Sanjay Ayer - The Example of Self Awareness
The Business Brew

Sanjay Ayer is a Portfolio Manager & Business Analyst at WCM; which he joined WCM in 2007. His primary responsibilities are portfolio management and equity research for WCM's global, fundamental growth strategies. Since he began his investment career in 2002, Sanjay's experience includes a position as Equity Analyst at Morningstar, Inc. in Chicago.

In this episode Sanjay "stops by" The Business Brew to have a candid conversation about what really matters in investing. Sanjay has spent a lot of time thinking about group think, the power of enabling analysts/talent to develop itself, spending time on the signal vs. noise, and many more important investment topics.

Sanjay's "best" quality might be his modesty. He's clearly a very astute analyst and a clear thinker. However, he is incredibly humble, modest, and stresses the importance of self improvement. At one point Sanjay said "I think if we were to hire for one quality, it would probably be just a keen, keen self awareness."

Please listen to this episode. And by listen, we mean really internalize what Sanjay says here. There are definitely important takeaways in this one.

Thank you for being a guest Sanjay!

Sanjay graduated Phi Beta Kappa from Johns Hopkins University (Maryland) with a B.A. in Economics and B.S. in Applied Mathematics.

Bill: Ladies and gentlemen, welcome to The Business Brew. Thank you all so much for your support. I appreciate it. I'm really looking forward to dropping this episode with Sanjay today. Please remember that the securities identified and described throughout this podcast do not represent all of the securities, WCM purchased, sold, or recommended for client accounts. As a listener, you should not assume that an investment in the securities identified was or will be profitable. Please keep that in mind as you listen to Sanjay.

I can't say enough good things about Sanjay and his outlook at the world. I'm really excited to drop this episode, and I really hope that as an investor and as a person, this episode does something for you because Sanjay is clearly a very good thinker, and a very measured person. He remains incredibly humble and understands what we're all up against in the market and the fact that the great managers of today can be forgotten tomorrow. I just think that his humility is something that should be modeled by all and I think he's got some really interesting thoughts on the industry in general. So, I hope that you all benefit from the conversation. Again, I thank you so much for listening, and I'm going to keep doing these as long as you guys like them.

[The Business Brew theme]

Bill: Ladies and gentlemen, welcome to The Business Brew. I'm your host, Bill Brewster, joined by Sanjay Ayer from WCM. Sanjay is a portfolio manager. As always, none of this is investment advice. We're not your fiduciaries, we're not your investment advisors. You need to hire your own people for that. Nothing's a solicitation or invitation to buy or sell a security. You know the drill, so get your own advisor and do your own work. That's the number one thing because this is all entertainment. With that, Sanjay, how you doing?

Sanjay: Doing good, Bill. How are you? Congrats on the podcast.

Bill: Thank you. It's been fun. Sanjay is a referral from Shomik, so that's how we met, right?

Sanjay: That's right, Shomik. I've had the pleasure of meeting Shomik and Mike P, NonGaap.

Bill: Oh, yeah.

Sanjay: -in real life. I know you've had both on the podcast. I'm preaching to the converted, but great people, just killing at their craft. It's been fun. It's refreshing to see people like that in this industry who truly think about relationships, and it's not transactional. But yeah, that's how we met.

Bill: Yeah, well, the other referral is from Rishi. He's the person that’s stapled in my brain, wealth games, not status games. I know it's an evolved quote, but once he said it to me, it just stuck.

Sanjay: [chuckles]

Bill: Most of the guests that have been on the podcast, I feel really fortunate because I can say that my experience with all of them is exactly what you said. It's not transactional. These are all people that I built up relationships with or are referred to through people that I built relationships with. It's been fun to get to know the guest list. I look forward to a good conversation here.

Sanjay: Yeah, should be a blast.

Bill: I was listening to Mike Trigg. Did you come over with Mike? I was listening on the Capital Allocators Podcast.

Sanjay: Oh, yeah. My life is pretty much Mike Trigg delayed by one year. I just followed him wherever he went. I started at Morningstar in Chicago, him and I worked together for three and a half years, and then he moved out here. I did my own thing, ended up quitting business school, and then kept in contact with Mike and he said, “Yes, Sanjay **[unintelligible [00:03:51]** Laguna might be something here,” and being from Connecticut, Laguna Beach seem like a foreign country, but here we are, the rest is history.

Bill: [laughs] Yeah, where in Chicago did you live?

Sanjay: I moved around. I moved every year between high school, and when I recently bought a house here in California. Lincoln Park, Lakeview, downtown. I saw it all.

Bill: I was division in Clybourn and then I was on Mildred and Wrightwood, and then I went up to Wilmette for a while. Now, I find myself in Florida.

Sanjay: There you go.

Bill: How is the Morningstar experience? I know that Mike was saying that he liked it. You and him lamented that some of the way that they went about their business, maybe [unintelligible [00:04:34] misgrowth companies a little bit more than you guys would hope. Is that a fair characterization? Or, am I putting words in his mouth? I probably am.

Sanjay: No, I think at the time, that's true. I'm sure they've evolved. My sense is they have evolved since then. If you were to look across the industry and say, "Where would you want to start your career?" I think Morningstar does a phenomenal job giving you the right tools, at least a long-term mindset, at least a framework and competitive advantage. It's up to you to maybe take it and run with it in any direction you'd like. But I think they did have a bit of an issue with some of those tech companies and moats, but like all of us, we all evolve and get better.

Bill: Yeah, no doubt. I have now spoken to Todd Wenning. Was he there when you were there?

Sanjay: I don't think we overlapped, no.

Bill: Okay. You do know how they're brilliant though, yeah?

Sanjay: Yes.

Bill: Yeah. I'll be talking to her not too long and I have found everyone that has come out of Morningstar, like how there is a common lens that you all see the world through that, I think, is probably a pretty good training ground there.

Sanjay: Yeah, it's a pretty good training ground, sounds like a really good alumni network at this point. Lot of people have left and had success, and a lot of great people I still know there. I've even checked the market cap recently, but they've done great things.

Bill: They put out a good product. I find as a buy sider, it's a pretty good tear sheet to get just an overview on something.

Sanjay: Exactly.

Bill: I like their moat ratings more than the conclusions necessarily, but I like it to ramp up on where you may want to look.

Sanjay: Yeah, the framework is, I think, it's the right one versus being elsewhere, where you're absorbed with quarterly earnings and noise. I think it's a great place to definitely to start your career, but even beyond that.

Bill: One thing that Mike said that I thought was really interesting, did you come into WCM-- When did you arrive, had the assets bottomed out and you were on the side of coming back? Or were you part of the rethinking the process for lack of a better term?

Sanjay: It was the latter. It's funny, sometimes the less you know, the better off you are. When I joined, we were seeing poor performance, assets were declining, right in the midst of the most severe of the decline. But being young and naive, you just think, "Okay, just pick a couple good stocks. It just right the ship," but we were thrust into it. It was great. It's like Morningstar, you're given a lot of ownership and a lot of responsibility. It's up to you if you want to own it or not. Yeah, I came a year after Mike. So, I saw the dip, if you want to call it that, and the second act, if you will, which has been great.

Bill: I think objectively was a dip, but it sounds to me as though it got you all to a much better place on the back end of it.

