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PUT ALL YOUR EGGS IN THE ONE BASKET

Everyone has heard the old saying that you should not put all your eggs in the one basket. From the start of my career in AIB this rule has been central to my investment philosophy and I have recommended it to everyone I know. The one thing it does not do however is tell you how many baskets you need to implement the rule. Should I put my eggs in two or three or ten or fifty baskets?

In the world of investment the saying will often mean spreading your investments across a number of different types of assets. Traditionally this meant having equities, government bonds, property and cash but in recent years this has increasingly included hedge funds, private equity, venture capital and commodities.

This rule, however can apply equally within an asset class like equities.

In my personal equity investments I have tended to have 5% as the maximum I invest in any one company at the initial purchase stage. This means that I should have at least 20 shares in my portfolio and in practice it has been a fair few more than this.

I have also tried to make sure that these shares are not concentrated in the one sector or the one country. In other words I keep lots of different eggs in different baskets! I would even go as far as saying that I was particularly pleased when I came across a new share in a different sector or a different geography because I felt that this was potentially putting a different egg in a new basket.

I have to admit that there was no scientific basis for my 5% rule. It was just one of those things based on gut instinct. I know there are limits to the number of shares I can follow properly but I am quite comfortable with the idea that I can easily follow a minimum of 20 with a 5% weighting each.

In recent weeks I have begun to wonder whether I should reconsider this 5% rule. I have begun to wonder whether I should increase it and I am not sure what the new upper limit should be.

The reason why I am going through this thought process is because I have been reflecting on the historic approach taken by my favourite investor Warren Buffett. In the book about his life “The Snowball” I have read about his willingness in the early days to invest heavily in a small number of shares in a narrow number of sectors and generally confined to the United States. He certainly kept a few large eggs in a small number of baskets!

In his 1965 year end newsletter he talked about a new “ground rule” that would allow him to invest as much as 40% in a single holding. He said that it would only be in exceptional circumstances that he would go that far but he did mention that he had regularly gone over 25% and in fact there were two holdings over 25% at the end of 1965. (Once again I would highly recommend reading his whole section on diversification which starts on page 9 at the following web address: http://www.ticonline.com/buffett.partner.letters/1966.01.20.pdf)

Reducing diversification in my portfolio is quite a big step to take and I do not think that I am as brave as Buffett. Even with a 5% maximum weight I have seen my portfolio perform in a materially different way to the world index. (See the 2009 performance section at the end). My instinct tells me that I should not do anything dramatic. I am therefore inclined to put a 10% maximum as part of my new ground rules and I am not even sure if I will use my newly created flexibility. I have started buying a position in a company that I think Buffett would be proud of but I am determined to be disciplined on price. I have put almost 2% of the portfolio into this position and I have a limit order on to buy more. If the price falls I might ultimately bring it up to a 10% weighting so watch this space!

MORE ON MAXIM-ISING THE IRISH ECONOMY

Last month I wrote about Maxim Integrated Products setting up a new support services centre in Dublin. I was interested to see the following in the Irish Times on January 28th:

TECH SHORTS: *Maxim Integrated Products, the Silicon Valley electronics firm that plans to create 100 jobs at an international business centre in Dublin, says it is making good progress in hiring its first staff and has been impressed at the quality of people available.*

"There's an incredible talent pool here and I've been very impressed with the people I've talked to and met," said Matt Murphy, Maxim's global vice president of sales. "It's an extremely educated workforce here – the percentage of the population with advanced degrees is unparalleled in any of the other countries we looked at."

He said Maxim was impressed at the level of support it received from IDA Ireland and the Government and had no concerns about the cost of doing business here.

I was particularly interested in the final comment that he "*had no concerns about the cost of doing business here".* This suggests to me that market forces have salary levels at a point where Maxim will find Ireland a profitable location to locate. Others will hear of their experience and will ultimately follow. It strengthens my conviction that there is light at the end of the tunnel! (Even if it is a particularly long tunnel).

PERFORMANCE 2009

In 2009 my fund increased in value by 47.4% and the world index increased by 26.5%. A good year!
The two year track record is as follows:

	Fund %	Index %
2008	-41.2	-39.7
2009	47.4	26.5

I think I have got the message across that I have no idea what the market will do from year to year and the last two years sure have proven that. My philosophical position is based on the idea that in the long run the world economy will grow and I will be able to find companies that benefit from that. I hope that I will be able to generate positive returns that beat the index and show that I can add some value.
Last year I joked that I hoped to give Warren Buffett a run for his money and the funny thing is that 2009 was good enough to suggest that it might not be a joke but having read “The Snowball” (referred to at the start of this opinion piece) I want to make it clear that I will not give Warren a real run for his money. I think that there are far fewer really cheap shares available today and the way my fund is structured with over 30 individual holdings and a couple of Exchange Traded Funds (like my Japan index ETF) means that a performance like last year is very unlikely to happen again in 2010. Even if I do increase my position size to a maximum of 10% I believe that a return of a few percentage points more than the world index would be doing a good job.
I will keep you informed as to how I am getting on.