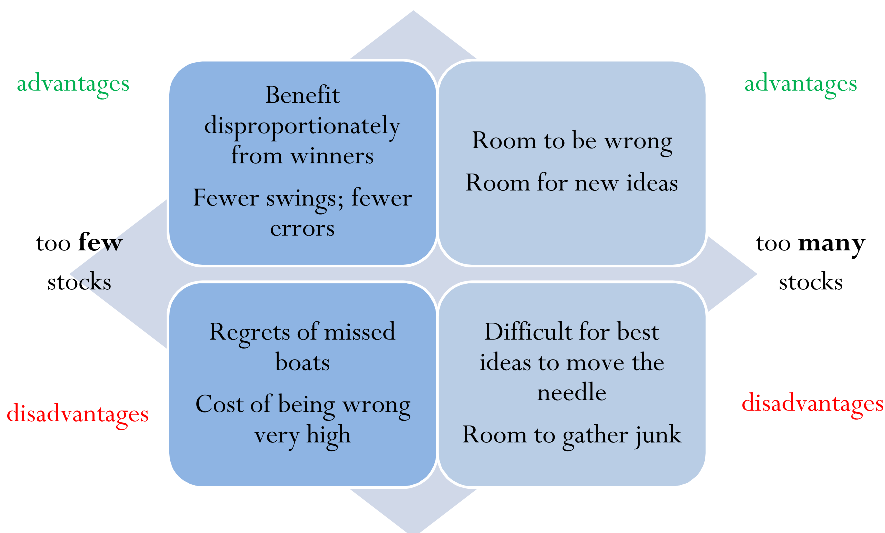
DMZ PARTNERS

# *Investment Philosophy* Our thoughts on right-sizing positions

5th October 2016

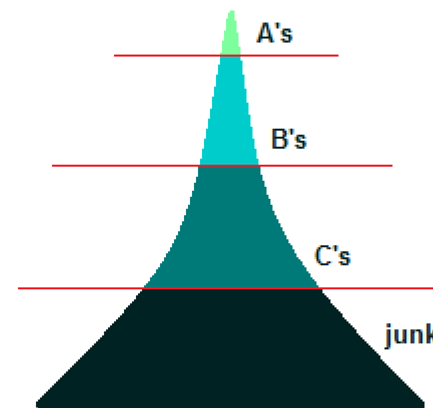
**Concentration/ Diversification - How much is enough?**

It is interesting to notice how even similar-minded value investors can be dramatically different in sizing positions. Even investors holding the same companies may differ dramatically in how they size them, leading to very different returns. We tend to be at the very concentrated end of the spectrum with about 4-6 meaningful positions and 4-5 toeholds/ tracking positions. In that sense our allocation is odd because we will simultaneously hold a 20% position and a few <5% positions which we will either make consequential or remove as we learn more. Here's a quick graphic of how we view the trade-off:




**What we like about our approach**

One of our favourite aspects of our approach is that it narrows down the "investable universe" - we tend not to look at a lot of Bs because we know our approach allows for only A's given the heavy concentration. Once you enter the B range its difficult for us to justify why we own a particular B but not another one and we want to refrain from ending up being diversified to the extent that our best ideas fail to move the needle. In our view, the quality curve fans out very fast - there are handful A's; several dozen B's; hundreds of C's and limitless junk!




**Tightly wound vs. Unwound**

If A's which we haven't owned but really like stagnate or depreciate and 10y estimated returns move up from sub-15% to 20-25%+ we will likely make room for them. That said, if our three favourite A's continue to be available at prices which make 25%+ expected returns realizable we will rarely buy anything else - there are very few things that we can call sure-shots. If they become very dearly valued (10y returns going to sub 15%), we are likely to venture out and own more A's which improve LT returns. In our office we use the phrase tightly wound, implying very high expected 10y returns (25%+) and unwound, usually after a large run in price, denoting low LT returns (sub 15%). Nor do we hesitate to trim unwound A's to own tightly-wound A's - a 20% size can surely become sub 5% if it has run too far and juicier deals await! Not a perfect science but one which has worked for us so far.

**I invite your comments** (soumil@dmzpartners.in)

Source: DMZ Partners.

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