Sanjay: No question.

Bill: Yeah, there was something that he said that really resonated with me. He said that there were three decisions, buying Dell versus Apple, Yahoo versus Google and eBay versus Amazon. Those are decisions that if either one of those had gone the other way, maybe there would be a different conversation. I think the reason that smacked me over the head is that's exactly the kind of mistakes that I made when I started to invest.

[laughter]

Bill: Oh, boy, is he talking to me? Or, what's going on?

Sanjay: Yeah, I know. I think a lot of people in that camp made that mistake. It was taking the value of a-- evaluation first approach to tech. I'm a big believer, I'm sure we'll talk about this, about learning from mistakes. Learning from other people's mistakes is great. In a way, there's nothing matches like viscerally learning from your own mistakes, making them, seeing the damage. Those will forever be etched in your mind. Yeah, I think it's funny. I think the industry, as a whole, doesn't really tolerate mistakes, but mistakes like that, if you can learn from them, and you get a chance to apply those learnings, the results can be pretty magical.

Bill: Yeah, I think something that I have learned is, if you are a little bit open, I'm on my own, so most of my learning is through Twitter and whatnot, because that's the community that I formed, if you're open with your mistakes, the amount of people that are there to help as long as you take down the veil of pomp, if I can call it anything else, there's a lot of really good people in this industry want to help. I don't know if whether or not the anonymous dynamic on Twitter helps with that because people are maybe a little bit more willing to share mistakes as opposed to put their professional reputation on the line. But I have found that rubbing my nose and mistakes publicly has been a pretty good thing for my learning.

I came into this, I owned fantastic compounders such as Cleveland-Cliffs. I liked Sears for a-- I mean, I never owned it, but I did research on it. Hertz when Icahn got involved, so I was really digging into the grungy stuff so to speak.

Sanjay: [chuckles] I love it.

Bill: I have morphed.

Sanjay: Yeah, a lot of us have. I feel like the sin of this industry is it doesn't allow talent to discover itself. A lot of people say there's no talent or is it skill? Is it luck? We could talk about that and have a fun conversation about that. But I think there is a lot of talent out there that’s just sabotaged by just some of the stuff that happens in industry. You mentioned pomp, I think that's definitely one of them.

Bill: Why don't we talk about whether or not it's skill or luck? Part of the issue is the trials are few and the resulting is easy. It's easy to look at people or firms that have had big years and you don't know, okay, is it for the right reason? Even myself, I had a pretty good year last year, I think I did a lot of things well, but I don't think I'm that good. It's hard to decipher how much is luck and how much is skill. How do you think about that?

Sanjay: Yeah, I think we all fall in the trap. If you want to learn about the profession or become great. We all study the big winners and look for commonalities among them and draw lessons from it. I think we all intuitively know. That's a pretty serious sample bias, right?

Bill: Yeah.

Sanjay: You're not talking all the quiet losers out there probably employed the same strategy and just for luck, or execution, or what have you, had different results. The quiet losers don't write books. I tell you what, I'm a big believer that we all underestimate the role of luck in all walks of life, but definitely investing. You know Peter Kaufman?

Bill: Yeah.

Sanjay: He's a friend of Charlie Munger. We've had the pleasure of meeting him a few times. His one of his many interesting ideas or concepts is, this notion that if you want to have success in life, in business, in anything, you'll make sure to positively spring load your starting conditions. I thought that phrase is interesting, positively spring load your starting conditions. My hunch is, if there is something that truly separates those big success stories from those who are less fortunate, it is that. There's something there where their starting conditions were such that when luck, when fortune went in their direction, they were able to see it, connect the dots, pounce on it, and in many cases, like build something durable on top of that.

While WCM had a lot of issues, when I look at us, and this predated me, I think there were a few things in place, a few starting conditions that were positively spring loaded in Kaufman's terms that gave us a chance to build something on top of it. I think that's an interesting framework he has.

Bill: Do you want to go through a little bit about the history? Your firm is so culture focused in the investments that you make, and my interpretation of what you went through internally is potentially why you put such an emphasis on the company's cultures that you're investing in. Is that fair?

Sanjay: Absolutely. I'll jump to the end. The question that I guess I'd ask you is what percentage of time, effort, bandwidth in this profession goes towards one of the following two things? Number one is minimizing career risk. Number two is trying to sound smart. If you just look around and really boil it down, what percentage is that? I'm going to tell [unintelligible [00:12:37] that's a pretty high number, right?

Bill: Yeah.

Sanjay: I'll give you a story, I think this might be a fun one. This is 10 years ago, December 2010. I'm in New York, Yum! Brands, when Yum! Brands [unintelligible [00:12:52] KFC, Pizza Hut, Taco Bell.

Bill: Oh, yeah. Yum! Brands China is an incredible brand.

Sanjay: I know. KFC--[crosstalk]

Bill: I used to [unintelligible [00:13:00] bang chicken companies, chicken producers. Through that, I got to studying Yum! China, and I never realized that in China, KFC is a heralded brand almost like Apple is. They really love KFC in China. I had no idea about that.

Sanjay: It's a luxury brand. It's not that's not far from it. I'd love to learn more about that, part of your life. Yeah, so Yum! Brands, KFC, Pizza Hut, Taco Bell, other core brands, I'm a huge fan of Taco Bell. My wife, she's a fanatic. Anytime we buy a house, one of the first filters is distance from the nearest Taco Bell.

Bill: [laughs] I live it.

Sanjay: [crosstalk] Anyhow, so we're at this analyst day, this is when WCM, we're not doing great, performance wise, [unintelligible [00:13:44] I've been hired in part to help that. We go through the analyst day, Pizza Hut, KFC present, then there's a break. I go to grab a drink of water, look at my phone, one of the stocks I pitched was down 40%, something like that after hours.

Bill: Oh, no.

Sanjay: It's bad, and so I'm just in a bad mood, just down on myself. I go back into this analyst day and Taco Bell management goes up and starts to present. They walk through their comps and their vision and all that. Then there's a moment where they go through their product promotions, their pipeline, and they start to put some promo, some commercials up there. I think it was like the new chalupa or gordita, I forget. They put that promo up there. It's a couple minute video. I find myself in the middle of it, taking notes about this new product. There's just a moment there, Bill, where I just stopped and I almost and an out-of-body experience, like looking at myself--

Bill: [laughs] What am I doing?

Sanjay: What is going on with my life? I look around, there's like, “What if an alien saw this?” All these smart people, we're in suits, with MBA, CFA, every three-letter credential you could have, doing something that we all know. Come on, even if this product’s a home run, it's like 2% of Taco Bell sales, which is 30% of Yum’s profits for one or two years. It's meaningless. If we're all caught in this trap, there can be moments like that that are epiphanies, lightbulb moments.

Bill: Yeah.

Sanjay: This was not that.

Bill: [laughs] This is despair.

Sanjay: This was a feeling of being a fraud. I was the person back then who can tell you, oh, why this was a waste of time. Hey, no [unintelligible [00:15:20] worries versus signal, all this fun stuff. It's like the guy who recommends everyone else to do meditation, but actually doesn't meditate. That's what I felt like. I was someone who was a fraud. I had a moment there. I called Mike Trigg and he talked me down. He's like, “All right, come back to Laguna.”

