

(Don't Always) Follow the Yellow Brick Road

By Mariko Gordon

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I'm no Wizard of Oz expert, but two things happened in the last few weeks that gave me an unmistakable, "Toto, we're not in Kansas anymore" feeling about the markets.

"Not in Kansas anymore" thing number one:

36 minutes into the Herbalife quarterly conference call, hedge fund manager David Einhorn ruined the company's victory lap. Sales may have been up 21% and net income up 22%, but because Einhorn [asked three questions](#) on the call, the stock immediately tanked over 20%.

A few days later Einhorn [spoke at the Ira Sohn Conference](#) (a fundraiser where hedge fund luminaries pitch their best ideas) and, because he did NOT mention the stock, Herbalife was up 14% *within one minute* after he flashed his last (the 137th) slide.

This gives new meaning to the expression *silence is golden*.

Don't get me wrong, Einhorn has put up monstrous numbers and is deservedly well-respected for his short calls. But last time I checked, investing is supposed to be based on something more intellectually rigorous than whether or not David Einhorn asks a question. (For the record, we have no dog in that hunt -- we don't own and never have owned Herbalife.)

"Not in Kansas anymore" thing number two:

Not long ago, we got a breathless call from a sell-sider claiming one of our stocks was going to miss the quarter. What caused him to call? It was the announcement of the CEO's retirement four months before his contract expired.

We were puzzled. Yes, it's true the CEO's contract didn't expire for another four months. That said, we were fully expecting him to retire, his successor had come on board a few months earlier and said heir apparent was doing a splendid job.

Indeed, we would have gotten antsy if the leadership transition had *NOT* been announced in that time frame, as it would have meant that something had gone amiss in either the



succession or the turnaround plan.

When we asked the sell-side analyst some questions about where he thought margins could go in the next two years, we got a [Ralph Kramden](#) "hamida hamida hamida" and heard some desperate scuffling through papers. His non-answer was followed by an email a few hours later with a bit more information.

Jeez, if you're going to go out with a negative call on something as tenuous as the timing of a clearly spelled out CEO succession, at least be prepared to talk turkey, if not numbers.

Watch out for the flying monkeys

Compare these twitchy investment perspectives to insights that come from talking directly to companies about their business, their strategy and their long-term opportunities.

Case in point: We recently came back from an analyst day, where we buttonholed those who actually run the business. We were happy to learn that the short-term issues that gave us a good entry point will soon be resolved. We were *thrilled*, however, to hear that we hold a stock that once seemed like a good business, but now we believe can be a great business and an even more profitable multi-year holding than we first thought.

Listening solely to the webcast of the analyst day would have meant missing the enthusiasm of a deep bench of imported talent, laser-focused on taking the business to new heights.

That's why we like to hit the road - there's real value to be had by being there in person (it's not the frequent flyer miles, trust me).

Back to the Land of Oz. All of this recent nuttiness leads me to conclude a couple of things:

1. As the "noise" in this market becomes deafening, it is ever more crucial to ensure that we're paying attention to the "signals" of what matters in a stock.

As more and more information (whether legitimate or not) gets disseminated and reacted upon faster and faster, having both clarity on what matters in an investment case and certainty that we're well grounded in those matters is critical to our succeeding as long-term, long-only investors.

2. Let all those who twitch taser-like at every piece of news continue to focus on the short term. Instead of peering myopically at the six inches in front of us, we'd rather look up and see farther down the road.



Obsessing over the near data point and asking the same question of management over and over and over can be counterproductive. Sure, we want to understand the worry of the day and be comfortable that the short-term issues won't cause a complete unraveling of future profits. But it's what a company delivers over the long run that will matter.

We've seen this obsession before in our stocks.

No one wants to write about that which is hard to quantify to a penny or to pin down to a specific date (or even hour!). We sit in meeting after meeting where the same, obsessive, short-term focused question gets asked over and over again. Why? Do people really think that management will suddenly say, "*Nah, just kidding, we're going to whiff the quarter. We were lying the last 563 times you asked us this exact same question*"?

The problem is that it's hard to quantify precisely the impact and timing of change. Not every action taken works. Not every action happens at the speed of light. The future is hard to predict with precision.

But surely God invented capitalism for a higher purpose than just serving up an opportunity for Wall Streeters to game data points, put up numbers and get paid. And that's why we like to meet the people who make the numbers real - so that we can focus on the bigger, long-term opportunities and ignore the flying monkeys vying for our attention.

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