Calculated conviction:

How the quality and breadth of a company’s moat shape risk

/ **By Bernard Drotschie,** Chief Investment Officer

The 2020s have presented many challenges - COVID-19, trade wars, AI, and wars in Ukraine. We like to think we are living in uniquely turbulent times. The reality is that every decade has had its challenges, and expect more in the 2030s, 2040s... What is important is to have a game plan.

Humans have evolved to manage risk, the reflex that snatches a hand from a hot plate occurs subconsciously. In this instant thinking fast overrides thinking slow. But this highly successful survival response is not often the optimal solution in the modern world. Indeed, successful investors tend to act in the opposite manner. A cold and logical assessment of the facts rather than knee-jerk gut feel. This is a foundation block of our investment philosophy.

Our starting point is deep fundamental research. Before asking what a share might return, we assess what is realistic – trees do not grow to the sky. We seek companies with sustainable growth. A competitive edge within a growing market for its goods or services is a key factor. For example, Visa and Mastercard's network effect within global payments has continued to dominate. Their growth drivers have been the transition from cash to card, as well as the world's population becoming wealthier.

We also ask what the company can withstand. A strong balance sheet indicates the company's ability to weather a downturn, fund its own growth and emerge stronger than competitors. By contrast, companies with limited financial resources may be good stories, but when they inevitably hit a speed bump, they can be forced into decisions that permanently destroy shareholder value. In the meantime, quality businesses take market share. Amazon.com is a case in point during COVID-19.

A dial, not a switch

Selecting quality businesses is the first half of the equation. The second half is a matter of degree. How much capital should an asset receive, given our level of conviction?

Our global equity portfolios tend to be concentrated because every position must earn its place. Conviction, though, is not bravado. It is a judgement on how clearly the road ahead can be read. When our research points firmly in one direction, we concentrate: fewer holdings, larger positions. When uncertainty widens the range of outcomes, we hold more stocks until the fog lifts.

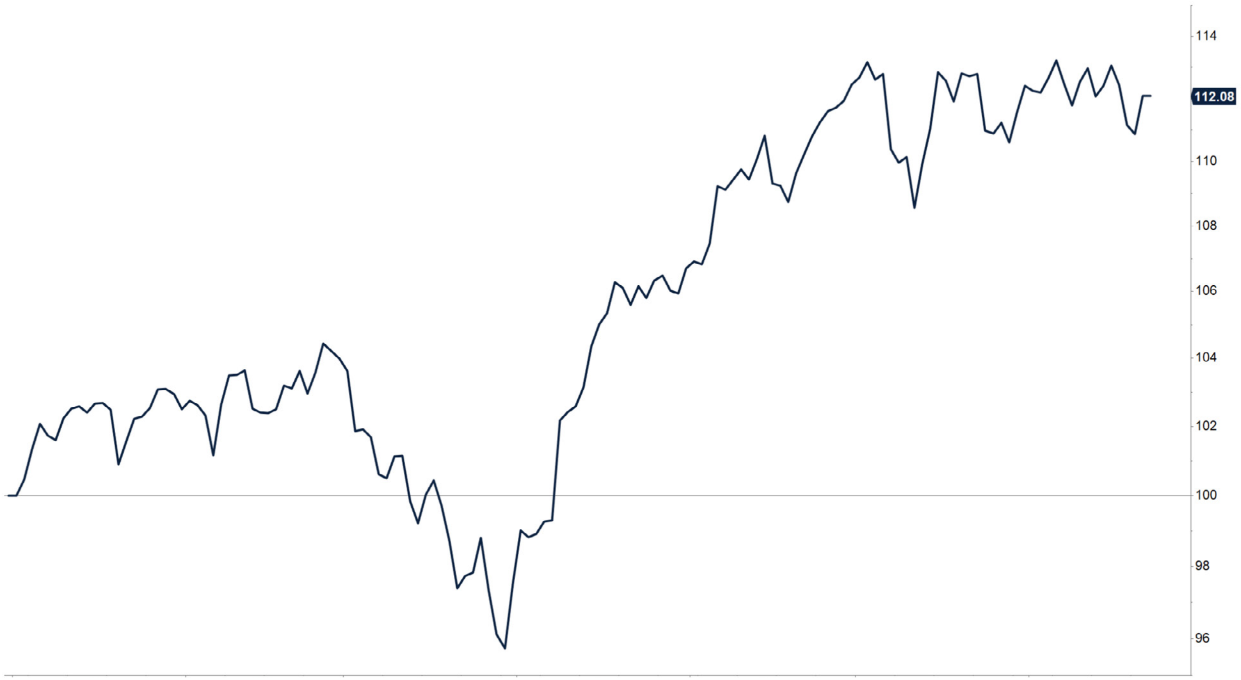
This calibration reflects the strength of our evidence, not our feelings.