Bill: “Why don't you come back home? We'll talk to you. You're loved here.” [laughs]

Sanjay: Yeah, so this was like we call it now my midlife crisis.

Bill: Oh, this is your Taco Bell midlife crisis?

Sanjay: This is my Taco Bell midlife crisis. It led me to like a-- frankly, Bill, like a decade long journey. It's like peeling back the onion. Clearly, there's something about this profession, there's a gravitational pull going on, that had me despite knowing all of that still there. It led me to peeling, really just going back to peeling back the onion while doing my day job, figuring out, what's the root cause here of what's going on with this industry? Are there other industries like in--? The premise was, if I could find those root causes, those would be the most durable inefficiencies you could exploit. It's not philosophical, it's not process, because those could be arbitraged away over a long enough timeframe. If you can find those root cause issues, you could potentially exploit those for a long time. That's really one of the journeys I've been on.

Bill: What are some of your findings on the journey?

Sanjay: [chuckles] I think there are certain professions and investing is one of these where-- I think you mentioned this, process and outcome are really hard to disentangle. Frankly, talent's really hard to evaluate. There's a couple things at play, I think you mentioned one of them already, the feedback quality is poor. If you're a long-term investor, you have long feedback loops from when you make a decision, and when you get the feedback, you don't have that many trials, you're not trading that often, and there's lots of noise. If you just do the calculation of feedback quality, it ranks very poor. That's part of it. There's no defined playbook on how to do your job, so you're totally unconstrained. Really, the shortcut to finding these types of professions is, when you often hear success stories attributed to, he's got it or she's got the magic touch, and you see that in investing, you see it at film studios, like when Michael Eisner in his heyday, he just had the magic touch of green lighting the right movie, sports, like, general managers, he's or she's got the magic touch.

What happens, Bill, in these professions is because it's so unconstrained, and there's no playbook and there's no feedback quality, you get these just arbitrary unwritten rules that emerge to fill the vacuum. I think those rules are extremely counterproductive, and no one really bothers to unpack them. If you did, I think you'd realize there's not much validity behind them. Quickly, I think the two that jumped out to me are one is groupthink, and two is fixed mindset. It goes back to the question you asked at the beginning. If I was to boil down the industry's issues as a whole, it would be the industry succumbs to groupthink and it dramatically succumbs to fixed mindset. I don't think that does anyone any favors, and in fact, it suffocates talent that probably would have existed otherwise.

Bill: When you referring to groupthink, are you referring to making-- and I don't think they're necessarily mutually exclusive, or one means not the other. I'm just trying to get in your head for a second. Are you talking about analyzing a company together? Or, are you talking about we all find ourselves in a suit taking notes on the next gordita and no one says what the hell are we doing? In what way are you referring to groupthink?

Sanjay: It's all the above. It is benchmark hugging. It is how we go about our day-to-day job. It is trying to just do what everyone else is doing, information gathering, no original thought. Everyone roughly doing the same, philosophy the same process. It's all of that. Anywhere you look, I think, instance for you see groupthink at play, and I think a big reason why somewhat paradoxically, is there's no constraints. You might know this, there's a study that was done about playgrounds. If you have a playground with a fence around it, what happens? Kids go around and explore the edges and whatnot. If you take that fence out, everyone gathers around the middle, because it feels safe. I think that there's an analogy there to investing in that the fact that is so unconstrained and there's no constraints at play, no playbook, it actually causes everyone, ironically, behave the same, and no one to look different. Paul Black, our president, always says, “If you want different results, you definitionally have to do something different.” That's obviously an issue here.

Bill: I find today to be a very interesting day to be having this conversation. To timestamp it it's March 5th. Like I said, I consider my work family, FinTwit. Here, I see a lot of people are buying a lot of the same stocks. I guess one that is wringing out, I am not saying that this is a bad buy at all. That is not my point. Please don't get it misconstrued, people. But Costco is a name that is really coming across a lot of people's feeds, and a lot of people that I respect, and maybe it's a really good buy, maybe it isn't, I don't really know. But I find a couple things about that name interesting today. One, when it was going up, and it was at this price, I didn't see everybody pounding the table to buy it. In my head, I'm thinking, “Okay, well, how much of this is just anchoring to a higher price?” And how much of it is, “Well, this is pulling back a little bit, and now it feels cheaper to somebody and then somebody says, “I'm going to buy it.” Then people say, “Oh, maybe Costco is a good buy here.” To your point, a groupthink, social proof type thing going on in people's heads. Then, people are all long in a similar name. Knowing the ingredients of the gordita is how you show that you know more about the culture and methodology of innovation at Taco Bell, so that you can provide this really deep thesis on the gordita R&D spend and the returns.

I'm not trying to take shots at anybody at all. It's something that I think about a lot because I see it in myself to where it's like, “Okay, well, I'm on social media,” which is by definition, social. “How much of this is my network telling me something? How much of it is my own thinking?” It's hard to decouple those two things at times.

Sanjay: It is. We like Costco, we've owned it forever, so we can get to that point if you'd like. I do think your broader point is definitely very topical. It's funny, anytime we interview someone now, we ask one of the questions, I used to like to ask is, “How have you evolved as an investor?” Why I say used to is now we just you get the same answer. “I used to pay too much attention to valuation.” I always underestimated the total addressable market. I always overplayed tail risks. All mistakes people talk about is mistakes of omission. “I didn't buy this stock, and it went up 400%.” You have to be careful. It's conditioning from a market that's been one directional. If you're a human, that's the case. If you're an algorithm, and if you've been an algorithm born in the last decade, you've been trained that way, so when you get constant, one-directional feedback, yeah, I think you have to be careful about over extrapolation.

On the other hand, it's very valid to say there's no brownie points for creativity. We look at Visa, everyone owns it, and has owned it, and it's done very well, and continues to do well. There's lots of those paradoxes in investing that you have to think through.

Bill: How concentrated is your book, like how many names do you guys run?

Sanjay: 30 to 40 names.

Bill: Okay. Typically, equal weight or top heavy, or how does that go?

Sanjay: It depends on the market environment. I think there's sometimes where there's a smaller tail of interesting investments, so that might make sense to concentrate more, but if everything looks roughly comparable, we'll kind of gravitate towards equal weight.

Bill: Yeah, that makes sense to me. You're talking about conditioning, and I've been ruminating on some of Munger saying that he's like a very good buyer, but he's not a particularly good seller. The thought that I've been thinking about lately is, I think that maybe part of the reason is, if you take Visa for instance, when that was spun out, it was clearly a good business. Now, I was too dumb to see it or wasn't-- that was back when I was underwriting loans, so maybe I just wasn't-- I'd like to think I could see it, but that's totally not true. That's just overestimating my own abilities. But if somebody saw that the business would be much bigger down the road, then you could make that buy and ride the business growth, and that's your margin of safety. Then, when you're correct, the market is going to heap a larger multiple on it. In order to really allow capital to compound, you need to be comfort-- or, I need to be comfortable. I don't know, I shouldn't talk in you, but comfortable with the market assigning a multiple to a company that has now realized the vision that you underwrote, and maybe you wouldn't pay your underwritten realized vision multiple, but that doesn't mean it's not worth it. That doesn't mean it's a sell at that point. It's just at that point, you've really won, so why truncate your wins? I think that's maybe how Buffett and Munger think about that. I'm not sure, but that's what I've been thinking through in my head.

