entrants, the threat of substitute products, the bargaining power of suppliers, the bargaining power of customers and industry rivals. The company must have a strategy for each – or face no threat of them whatsoever.

"If I still like what I'm looking at, I move to the quantitative stage and go back as far as I can go," he says. The quantitative model, he says, has been developed over 20 years and looks at 150 metrics – both operational and financial.

Cash conversion is one – companies that convert accounting earnings to free cash. This should be over 80 per cent on a rolling five-year period. Games Workshop and fellow top 10 holding **Bioventix** (BVXP), a pharmaceutical company, are close to 100 per cent.

Equally important is return on equity capital employed – which measures how efficient a company is at generating profit from equity capital. Mr Ashworth-Lord is a bit more lenient, and includes stocks that go as low as 20 per cent. Bioventix and Games Workshop are above 60 per cent.

Such companies do seem a touch dreamy – the perfect stock. However, Mr Ashworth-Lord does not do down valuation. Companies must be bought at the right price, he says, even great ones. But how does a man who calls efficient market hypothesis, the idea that stocks eventually get priced accurately, “the biggest load of tosh” value a company? He uses 10 per cent as the cost of equity capital, so if a business has a stable £30m cash flow, the company is worth £300m.

“I would be prepared to pay fair value if it’s a great company,” he says. “But never more than fair value.”

Mr Buffett and by extension Mr Ashworth-Lord are known for never selling companies unless something dramatic has changed – buying and holding forever. However, equal to the challenge of when to sell is what to buy; such companies must be few and far between.

Mr Ashworth-Lord says there will always be companies that capture the customer’s mind, such as Games Workshop, or have proprietary technology, such as engineering outfit **Rotork** (ROR). And finding new companies can be as simple as looking for more of the same.

“Games Workshop has managed to capture its customers in a sub-culture. Find me another sub-culture and I’ll invest in it.”

CV - Keith Ashworth-Lord

Keith Ashworth-Lord is managing director of Sanford DeLand Asset Management and set up the firm and the CFP SDL UK Buffettology Fund in 2011. Prior to this he was a consultant for stockbroking and fund management companies, and private investors. His early career was spent in equity research, before he become an investment manager. He has a degree is astrophysics from Queen Mary College, University of London.