



The Art of Portfolio Management

"You Can't Dance With All the Girls"

As analysts, we are always looking to discover new companies in which to invest but as portfolio managers, we know that the foundation of a good portfolio rests on a concentrated selection of companies -- the best of the best with the most promising prospects.

On the U.S. stock exchanges, there are about 9,000 publicly traded companies. Around the world, there are a few thousand more publicly traded companies. Out of all of these companies, only a relative handful meet the standards that experienced long-term investors seek.

First and foremost, an investment-worthy company should be of high quality. Top-quality companies have faster rates of sales growth, more stable profit margins, higher returns on equity and better track records for growth in earnings and dividends per share.

High-quality companies have other identifiable characteristics as well, including top-notch management teams, a dominant or leading market position, a heavy emphasis on research and development, substantial plowback of earnings to finance future expansion and a strong financial position with low levels of debt. Finally, these companies tend to be in expanding areas of the economy that have superior prospects for continued growth at above-average rates.

Why not just buy a basket of companies? The primary purpose of owning common stocks is to share in the growth of the earning power and the dividend-paying ability of the underlying companies. Investing is a financial commitment to the future progress of the company and it makes sense to focus on the wheat and not the chaff.

By using a "basket approach", an investor is making a financial commitment to companies that may or may not be investment worthy. Even if there are a few worthy companies in the basket, they will not be appropriately sized to make a meaningful contribution to the progress of the portfolio as a whole.

In essence, the "basket approach" aims for at least average results -- and assumes that average results are a worthwhile objective. Common sense should tell us that selecting the best partners to tango with is a better strategy than filling out the dance card indiscriminately.

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