Stock picking matters: Kanko, Jenkins

Mark Noble / November 25, 2009

There really is such a thing as talent and expertise in stock selection, and the two principal partners of Black Creek Investment Management are out to prove it. When star fund manager, Bill Kanko left Trimark back in 2004, he could have gone anywhere. He was and remains one of the industry's best-known stock pickers, having led mandates, both small and gigantic, to stellar returns over more than two decades of fund management.

Instead, Kanko opted to go it alone, launching Black Creek shortly after he left Trimark. Kanko explains he didn't want to be burdened by the marketing driven culture of many of the country's largest investment firms. He wanted to do what he does best: manage money.

Last year, Richard Jenkins, a former colleague of Kanko's at Trimark, joined the firm and the two managers oversee the flagship equity mandates for Harford Investments.

While Kanko and Jenkins tend to have concentrated portfolios of global large-cap names with long-term investment horizons, their short-term performance over the last year, has turned heads.

According to Morningstar Canada, Kanko's Hartford Global Leaders Fund is up more than 20% on the year and for a large portion of the year it's been the best performing global equity fund in Canada. On the Hartford International Equity Fund, Jenkins is up 33.1% on the year.

Kanko and Jenkins say they're not doing anything different; they're just implementing the system of disciplined stock picking they learned at the feet of fund luminaries such as Robert Krembil at Trimark, which they have been using for more than two decades.

What's different, they tell Advisor Group, is many fund companies in Canada have abandoned a commitment to disciplined stock pickers. There is no longer a willingness to stick with managers through thick and thin and see a long-term investment process through.

How did the creation of Black Creek Investment Management come about?

Bill Kanko: Right from the early days, and the reason that Black Creek ended up being a sub-advisory, we wanted to create first and foremost an investment management shop; not an asset gathering shop, not a mutual fund distributor. The focus has to be on investment management where we are really selling our capabilities in global equity management.

Richard Jenkins: If you study the industry and the way it's progressing in Canada, certainly on the distribution side, scale and cost-effectiveness are becoming very important. That means you need to have organizations with deep pockets, which have scale. I don't think investment managers are all about scale or at all about deep pockets. The game is about investment management, which is about ideas.

For us, its important that employees of the firm have their investment dollars invested in the funds managed either directly in our own product, or through the Hartford products.

How many managers and analysts do you have on your team?

Jenkins: Personally we don't like to use the term analysts. We think of all of us as managers. To be a portfolio manager you need to be analyst to understand all these companies that you're invested in. Bill and I are doing the same thing we did 20 some years ago when we started — we come into work and study companies. We are three people and we've hired a fourth. We have a person to run the business side to make us money.

We think that's a good enough team to help us cover stocks globally. I remember when I started at Trimark we had four people on the equity side. We were managing $15 billion at the time. That was good and we delivered good results and so we feel comfortable with our size today.

As managers you both have such strong personal brands, so you probably could have chosen to work with any distributor. Why did you choose Hartford?

Kanko: When I was just setting up Black Creek, I was really trying to determine whether the world needed another mutual fund company. The economics of the business has changed dramatically from ten years ago. You couldn't go out with one manager and one fund and make a go of it. Every mutual fund company has to have a core selection of funds. You have to have a number of managers. The scale required to be in the mutual fund business is dramatically different from 10 or 20 years ago. Quite honestly I didn't have the wherewithal to make that happen.

I ruled out going with one of the bigger mutual fund companies because I didn't want to manage two to three billion at five to ten basis points.

I want to help something grow over twenty years. While it's a huge opportunity cost in the short-run, 10 to 20 years out there will be a huge amount of satisfaction.

Jenkins: With Hartford specifically, they have used this distribution model very successfully in the United States, a model of third party managers on the equity side. It's a long term model and they helped build some very successful firms there.

We think they bring to the relationship a number of skills, product and product design, perhaps that will include products on the insurance side in the future. It is helpful to work with a firm in understanding what works and what doesn't work on the insurance side.

Were you both mentored by Trimark founder Robert (Bob) Krembil? As a result do you both employ the same investment style?

Kanko: Yes, but it wasn't just Bob. I was also mentored by his former partner from a long time ago, Russell Morrison. I've learned equally from Krembil and Morrison as my mentors over a long period of time.

Jenkins: Same for me. Both those men were very kind in helping us learn about investing.

Could you explain this investment style and what makes it successful in your view?

Jenkins: To some degree the philosophy is constant but the environment around us is changing in a rapid way. There is a huge universe of companies. It's impossible for everyone to know everything about each one. Therefore, you build a diversified portfolio of 20 to 25 names. You have an idea on each name and why you think it's undervalued in the long-term. You work really hard to come up with the next idea to replace your least preferred name. That means over time we can look at more growth-oriented or value-oriented companies, sometimes we look contrarian. The fund may look like many different things.

In all of those cases, that's actually the function of the world we live in, rather than the investment philosophy. If the world collapses like it did last year, we can find more growth-oriented companies at inexpensive prices. If the world gets more expensive, like 2006 and 2007 or 1996 and 1997, that means will probably look at more value-oriented or conservative companies.

It's really a question of where do we find the idea that we think is dramatically undervalued in the long-term.

How do you determine the idea? Do you have a top-down macro view and then apply a bottom-up selection of stocks? When you're looking for an investment idea what's the first step of where to go look?