Conviction in action (and inaction)

This year offers a case study in the virtues of conviction in an uncertain world. The US military action in Iran at the end of June triggered an immediate knee-jerk reaction on the oil markets. Fear of a global economic downturn spread, and stock markets worldwide sold off.

Over time, substitutes were found, supply chains adjusted, and markets moved on. Geopolitics muddled forward in its usual messy way. And share prices regained their lost ground before climbing to new record highs.

MSCI AC WORLD INDEX HIT NEW HIGHS

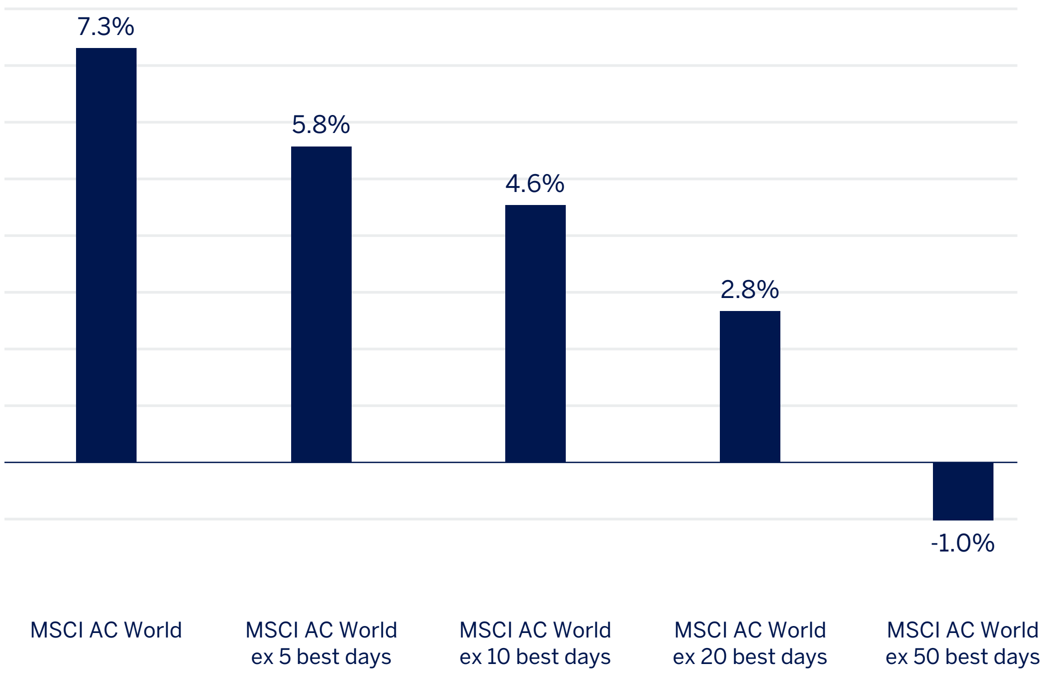


Source: Melville Douglas, FactSet

Time and again, markets find solutions. That is why the costliest mistake in volatile markets is often flight rather than fortitude. The chart below reminds us that attempts to time markets - particularly selling into periods of stress - often occur at precisely the wrong moments. The best days were often during crises, such as the global financial crisis of 2008/09, COVID-19 and last year's tariffs. Over the past 25 years, avoiding the 10 best days would have slashed your average annual return from 7.3% to 4.6%.

Our commitment remains unchanged: invest in a diversified but high-conviction portfolio of the world's strongest franchises, capable of weathering volatility while compounding returns attractively over the long term.

ANNUALISED TOTAL RETURN SINCE BEGINNING OF 2001



Sources: Bloomberg and Wells Fargo Investment Institute. Daily data: July 1, 1995 – June 30, 2025.

TOP 10 BEST DAYS SINCE 2001

Date	Return
12/10/08 (GFC)	+9.3%
24/03/20 (COVID)	+8.4%
28/10/08 (GFC)	+7.0%
24/11/08 (GFC)	+6.6%
19/09/08 (GFC)	+6.2%
08/12/08 (GFC)	+5.7%
09/04/25 (Tariffs)	+5.7%
06/04/20 (COVID)	+5.5%
13/03/20 (COVID)	+5.3%
10/03/09 (GFC)	+5.1%

To those who prepare

So, while risk is synonymous with uncertainty, it is also a reminder of one of the few guarantees in life: markets will have bad spells. And while we are all naturally gifted at predicting and avoiding risk in our daily lives, the analogous task for investors benefits less from agility and more from preparation.

Preparation is the foundation of conviction: the quiet product of knowing what we own, why we own it, and what it can endure. That way, risk management is not purely defensive. It is about withstanding tough times and benefiting from the good ones. The difficult times are guaranteed, but good times favour those who are ready for them.

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