



# Fisher Funds

## Investor Education Centre

*Making investing enjoyable, understandable  
and profitable...*

### Circle of Competence

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We have just finished our annual investor roadshow where we had the opportunity to talk to thousands of investors and compare views on markets and stocks. We enjoyed talking about companies we own, but sometimes investors were surprised that we didn't have a view on certain stocks or certain markets.

The reason for this is that we like to remain within our circle of competence.

A long time ago, Warren Buffett commented that "You don't have to be an expert on every company, or even many. You only have to be able to evaluate companies within your circle of competence. The size of that circle is not very important; knowing its boundaries, however, is vital."

I very much agree with this philosophy.

I believe that you have to truly understand a business if you are to invest in it. You need to know what it is worth and what it is capable of becoming. If you can't understand it enough to value it, how will you know when it is time to sell or buy more?

There has to be a buyer for every seller in a share market transaction. One investor has to believe a stock is worth selling at a certain price, and another investor must believe it is worth buying.

I don't mind having a different view on a stock than other investors, but my view needs to be based on a thorough understanding. I don't want to be on the wrong side of a transaction because the other investor knew more than me, and caught me out.

This is why I have typically avoided investing in complex companies, or businesses where I just can't see what makes it better than competing companies.

Similarly if a company's future profitability is impossible to predict because it is out of the company's hands, I put it in the 'too hard' category and avoid it.

We had a handful of roadshow attendees ask us why we hadn't invested in resources stocks in Australia. The answer is simple – they are completely outside our circle of competence, and, we would argue, the circle of competence for a lot of investors.

Resources stocks are essentially businesses that dig something out of the ground and then sell it on a world market at whatever the prevailing price is. While buying shares in an oil company when the oil price is rising seems a pretty easy thing to do (even for a relatively incompetent investor) it is not always that straightforward.

You can't know in advance when the oil price might turn the other way, leaving your oil company shares worth a whole lot less than you paid for them.

To really understand resource companies, you need to understand commodity price trends, global demographics, currency hedging strategies, mineral extraction technologies, political regimes, and geology.

As Buffett says, a circle of competence need not be large. I am comfortable to sit in my circle where I know more about my investments than any other investor.

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