Patient Investing – Theory and Practice

Patience is a psychological trait common to many of the greatest investors. It can broadly be defined as the capacity to accept and tolerate delay, trouble or suffering without getting angry or upset. In a recent video interview, Monish Pabrai, a U.S.-based investor with an excellent track record, said patience is the number one trait for an investor who wants to outperform the market. He contrasted patience, which involves a comfort level with long periods of inactivity, with having a bias towards action. The patient investor should act in a meaningful way only when investments are widely mispriced, according to his method. Pabrai's useful comments address patience when searching for new investments, but patience is also required when managing existing investments.

Famous investor Warren Buffett has stated that his favorite period of time to hold a company's stock is forever. However, practically speaking, most investors lack the analytical skills of Buffett, and an indefinite hold period is only desirable if the company under consideration has a strong and enduring business. This is well illustrated by an anecdote in Stephen Jarislowsky's 2005 book *The Investment Zoo*. Jarislowsky, a Canadian billionaire, invested $2,000 in three different companies and held them for 50 years. Reynolds Metals, a cyclical aluminum producer, had its ups and downs and gave him a relatively modest return. United Airlines, a U.S.-based commercial airline, gave him a more profitable but rocky ride, as it faced significant industry competition and sometimes ran at a loss.

The third company, U.S.-based healthcare company Abbott Laboratories (NYSE:ABT), delivered exceptional returns, as his initial $2,000 investment compounded into $1 million. Jarislowsky attributes this result to patience and keeping an eye on the fundamentals rather than luck. Extreme long-term patience works best when the companies are largely non-cyclical and can compound gains on top of gains, year after year. Abbott is a perfect example, as the demand for its wide array of products such as pharmaceuticals, nutritional supplements and medical devices has been steady over time.

There is still room to invest in cyclical companies, but long-term patience may yield disappointing returns if they are not sold at industry peaks. One simple reason why long-term patience can yield exceptional results is tax minimization. If we compare two investors with taxable accounts and the same annual returns over the long run, the investor who triggers fewer taxable events will finish with greater wealth. Also, transaction costs will reduce the returns of less patient investors. It is not surprising that patience contributes to investing success.

Patience involves delayed gratification, which has been linked to positive outcomes in other areas of life, including academics and physical health. Interestingly, people often learn to be more patient as they age. While working on this article, we came across a good quote from a British novelist – "It is very strange that the years teach us patience - that the shorter our time, the greater our capacity for waiting." Based on our own experience, this is true, as we are more patient as investors than we were a decade ago, and it has served us well.

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