WE ARE PLEASED TO START A SERIES OF MONTHLY ARTICLES TO SHARE OUR VIEWS ON GENERAL INVESTMENT MATTERS AND OUR OPINIONS ON THE EUROPEAN AND NORTH AMERICAN MARKETS.

HOW WE INVEST IN STOCKS

HOW SHOULD ONE THINK ABOUT INVESTING IN STOCKS? INTERESTINGLY, THIS QUESTION IS ALMOST NEVER ASKED. YOU GENERALLY SPEAK TO YOUR BANKER OR INVESTMENT ADVISOR, WHO WILL ADVISE POTENTIAL INVESTMENTS BASED ON...BASED ON WHAT, ACTUALLY?

SOMETIMES, it will be suggested that you invest in a range of companies to benefit from a potential trend, such as Artificial Intelligence or solar power, or any other trend that is currently making headlines. Sometimes, it will be based on geography. Ten years ago, pretty much everyone recommended you invest in China "because its economic growth is so much higher than in Europe or the US". Never mind that economic growth has zero correlation with equity performance (or that ownership of companies in China is murky at best), it's a pretty good sales pitch.

What is generally missing from these recommendations is a clear explanation of why a company could be a good investment. Stocks are generally lumped together in trends or geographies and that's that. The approach is clearly top-down and the actual stocks are almost an afterthought.

We at FFM, we approach investments in stocks in exactly the opposite way. We have one clear guiding line: since we live in a capitalist society, economic theory dictates that companies generating outsized profits will attract competition, which will then reduce these profit margins. And, most of the time, the theory holds. Only exceptional companies manage to maintain and grow these outsized profits over time.

That is why, of the about 55,000 companies listed on stock markets around the world, we believe only a handful (150 at best) are worthy of investment in their stocks. After all, as a stockholder, you are last in line when trouble hits. At worst, you lose 100% of your investment if a bankruptcy occurs. But even when a company doesn't go bankrupt, you will not be able to generate acceptable positive returns if the company just manages to survive. It has to thrive, and thrive over the long term, and that is incredibly hard to achieve.

To be able to measure a company's ability to thrive, we use a measure few others look at, the growth in Free Cash Flow per Share. Simply put, Free Cash Flow indicates the amount of cash generated each year that is free and clear of all internal or external obligations. In other words, it reflects cash that the company can safely invest or distribute to shareholders. If that indicator is

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not growing over time, then the company's share price will flatline or go down. Certainly, management and employees can do well, but shareholders will not. Share price follows Free Cash Flow per Share growth.

A good, actually bad, example is Swiss food and drinks giant Nestlé, a staple of many portfolios and funds across the world. No client will ever be mad that you invested in that company, but one can question if it is a good investment, as you can see here:

Since Nestlé's Free Cash Flow per Share (first bar chart; FCF/Share) has not done anything in the past five years, Nestlé's stock has done nothing either (second chart; Nestlé Equity Candle chart over a 5 year period). Unless that changes, Nestlé remains for us non-investable.