Sanjay: Yeah, I think that's right. I think it's a balance. The worst thing you could be is engaged in false precision, thinking the exact right price to pay for a stock or the exact intrinsic value. You do have to have some framework, if things do get crazy, at least, you might not want to sell a name, but maybe you trim it or manage position sizes accordingly. Again, I think a lot of it's also timeframe. People, and maybe social media hurts this, but one of the ironies of investing, I think, is if you're trying to make money all the time, you're less likely to make money over time. If you're trying to time every cycle and get in and out, I just think the more decisions you make, the more room there is for error. I think you have to balance that when you're thinking about valuations. I know it's lots of debate about value growth today.

Bill: Yeah, well, that's always more fun for the headlines than it is in reality, right?

Sanjay: I think so. Yeah.

Bill: Have you been influenced at all by marathon the way those guys think, like capital cycle theory?

Sanjay: Yeah, I think one of the better books on investing. It's funny, I don't know, what do you think but all the great books about investing are traditionally value investing books. I think that's everyone's been taught that way. As a result, I think value investing has, and again, some of these lines, I think, are totally the people draw the lines to bright, in the end, growth is a component of value, I think. You and I probably agree on that. Value has been steeped in this intellectual discipline. You're exploiting mean reversion, recency bias, time arbitrage, that makes sense. Whereas growth, I think, means a lot of different things to a lot of different people. [crosstalk] use overpaying blindly for good companies. I think when the books are written on growth investing, it'll be understood that at least the quality growth, the stuff we do. You're exploiting just a different set of biases, it's anchoring, it's career risk to some extent, it's change blindness.

Bill: Do you mind expanding on that? I'm not sure that I understand how-- so if you're saying anchoring, are you saying that people are anchoring to older valuations or how big businesses used to be able to get and now the rules are slightly different? Is that where you're going with that?

Sanjay: It's part that, but it's just part how people model companies. If you're in 2007, and Amazon-- I don't know, I forget the numbers. Let's say they're growing 25% and you go to your boss, your PM, you're an analyst, junior analysts. "You know what, 2019, I think Amazon's still going to be growing 25%." You're going to be laughed out of the room, right?

Bill: [laughs] You're going to be get kicked out of the room.

Sanjay: Yeah, you're done. We call it extrapolating [unintelligible [00:27:10], you take recent results, and it's very hard to have an imagination that doesn't-- it's almost intrinsically motivated to model out in detail for a few years and then fade it. It's hard to say, 5 years, 10 years, 15 years, what's the growth look like? Obviously, most of the value is in that tail that you're just arbitrarily fading away. I think that notion of anchoring has created an inefficiency for growth investors. Now, of course, I can cut both ways. At some point in time, like imagination, you could argue. In some pockets of the market is probably gone from undervalued traits and overvalued trait, people might be overimagining things in certain pockets of the market. I think that's just decomposing some of those behavioral issues or biases and understanding where the market is, is probably more productive than some of the discussions you hear out there.

Bill: Yeah, I think that to your point on how it gets tough to figure out whether or not the outcome is the result of good process or just the result of playing in the right pond or whatever. With growth, investing, as I perceive it, a lot of the value is in terminal value. By definition, if rates were to come down, you would think terminal values would go up, all else equal. So, before I opened my eyes and listen to what people were trying to hit me over the head with a hammer for years I should have listened to earlier, I somewhat discounted that. I discounted people's results, because I viewed it as somewhat an interest rate outcome, which was wrong of me to do, but that's what I did. Then, two, I also think that I was so fearful of terminal value that I actually let myself get intrigued by near term cash flows, and totally discounted the terminal value risk that the near-term cash flow multiple implied. I think that that's probably why when Mike said those three businesses that were classic tech value, that's where I think I had flashbacks-- [crosstalk]

Sanjay: Yeah, the risk when you're modeling decline, especially in technology is you tend to think linearly. If a company grew 5%, you say, okay, it's going to be tough. It's like three negative one. It's never like that. It's three negative 20, negative 40. You're going to always overestimate that decline or underestimate that decline, again, because of the anchoring dynamic, especially in markets where there's feedback loops and network effects and such.

Bill: Do you think that some of that also has to do with the business starts to unravel and then the morale within the company starts to unravel, too? I'm thinking through just the cultural lens that you look through the world at. Trying to turn around a shrinking entity is not a very fun thing to do.

Sanjay: Yeah, it can spiral. I think you have to know-- this is the tricky part, how much of a company's culture is a function of performance. This is like the halo effect idea. If a company's doing well, it tends to be described as having a good culture. People are getting the cause and effect in the wrong direction in many cases. I think you have to be able to detach cultures that are purely a function of [unintelligible

[00:30:15] culture in that case, mindset that it's a function of a company being at the right place at the right time, versus something that's truly at the core of its DNA.

Bill: When you're meeting with management teams, has it gotten to the point that your firm rap precedes the meeting to the point that you can say like, "Look, this is what we're really focused on. We want to come in and have a culture discussion?" How do you make sure that management teams aren't almost prepped for the questions that you're going to be asking? You know what I mean?

Sanjay: Yeah.

Bill: You guys are well known now. I would think it's-- on one hand management teams would welcome the conversations that you want to have. On the other, they may know how to sell to you a little bit better than they used to.

Sanjay: Yeah, that's a fair point. There's a balance there. Yeah, a lot of companies do ask us for the questions we're going to ask. With some companies, we were comfortable, enough with them that we know we can read through the lines and understand if they just read off a script or not. Whereas others, you'll maybe want to be a little more cautious on sharing those questions. It's a mixed bag, I do think there is an art to it. There is what the answer to the question is, but there's also an art of just reading the answers and reading between the lines as far as what's behind it and answering the follow-up questions to that, that gives you a sense if there's meat underneath it, or it's more fluff.

Bill: Have you found COVID makes it more difficult? I would assume being-- Do you find face to face is helpful to read body language and ask follow-ups and things of that nature?

Sanjay: No question. There's subtle cues, all of this culture is a soft thing, and being on the company's headquarters walking around and seeing how people are looking when the CEO walks by. I mean, there's just lots and lots of subtle cues that you can't replicate over Zoom.

Bill: That's cool. Do you ever do stuff with body language, psychology studying, and stuff like that?

Sanjay: We've tested it out. Yeah. We've had a few firms come by and tell us things and it's always funny because it's like something I'm doing like [unintelligible [00:32:12] steeple clothes which shows I'm defensive. I've been defensive my whole life, I guess.

Bill: [laughs] This is how I talk to my family. What do you mean?

Sanjay: No wonder my wife's mad at me. You said our brand is well known and whatnot, we're still in the second inning as far as understanding culture. I think we've come a long way and we have a playbook. I think maybe relative to others, we have a head start, but there's still so much to do and so much to learn.

Bill: Something that I think is really cool about the letter that you sent me about the WCM platform is, you said that you've disrupted the industry by flouting the unwritten rules, do you find that within your firm-- I got to think it's a point of pride and how you go about your business and how the embracing of a mistake, not the encouragement of a mistake, right? To treat a mistake as a learning opportunity, I would have to think results in much better retention and camaraderie, and ultimately sustainable, I guess, cultural edge, right?

