Laurus
INVESTMENT COUNSEL

GLOBAL SMALL CAP SPECIALISTS

MONTHLY COMMENTARY | February 2023

"Experience without theory is blind, but theory without experience is mere intellectual play."

- Immanuel Kant

Over more than a decade (2008-2019), baseball's Major League home-plate umpires made every pitch call correctly on one team roughly twice per season. Among the 114 umpires with at least 5,000 called pitches during that time, the range between the least accurate and most accurate umps is narrower than 4 percentage points, ranging from 86.2 percent at the low end to 90.1 percent at the high end, with an average of 88.5 percent.

In a comprehensive study of 11 seasons of MLB data by Boston University's Mark Williams, Joe West was the umpire with the second-highest percentage of bad ball-and-strike calls when working behind home plate. Over those eleven seasons, he averaged 21 incorrect calls a game, or 2.3 per inning, compared to the Major League average of 14 per game, 1.6 per inning. West made even more errors than Angel Hernandez, widely regarded as baseball's worst umpire, and was clearly among the lower performing umps. Yet his terrible record was clearly outdone by his well-earned reputation for turning situations into conflagrations and making himself the centre of attention.

Poor decisions and poor deportment are a lousy combination.

In all likelihood, West wasn't very self-aware – in his eyes, everybody else was stating opinions while he was stating facts. That reality – or failing – is blindness bias, our well-established tendency to see the existence and operation of cognitive and motivational biases much more in others than in ourselves. As Daniel Kahneman, the world's leading authority on human error, explained in Thinking, Fast and Slow: "The premise of this book is that it is easier to recognize other people's mistakes than our own."

As investment managers, we must recognize that individually, and as a team, we are likely to have biases about our stock selection process, the sizing of positions, portfolio construction, and even risk management. Certain behavioral biases affect us as individuals, while others are more prominent in group settings. One way to guard against groupthink and conformity is to be thoughtful about the design and management of the team itself. Collaborative debate and disagreement are hallmarks of effective working groups and avoids the pressure to "go along to get along", a feature that is not conducive to good decision-making.

Our approach is to begin with a list of "must-have" attributes in any company we choose to analyze – business characteristics that enables a company to resist competitive forces and thereby produce high and enduring profitability. From there, the primary research objective is to determine if a business has a durable competitive advantage and, if so, how that differentiation translates into its growth profile, margins, business resiliency, and so on.

The advantage of our approach is ensuring the individual strengths of the team are focused on debate and disagreement of businesses that meet our portfolio needs rather than our own particular biases which may have detrimental effects on investment decisions. Our specialty – investing in small-and medium-capitalization companies – can entail special risks, such as limited product lines, markets or financial resources, and potentially greater market volatility than securities of larger, more established companies. We believe that by ensuring our fundamental, research-oriented approach that invests in "high-quality" smaller companies can minimize many of these risks.

"Having our own way" is inevitably human - unfailingly and frustratingly human. We're often wrong, but never in doubt as my very good friend, Paul, loves to say. Bias, like wisdom and wealth, compounds, making "our own way" particularly detrimental.