As We See It

Nobody has ever bet enough on a winning horse.
— Richard Sasuly, Author

Our investment style has some similarities to the concept known as a *Coffee Can* portfolio. The Coffee Can portfolio concept harkens back to the days when people put their valuable possessions in a coffee can and buried it in the back yard. The success of the program depended entirely on the wisdom and foresight used to select the objects placed in the coffee can.

We were first exposed to this concept in "The Coffee Can Portfolio" written by Robert G. Kirby. Mr. Kirby's article was originally published in the 1984 fall edition of the *Journal of Portfolio Management*. As described in the article, a true coffee can portfolio would be a portfolio that was untouched after being structured.

Mr. Kirby tells the story of his experience with one client for whom he managed money in the mid-1950s. He had worked with her for about ten years, when her husband suddenly died. She inherited his estate and called Mr. Kirby indicating she would like to add his securities to her portfolio. It turned out the husband had been piggy-backing Mr. Kirby's recommendations with a small twist. He made no sales. He simply put about $5,000 in every purchase recommendation and tossed the certificate in his safe-deposit box.

The result was an odd-looking portfolio. There were a number of small holdings with values of less than $2,000 and several large holdings with values in excess of $100,000. There was one jumbo holding worth over $800,000 that exceeded the total value of his wife's portfolio and came from a small commitment in a company called Haloid, which later became Xerox.

As fiduciaries, we cannot manage portfolios in this manner. We must keep positions to a reasonable percentage of the portfolio. After all, a greatly oversized position might turn out to be an Enron. However, we believe we let our winners become oversized positions to a greater extent than many professional investors. For example, most of our equity portfolios consist of approximately thirty positions. These positions—which might have been somewhat equal when the portfolio was originally structured—become varied over time as some stocks perform better than others. As time passes, it is not unusual to find the ten largest positions in many of our portfolios approaching 50% of the portfolio's value. This development can result in greater volatility but also in better returns.

What is happening with the portfolio is that the stocks of better performing companies become an ever larger portion of the portfolio with a comparable impact on performance. Meanwhile, the stocks of poorer performing companies become a lesser portion of the portfolio and thereby have less of an impact on the portfolio's performance.

Individual stocks seldom perform the way one expects. They either perform better or worse than expected. And, like a horse race, it is not known ahead of time which stocks will be the better performers and which stocks will be the laggards.

Year End 2013

450 Regency Parkway, Suite 410 | Omaha, Nebraska 68114-3701 | *tel* 402.392.2606 | *fax* 402.392.2597 | www.lawsonkroeker.com