Sanjay: I'd like to think so. Now I look back, disrupting the industry is probably a strong word. I do think it's something we pride ourselves on. Effectively, when I say platform, what I'm referring to is you're taking groupthink and fixed mindset, which are kind of the inefficiencies of the industry and flipping them on their head and saying, “Let's think different and get better.” Those are the core values of the research team, thinking different and getting better. I think it stands out in the industry. Especially the fixed mindset, it's funny when you bring people in from other firms who've had experience and they come to a meeting, Mike, or myself, or Pete Hunkel, one of the PMs, so we're just talking about mistakes. Lots of vulnerability, and just talking about the mistake we made and what we learned from it. it's like, “Well, that wouldn't have happened elsewhere.” To me, it's just dismantling a lot of the theater. You said pomp, and it's a great word. It's not about trying to show other people you're smart. Let's try to get better. I'd like to say that our team that if you're not cringing at the work you did five years ago, you're probably not getting better. That's a good little acid test to go see what is your improvement in reality.

Bill: Do you measure that day to day, week to week, or is it just quarterly reviews? How do you measure progress in that realm? Because it is soft, how are you getting better is a soft question, but it's evident from listening to you and Mike, and it's Paul, right? Paul Black. It's evident that it's an ethos that clearly works over there. I'm just curious how you make sure that it's actually occurring.

Sanjay: Yeah, it's hard. You need a culture and you need some system because as I mentioned at the Taco Bell anecdote, that pull towards like busyness, expiring knowledge as Morgan Housel puts it, that's gravitational. If you don't have checks and balances in culture, that's going to be your endpoint. It's being like everyone else and having a fixed mindset. Here, we talked about constraints, I think you have to have some artificial constraints. We have a-- twice a year, we do a reflection week, everyone's got to turn up the screens, turn off the quotes, turn off the news flow and just reflect. We had this concept internally, we call return on time, which is basically-- it sounds so simple. It's like, are you spending your time wisely? It sounds simple, but in this industry is deceptively hard for a lot of the reasons we talked about, the feedback quality and whatnot. Yeah, I'm a big believer-- I don’t know who it was, Michael Lewis, or maybe Kahneman, when their quote was like, “People waste years of their lives, because they're not willing to waste hours.” I think that reflection week, auditing your return on time, how did you spend the last six months of your time? Did you get better? Did you think different? Show me examples of that. That's the best way to make sure that we maintain that spirit because as you grow, as you scale, I think there is a potential regression to the mean on some of those friends. You have to stay on top of that, we have to set the tone from the top down about showing mistakes and showing vulnerability, and staying humble, but I think you also need some sort of system.

Bill: Do the analysts get to weigh in on whether or not you've grown?

Sanjay: Oh, yeah.

Bill: So, it's like a 360 process?

Sanjay: Yeah, it's a pretty collaborative team. I think we try to as much as we can try to keep it flat, hierarchy, and have people call out analysts, PM, distinctions hopefully are less relevant as they are maybe potentially other firms.

Bill: That's cool. Does somebody come in, or how did you come up with this idea?

Sanjay: Oh, it's just a lot of iteration and testing. I drive people crazy, because I'm just going to test things and experiment and lot of them don't work. I'm not sensitive enough to disrupting people's workflows with experiments, but it's just the basic mindset of getting better, and how do you do that. I think if you want to get better, you have to have a mindset of reflecting, doing postmortems on your investment decisions, or your noninvestment decisions. And just having obviously a trust level, that's where the culture comes in. Having a trust level where people can separate the idea from the person. It's not an insult when you say like, “Hey, that was a mistake.” It's not like we're hardcore. It's not the radical candor stuff you hear about where we're just calling people out in real time, but it is an element of trust. You understand we're all in this together. If you get better, if you make me better, if you think different, if you make me think different, that's our only hope. It's like sustaining success.

Bill: How does idea generation bubble up? Is it just from the analysts for the most part, do people have coverage over there? Or is it the freedom to roam-- getting back to this, putting up fences around the playground? Is it coverage verticals or is it mostly generalist because you all in higher positions are generalists, right?

Sanjay: Yeah, we're all effectively generalists on the team. There's a couple people who have small corners of the market that they overindex to, but we're big believers in this notion of pattern recognition. History might not repeat itself, but it tends to rhyme. If you believe that, you're doing yourself a massive disservice, not studying history. You just see certain patterns emerge across industries, across sectors, across regions. I think a lot of the variant perceptions we have are just connecting dots between two industries, two companies that if you were a specialist structure, you just never would-- you connect. There is soft coverage list, but we're not a believer-- and I've seen this before, if you just have someone who knows more about banking than everyone else, they're just going to come in the room and overwhelm everyone else, just with knowledge. Then, everyone else is going to sit back, “Oh, I guess this person's right. It's hard for me to challenge them. I don't have enough context.” So, having common line of sight across the companies while having sensible coverage responsibilities, it's the balance we're trying to strike.

Bill: My favorite line that you wrote in the letter, let me find it, I think it says, “Few things are as dangerous as an analyst with an initiation report and three expert network calls under their belt.” I thought that I have found myself in that exact problem, or that exact situation. It's like, “Oh, I get this.” I have to remind myself, like, “I'm certain I don't get any of this. I just need to figure out the questions to ask.”

Sanjay: I need to give proper attribution, I think that was NonGaap who said that.

Bill: Oh, yeah?

Sanjay: I don't know if I footnoted him, but that's his take, I think, which is brilliant. Yeah, it's a challenge because as you get more resources and can afford things like expert networks, you lose potentially some of that scrappiness. If I don't have access to anything, I just like be super scrappy. In a way, you have to guard against that as you have success and you grow.

Bill: How have you guarded against that?

Sanjay: It starts with self-awareness. It's those return on time audits, it's just a reflection and saying, “Look how much time I spend on expert networks this quarter?” That's exactly what I'm saying. I'm not to say, I mean, they're useful and all that, but am I losing some of that scrappiness? I've toyed around with things like artificial constraints, should we just stop using X, Y, or Z for three months to come rebuild that scrappiness? Mixed views on that. I think at least just thinking about that and experimenting with it and tossing the idea out there gets people thinking.

Bill: Go knock on doors and let me know how it goes.

Sanjay: Exactly.

Bill: I don't want to do that. [laughs]

Sanjay: Old school.

Bill: Yeah, I like that. What’s your favorite memory of when you were a scrappy analyst? Do you have one? I know it's like a weird question. Did you have a favorite investment that you made back when you were doing all the scrappy stuff on your own when something really unlocked for you? Mine was when I thought that I unlocked Buffett's airline thesis, and that turned out to be a massive mistake in my life. Well, not really. I got out in time, but it could have been bad.

Sanjay: How did you unlock it?

