Q&A with the Managing Partners of Bristlecone

1. How and why was Bristlecone formed?

The firm was formed in 2004 on a simple idea. Following the revelations of analysts' conflicts of interest in 2002, and the scandals affecting the mutual fund industry in 2003, we felt that the money management world was becoming increasingly stagnant and self-serving. It was clear to us that the typical industry objectives such as gaining market share or growing assets under management do not matter much to clients as they decide on the stewardship of their portfolios. Consequently, we saw an opportunity to create a firm that would serve investors' interests better by focusing on how to generate good investment performance over time.

2. How is Bristlecone different then?

Our goal was to defy the prevailing conventions and "think out of the box". Many investment organizations spend too much time on short-term forecasting, whether trying to predict the economy, or a company's earnings next quarter or next year. The problem is people consistently overestimate their predictive faculties. Most professional investors also focus on short term issues such as returns relative to an index, attribution analysis, and other statistical tools that have very little impact on their ability to deliver good investment performance over time. At Bristlecone, our only ambition is to be experts at valuing businesses. Our success as investors is a direct result of the success of the businesses we own.

3. Why is business valuation the key to your investment philosophy?

As you know, investing at its core is simple: you give up a few dollars today with the expectation to get more dollars back later. Our investment approach is derived from this simple definition. In its application, it is similar to the process that one would go through when buying a small business such as a restaurant for instance. Our hypothetical entrepreneur would conduct an extensive due diligence on the restaurant with two goals in mind: 1. To not lose money, and 2. Get more cash out than he/she put in. We apply the same no-nonsense process to stock investing. We try to minimize the chances of losing capital by investing in companies that are well managed and financially strong. We also try to maximize our chances of making a profit by paying a price that is significantly lower than our assessment of the value of the business. The two concepts together are the basic tenets of value investing.

4. Can you give us a little more insights in your process?

Absolutely. The first step is to thoroughly educate ourselves about the company's business and its competitive environment, so that we can get a sense of whether its economics are likely to remain good or not over the next five, ten or fifteen years. The second step involves assessing the quality of the company's managers in order to know our potential future "partners". The final step is the valuation work. Only when the market price is significantly below our assessment of the business' worth will we commit our investors' capital. Through the whole process, Bristlecone's Managing Partners are directly involved.

5. Do you use any Wall Street Research?

Not much. Our research is conducted in-house. Wall Street research can be useful to get some factual information about a company or an industry in a quick and orderly fashion. However, we find that most analysts on Wall Street come extremely short when it comes to assessing a management team or valuing a business. Additionally, we would never commit our clients' capital without having done the work ourselves.

6. How does your research flow into the construction of your clients' portfolio?

This is a great question since it illustrates our differences again. Our typical mature portfolio includes 25-40 different securities. Given the depth of our research process, and our time horizon (3 to 5 years), the portfolio turnover – the number of issues that are being bought or sold every year – is pretty low at about 20% to 30%. In doing so, we reduce the transaction costs and the amount of taxes that our clients will pay over time. Consequently, a mature portfolio will see about 5 to 10 new investment ideas per year on average.

7. What about cash and industry diversification?

Again, we act like entrepreneurs and we go against the conventional "wisdom". Because we do not believe that anyone can consistently predict the returns delivered by the market or any industry, the portfolio is built one idea at a time – "from the bottom up". There is no such thing as a predetermined allocation to certain industries. If we cannot find any attractive ideas in an industry, or if we feel that we do not have enough expertise in it, we do not feel compelled to invest. The cash position is also a by-product of the flow of ideas in and out of the portfolio. When we can't find anything to buy, we stay in cash.

8. Who is your typical client?

Whether they come directly to us, or rely on the expertise of their advisor, our clients appreciate our "boutique" feeling and the personal attention that comes with it. They probably felt like faceless account numbers with some of our competitors. They like the fact that, at Bristlecone, the professionals who make the decisions are accessible and invest with them. Because a lot of our clients are entrepreneurs themselves, they also understand that to be successful, one needs to think differently. Finally, they appreciate our candidness in discussing both our successes and our failures.