Kanko: For me there is no first indicator. What we do is a process. We do the same thing day in and day out. Presumably we've built up a knowledge base over time there are areas where we know things and other areas where we don't know anything and we continually trying to learn about different businesses and companies. It's really a follow your nose process — ideas come out in a bunch of different ways.

Sometimes an idea comes from re-reading a report. Sometimes it's visiting a company or going to a conference. Sometimes it's reading a book. Sometimes it's listening to a presentation. The genesis of an idea is really putting together bits of information to have a view of a company that is different from what other investors are saying. That information may be something that is current, or it may be something you noticed from five years ago.

It's not a top-down screening process. It's bottom-up in the sense that we're looking at individual companies. As part of that knowledge base, we do know certain things about the way the economy works or doesn't work, the way technology effects us, things like demographics plays a part in a knowledge base. It's not all strictly bottom-up, because you have to have a view of those things.

Jenkins: There's really two components of this. There's the analytical side which is how to I value a company: what's its competitive position, how do they add value, those sorts of things. If you're looking at a certain part of the world, you need to understand economics, politics, and demographics of countries.

Kanko: Our tagline, which were hoping to trademark any day, is "Unique insights, proprietary ideas." We're trying to find things about a company that are going to make that company profitable in the future to the surprise of other investors. Everything we do rests on judgment because there is no right answer.

How do filter a global universe of stocks down to 20 names? How long does it take before you have conviction in an idea?

Jenkins: In some cases it takes me a month, and in the longest case, it took me ten years. You're trying to judge the business, the management and the price. Frankly price is the easiest one to understand. Your assumptions about the future have to be different to what everyone else is thinking and that relates to your view on the future of the business. With the idea that took me ten years to execute, management issues were the case.

Decisions to buy can be done quickly. Sometimes you have long-term thesis on the company but the price is not right. When the price comes down, away you go. That happened a fair amount last year with a number of companies we had a long-term idea on. Prices came down to where we wanted them to be and we moved quickly.

Kanko: There are probably 50,000 or so public companies. There are investment management firms that are in the screening process. They are looking at companies that have P/E of 11 times or less, etc. You can do the numbers. At the end of the day any computer can do that.

Even with an army of people, you're not going to be able to know everything about everything. We flip the investment process upside down and say, let's find 20 good investment ideas. Then, let's work to find the next one. It becomes a very manageable process if you view it in those terms. You're not going to own 20 of the next Microsofts and Googles. You're not going to have the 20 best ideas in the world, but what you can do is have 20 good ideas.

There are mutual funds out there that employ an army of analysts and say they are doing unique stock picking, but in the end they end up being very correlated to their underlying benchmark. Why do you think that is?

Jenkins: It isn't just mutual funds. When a market is that is going up and up for a number of years, people get extremely focused, — and rightfully so — on tracking error. The reason for that is if you look different, you look out of place. Psychology comes into play because underperforming or looking quite different is a negative.

Perhaps our personality and pedigree suggests that we know that underperformance is part of it, we're focusing on trying to have the best numbers over the next ten years. It's a different focus.

A number of other firms have become this way, they have become supermarkets, their incentive systems are incredibly short-term.

Kanko: Size is an issue as well. There are diseconomies of scale in this business. A firm reaches a size where overall it becomes much more difficult to beat the indices because of size.

Jenkins: Human beings that are part of organizations that make decisions by committee will often settle for the least common denominator. Ideas that are generated are not ones that are brilliant but are ideas that generally everybody agrees upon and are quantitative.

We have tried to come up with a way where individuals are making decisions but they are not alone. The culture and structure of our firm allows people to make individual decisions, but they have partners working with them that are serving their best interests by questioning what they are doing.

Is there a point where you'll abandon an investment idea on stock selection?

Jenkins: We write out the ideas here of why we own a stock. We write out what the opportunities are, what the threats are. That's so all of our partners know what the idea is. Then, we run the analytical metrics. One of the reasons we do that is because as time goes by, we can go back and revisit why we own a certain company.

As the business strategy changes, as management changes, we can honestly assess that it's not happening. As Bill mentioned earlier, this is about judgment. There is no proof that our decisions are right or wrong until well after we make them.

More often than not, we find something leaves our portfolio because all of the analysts start talking about an idea that we had and the share price has moved, outperformed to such a degree that we can sell it at a good price.

Why do you think your investment style held up so well in this last year?

Jenkins: If you look back at 2008, it was very good year for us even though our numbers were negative. That suggests the process wasn't just about one year. Going into the downturn, the only opportunities that were presenting themselves were pretty large and dull companies that were just cheap.

Midway through last year, when the recession took hold and stocks really got cheap, we could see a lot of opportunity in the businesses we wanted to own. In some cases, these were stocks we wanted to buy for more than ten years, but the prices were too high. We were ready to act.

Bill and I had managed through a number of crises. We have a fair amount of experience, we could understand, that even though last year was different from other crises, we knew there were certain things you needed to do to have good performance on the other side.

Kanko: Both Richard and I have had periods where we tend to lag and periods where we outperform, but it is really only over time that you can demonstrate value added. That's really over a long period of time — as Richard said, ten years is what we're striving for. You can't manage the numbers on any one year basis. Our process is that we try to be consistent in that process so changes happen on the portfolio based on what we do.

Of the 21 names in the Global Leaders Fund, 11 of them are new for this year. We did make a lot of change in the fourth quarter of 2008 and first quarter of 2009 and we got fully invested through the springtime when headlines were the worst. Maybe some of our competitors got spooked or scared — who knows? We followed our convictions and it is what it is.

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