Bill: Well, I listened to what Phil Ordway said at Manual of Ideas in his presentation. I thought to myself, “This guy's either insane or pretty smart, and I need to figure out whether or not he is.” It sent me down a rabbit hole of studying the airline industry that I didn't think that I would get into. I think a lot of people cite this common book that was written about Delta, but it was really about the entire airline industry. It was that, and then reading some of about how Southwest went about their business, trying to figure out what the ultra-low-cost carriers, how they attack the hub networks, and why the hub networks exist, and just really understanding where people's narratives were completely wrong. One thing that a lot of people like to say, is they like to say, “Well, now that there's consolidation in the industry, there's pricing power.” If you actually look at the data, and Phil is the one that put me on this, there's more competition per route now than there ever has been. Part of the reason is, these hubs now have hit a scale where they can move the planes around to the profitable networks, or the profitable routes as necessary.

Just decoupling a little bit of the narrative from reality and then looking at the returns in the business, I think that what they thought that they saw was a consolidated industry that you can now underwrite average earnings in. Then I think that the credit card networks are the cherry on top where you had improving capital needs, that people maybe were not fully understanding how important those credit card networks were. Now that you've seen them raise capital, like United did that raise with their mileage program that I can't think of right now, that was wild when I saw that broken out and how Goldman structured that, you start to see, at least internally the accounting. Now I don't think that you can actually spin that off. It's more valuable in the actual airline. It was just interesting to see all that. I knew that I knew the industry when I could listen to a call and know which analyst I thought knew their stuff, which analyst I thought wasn't doing their homework. That's when I felt I knew something.

Sanjay: Yeah. I think scrappiness can come in lots of different forms. One of the things that I recall is when your-- this was six, seven years back, maybe a little longer. We went to China, and we didn't meet with any companies. All we want to learn was about this thing, it was still relatively early, which is WeChat, and how WeChat, Tencent, was going to move into payments and leverage their messaging platform, and we just spent a lot of time with people who use the product, and developers and partner, people we just reached out to directly, as opposed to the sell side, broker-sponsored 30 company over a six-day trip where you're meeting CFOs who aren't telling you anything.

When I say scrapping is, again, that gravitational pull towards busyness, and conflating busyness with productivity. I can't stand when an analyst says, “I met 26 companies over four days.” It's like, “Okay, what was the return on that time? What insights did you come up with?” I think people take too much pride in just being busy and they're not thinking about the numerator in that return on time kind of dynamic, as far as insights, and obviously, ideally, some portfolio actionability. I think that's a good example of you didn't need any resources, you just need to have an element of scrappiness and getting out to China, of course, but once you're there, it's just on-the-ground research.

Bill: I know you didn't rely on one broker to do like a company tour, but did you rely on intermediaries to introduce you to people or was that--?

Sanjay: They were a couple, just people that we knew, that we just reached out to someone or introduced us to someone else and you just connect the dots organically.

Bill: What did you-- when you went over there, this is six years ago, what did you find?

Sanjay: We found that this WeChat payments was going to be a big deal. It was just starting to ramp and you're seeing some articles here and there about it, but it was still people thought it was maybe a couple years away. I'm sure you know this, but China, emerging markets, one of the mistakes we made for a long time was-- I talked about pattern recognition. We had a blind spot as far as applying developed market patterns on to emerging markets. Let's find the Walmart of China, let's build a whole framework around retailers and how they evolve and percentage of GDP, where they peak, etc. You apply that to China, and you think, “Okay, let's find a few retailers here, the next $100 billion retailer.” Then, you find out that e-commerce just leapfrogs brick and mortar, and there is not going to be a massive, massive brick and mortar retail or pure play-brick and mortar retailer in China. That was one of the lessons we learned many years ago was, especially as you do more in emerging markets, you have to recognize and be sensible with the pattern recognition, but don't just blindly apply them.

Bill: Now, this may sound silly, because if you can't apply it one way, how could you apply it the other, but it seems to me just from reading, that China has almost leapfrogged-- if you were to start where we are from scratch, it might be closer to what they have than what we have. Then the question becomes, “Well, can we apply where they are today and say that maybe we're going there?” I don't think the answer is yes because of legacy fleets, and sort of the way that everything is set up. Are there lessons that you think that you can reverse supply? Or does the cultural difference or structural impairment or impediments preclude that?

Sanjay: No, I think you're right. I think if you're going to draw patterns, it would be in that direction, especially in the digital world, where China just-- people didn't have those entrenched habits of going to the mall once a week, or especially just born in the mobile phone era and used it for everything and see how these super apps and whatnot emerge. If you look at the roadmaps of what Facebook and Snapchat are trying to do, and other companies, it's effectively the Tencent playbook. I think you have to see where it's applicable. I think there were some nuances as far as how China developed, why Tencent has that type of position that are not going to be the case in the US. I do think directionally, when you think about the future commerce, retail, or even media, live streaming, social commerce, China is ahead of the curve there. Then, you have to break down some of these cultural issues you mentioned, saying, “Okay, is social commerce is going to be a huge thing in developed markets, like the US?” Some of those will be yes, some of those will be no, but I think you're right, as far as which direction that arrow should point.

Bill: It's very cool to watch these companies that-- now when I'm speaking, I'm thinking I spent a lot of time looking at media assets in general, and seeing Twitter, getting closer to trying to become a little bit of a-- not a closed loop per se, but keep more of the economics within the business, seeing like Facebook create-- this podcast. I haven't been on Facebook in a while, the blue app, because it turned into politics and stuff that didn't make me very happy. Here, I'm thinking about, okay, well, how am I going to promote this podcast? It's something that I care about, and I'd really like it to succeed. Sure enough, top of mind is Facebook, I got to go on it. Realizing how these businesses have become the rails to commerce that I guess this is what people were telling me four or five years ago, and I was saying, “I don't have the vision to know. How can I possibly know it's going to turn out that way?” But the way that attention seems to trend towards assets, and when you couple the scale on top of those assets, it's very, very interesting to me. Specifically, I guess, the three most interesting businesses to me would probably be Netflix right now, probably Disney, and Twitter would be the three that I'm obsessed with. It's for that reason, it's something about scale plus attention. It's just wild to see play out because I never thought the businesses could get this big and this powerful, and command this mindshare.

Sanjay: Yeah. I think Tim Wu, if you're familiar with him-

Bill: Yeah, *The Attention Merchants.*

Sanjay: -he wrote a good book, *The Attention Merchants.*

Bill: Great book.

Sanjay: Yeah. We had him in the office a while back, and he's great.

Bill: He just went to the White House.

Sanjay: Yeah. We had him before the antitrust thing took off, and see a lot of interesting things to say. I think he was dead on as far as what these companies-- where they were going to end up, calling them digital utilities is probably not that far off as far as the importance and how they've embedded themselves in our lives. Yeah, utilities are often viewed as a pejorative term as far as multiples and whatnot go, but I think factually speaking, that's what a lot of these companies are evolving into.

Bill: Yeah, well, the nice thing is they don't require capital in the traditional sense. It's all through the income statement. Once it drops out, it's all free cash flow. It's a little bit different than a utility. Not once you do the adjustments in the cash flow statement, but on the income statement, it's quite a bit different. Do you have an industry that you enjoy the most? Or, do you just enjoy looking for patterns? I guess I don't want to say either/or, but is there something that has your--

Sanjay: Yeah, I enjoy--

Bill: Other than Taco Bell?

Sanjay: Taco Bell is number one. No, I think the patterns are fun. You can see, for instance, we own a lot of healthcare companies, but if you actually dig a layer deeper, what they are is industrial business models. You're basically marrying an industrial moat, while capitalizing on the tailwinds that you see in healthcare. I think that's where it gets fun is when you can draw-- and not all the companies we own fit these frameworks but when you can draw these connections and see something that the specialist doesn't and understand, "Okay, why this is durable?" Where someone might look at that and say, "It doesn't look sustainable." That's some of the more fun stuff we do.

Bill: When you're finding a healthcare company that has this sustainable tailwind, and I don't mean to keep going back to culture, but I think it's so important in all your communications that I've seen or heard, how do you assess the metagame that these healthcare companies are playing? This is going to be such a dumb question, but it's the one I have. You have two pretty similarly position companies. How do you guys think through digging through, what are the nuanced questions that you're thinking about it's going to be situation specific? To get you to the answer of, which horse do I really want to bet on, with which set of jockeys?

Sanjay: Yeah, it's the answer you'd expect, which is--[crosstalk]

Bill: Yeah, it had to be. There's no way to give an answer to that question. That's the most fascinating question to me.

Sanjay: Well, I'll give you one. I think in fast moving dynamic industries that are still in their early stages, I think you have to put a premium on adaptability. I guess that might be an interesting topic why are we focused on culture. We think it's a subset of what you might call compound-y knowledge. Again, I talked to Morgan Housel, expiring knowledge. I think what we're trying to pursue, in addition to all the day to day bottom-up work is, are there fields of compounding knowledge that we can find? I think investing to me, it's really just a series of judgment calls. Those judgment calls, I've come to believe boil down to just a few types. I would say, four types of decisions that drive a lot of alpha or most of the alpha. Two are about the present, and two are about the future. In the present, you're looking at a company, it's doing well, is it sustainable? You're looking at a company, it's not doing well, is it temporary or is it fixable? Or, is it structural?

Take the future, a company's going to face challenges, you know some of them you don't. Are they going to be able to navigate that? Then, a company is going to have opportunities. Some you know, some you don't. Are they going to be able to capitalize on that? You just take those four decision types and then you say, “Can I as a firm, as an analyst, just on a micro basis, bottom-up basis, over decades, consistently make those right, when everyone else is looking at the same set of information?” Probably not. I think as the timeframe grows longer, and you have any sense of humility, the odds are going to start to work against you, especially since challenges, opportunities, they come in different forms, shapes. If that's your whole framework, I think you can have success over 3 years, 5 years, 7 years, maybe 10 years, but then the odds work against you. Then where we try to ask, “Okay, if that's the case, can you find fields of knowledge that can improve your odds, your hit rate on all those judgment calls?” I think that's where culture comes in, is if you apply a cultural lens to each of those four decision types I mentioned, you have a much better chance of being right, at least that's our hypothesis, and especially with culture, especially with the future, because people, I think analysts, and I’m curious to get your thoughts, I think we spent too much time trying to predict the future in a point sense. Let's try to figure out the exact challenge that's going to come across this company, or what's blockchain going to mean for this company?

Again, I just think the odds of you getting that right, we should do the work, try to have a view, but the odds of you getting that right in a vacuum over a long period of time is very low. A different view, a different lens is, there are going to be opportunities and challenges. Does the company from a cultural lens, really DNA, do they have the ability to navigate those challenges, sidestep those landmines, capitalize on those opportunities? People talk about margin of safety with valuation, in many ways, I view culture as the ultimate margin of safety. Take Amazon, you look at Amazon, I might have the years wrong, but 2007 or 2006, could you have predicted AWS?

Bill: No, definitely not.

Sanjay: Probably not. Maybe there were five or six people who saw it coming and knew it's going to be a juggernaut. Could you have predicted that should something in infrastructure services come along, Amazon would be quicker to capitalize on it or pounce on it, than Google, Oracle, IBM, etc., perhaps. I think that's a more knowable question to ask. You go to China, you go to China tech, we talked about Tencent. Could you have predicted that when the market shifted to mobile, Tencent, it would have been hard to predict WeChat and how big it became. But could you have predicted Tencent would have managed that transition better than some of the other companies like Baidu, because of its culture? Perhaps. I think putting your emphasis there and trying to get collectively improve those odds on those decision types, to me, is a worthwhile pursuit, it's hard to do, there's no shortcuts. To get back to your question, I think that's why we view culture is so powerful, and in those fast-moving early-stage industries, it's really hard to predict how it's going to play out over 5, 10 years. I think everyone loves to say they're long term, but it's hard to see the long term. If the company is adaptable, they'll do a lot of that work for you. I think that's why it's such an emphasis for us.

Bill: I love that answer. That answer is fantastic. It reminds me of-- I had a podcast that's going to come out next week with this woman, Liz Simmie. I have been internally debating morality in investing because I have a position in Philip Morris and Altria, that I don't feel great about owning, like, fundamentally, but I find them to be fairly high-quality businesses, even if they're facing customer headwinds, to say the least.

Sanjay: Sure.

Bill: I had asked what's the point of ESG, or morality in investing or whatever. She had responded, and she's really dedicated a lot of her time to ESG. Her encouragement to me was to think about ESG through a cultural lens. That the fundamental reason that I should care about something like ESG is not necessarily to draw the distinction between cigarette companies should never be in your portfolio, which she does not, she runs a true ESG fund. She's not going to include that, but what she got me thinking about is, who are the types of people-- this is one of the reasons that I really like Markel, and how they hired Saurabh. For them to go to Google and for Tom to meet Saurabh, and for Saurabh to share some of what he learned at Google with Tom, and then for Tom to be open minded enough to say, "Okay, well, maybe I should go back out to Google to learn a little bit more about that." Then for them to be open minded enough to-- like all of them, not just Tom, but for Saurabh also to come to the table and say, "This is maybe something that we can join two really different ways of looking at the world, but we could come together. I'm in Google, you're in Virginia, I do tech engineering, you do insurance underwriting and equity research." For me, that was such a high signal hire to me for a number of reasons.

Even if I wanted to be the least charitable that I could possibly be to Saurabh, I would say, well, he wanted a job in asset management and that was it, and I just know that that's not the answer. I know that it's a bigger answer. I've been really fortunate to know him. I've been included in some things that he works on. I just love the way that he-- you talk about humility, and you talk about somebody that I think approaches the self-improvement game in the right way, shape, and form and the way that he has fostered open conversations by putting parameters around them that make people feel safe. That is something that I just overweight that relative to everyone that I hear talk about Markel. I don't own it right now, but that's maybe a mistake and I've been thinking about that.

When people ask, “Do you think they still have it,” and whatnot, yeah, I do. A lot of the reason that I do is knowing some of the players and knowing how they think about things, and just seeing how all those tealeaves come together. I think it's a marriage of these concepts. To your point, like, could I have known that 2020 was going to come out and really do damage to the insurance industry? That's probably knowable, that at some point, you're going to have a catastrophic year. Do I know how exactly they're going to respond? No. But can I think through how they're probably having internal conversations and how they foster debate? Yes, that's something that I think I can get my head to. Then some of it’s being able to ride through the down period and say, I've trusted these people to do their job. Now I’ve got to let the bet that I laid play out is how I think about it.

Sanjay: Yeah, I think you're right on, and culture is connecting dots. We haven't found any quantitative way, they're just like reverse engineering. You just have to see certain things and connect those dots. Then, rather than try to predict those point events, like 2020, use those for reflection. If you have a thesis that is based on a company growing its moat with a strong corporate culture, if that wasn't in evidence in 2020, then your thesis is probably busted. I think you have to also think about looking back, spending time seeing if the company lived up to how you expected it to behave during times of volatility, and you need that. Unless you had that feedback, like those types of ups and downs, it's very hard to say there's a company in a 10-year great market and great environment, really have a great culture or they just riding the wave? I think you really have to hone in when there is issues and challenges and external challenges, make sure you spend enough time reflecting on how things played out.

Bill: It's been amazing to see how adaptive some companies are. There's the part of me that is the traditional value guy that says, “Oh, well, when you look at the multiples of some of these growth companies, that's so silly relative to these other multiples.” But the other side of that is, look at how resilient they prove themselves to be and how adaptable a lot of them prove themselves to be, that's amazing. Then, the direct relationship with the consumer I think was really elevated this year, or in 2020, as opposed to when you had to get something through somebody else, that somebody else tended to be Amazon more often than anything. It was a wild thing to live through.

Sanjay: Yeah, and it goes back to where we started, like the positively spring loading your starting conditions or like Shopify, which we've owned. They've had lots of wins behind their back, whether it's direct to consumer commerce, which they, of course, helped enable, but there were also other building blocks at play. Then COVID. It pulled in their view of the world, but they really capitalized on it. It's clear as far as their culture and what it was and what it stood for, and you saw it play out in real time in Q1 and Q2 of last year. When we talk about adaptability, that's just a great acid test to evaluate it.

Bill: Did you read Mike NonGaap’s write up about Toby, and he compared to him, and what his gaming persona would be and how Shopify was within that game, and then Toby responded, that was awesome.

Sanjay: That was, we talked about NonGaap, but that was one of the better pieces I've read in the last four or five years. Yeah, I think he nailed it.

Bill: Yeah. That was awesome. That's the thing that's crazy is how smart so many people are. I couldn't have put that together. There's no way.

Sanjay: Yeah. It gets to the root of the company. It's not, yes, there's tailwinds, and you can look at payments, and FinTech and shipping and look at these things, all these individual things in isolation, but what Mike did, and what we tried to do is, he tried to get to the root cause and foundation of the company the DNA, like what's going on here? I think Toby respond to him saying, like, I think you nailed it. It scared me by how well you nailed it.

Bill: [laughs] Am I that transparent? How do you hold something like Shopify?

Sanjay: I guess, to start, I think Shopify has been one of those rare, really just magical scenarios where a company just by solving their customer pain points, introduce new network effects, or at least feedback loops into the system. When you get those, you don't get this too often, but basically, you get the best of all worlds. Your revenue growth curve gets extended, you're deepening your core moat. If you think about counterparty relationships the right way, you're generating more goodwill in the present with your customers while introducing more pricing power in the future. All that goodness has supported Shopify over the last five, seven years.

To your question about how do you hold it, as valuations evolve, your thesis needs to evolve too, and I think a lot of people talk about thesis. People talk about creep too much in this industry, like thesis always evolve. Even audit your winners. Invariably, the thesis you had is not exactly the reason the company did so well. It was something else you didn't predict. For Shopify, I think, yeah, as valuations evolve, you have to start asking different types of questions. Now, it's over the next five to seven years, it's can they solve the merchant pain points that they haven't solved yet, and those are potentially-- I mean, definitely shipping for one, like, how do they help their merchants keep pace with Amazon, and then demand? Right now, merchants struggle with demand, Google, Facebook, and the two companies that are doing it the most. Can Shopify insert themselves into that? That's a different dynamic. There's things that they do that are going to help them with that, but I also think it's going to introduce potential tensions into the models. You just have to wrestle with that, but you have to ask the new questions. I don't think you can just anchor to, “This is a great engine for e-commerce.” I think that's probably recognized at this point. Now you have to say, “Can they evolve and adapt?” There's lots of questions you can ask underneath that to arrive at that conclusion.

Bill: It's hard not to give somebody like that company the benefit of the doubt, given how well they've executed through this entire process. What a great test in a company like that, that's going to require all companies need to be flexible. I think that company particularly proved adept at being flexible and solving the pain points, like you said, it's interesting. I think Twitter's going to go through it. What they laid out, I think they're going to go through their own little version of it, and we'll see if it works. It's very cool when you see that inflection point in ethos, at least in the way that people are thinking. With Shopify, I don't think it was really an inflection point. I just think it was people waking up to who Toby is.

Sanjay: I think in that case, it does run in the DNA. I don't think there's enough written or studied about managing ecosystems, and a lot of people call it platforms, that's an overused term, but just there's an art to it. How do you manage all these different counterparties, it's a lot of complexity, and some simple decisions can actually have a lot of unintended consequences. That's like Shopify and other these ecosystems, you really have to laser in on and just understand how they think about it because there are tradeoffs. If they're aware of those tradeoffs, are very cognizant of it, I think you should give them a longer leash kind of as I think you alluded to.

Bill: That's very insightful. I'm going to have to ruminate on that for a little while before I come up with something smart to say. I think that makes sense, like understanding the weakness. Shomik had talked about it, too. But when you said it, it's like-- I don't know, I have these conversations, and they retrigger thoughts.

Sanjay: Yeah. I can give you one example is, it seemed very logical as an ecosystem to treat your best customers, give them special treatment. Let's say, you're Alibaba, and you have power sellers, let me treat them very well and give them special terms, and really focus on that sensible, and at the point, but what you do is you also potentially create disruption in that tail, the smaller tail of merchants you have, and maybe then they don't get enough volume on your platform. Then they look elsewhere to companies, like **[unintelligible [01:06:51]** or other companies in China. It's all these tradeoffs you have to make, and as your ecosystem gets more complex, as you add more counterparties with Shopify might, if they start to do more in the consumer realm. There are tradeoffs that you have to think through their tensions that you didn't have to deal with before. Shopify, they've done phenomenally well, but that alignment, it's been so clear, it's all about the merchant, help the merchant, help the merchant, and the company will do well. You start to introduce developers, partners, customers, then those easy decisions start to have tension underneath them. They're just incredibly thoughtful at thinking through this. I think that's when you think about like a dynamic company evolving, these are the conversations you have to have. And then being from a cultural lens, they're the good guys now. Will that always be the case if they start to do more in other areas where they have to create tensions? Maybe, yeah, that just becomes a little bit of a challenge, too. So yeah, this notion of ecosystem management, it's one of the topics I find most interesting, I feel are still underdiscussed, or at least understudied.

Bill: I think the thing that's going on in my head, when I'm listening to you speak about that is, when you have seen a company execute for so long and do it so well, and now it's faced with new questions. As an analyst, how do you think through saying like, no, they're wrong here? I would think in that scenario, they've earned so much deference, that it's almost hard as an analyst or a PM to say, "This is the time that they're not right on this." But it's so important, because that insight is what actually is probably going to be the insight that leads the numbers that everybody else realizes, like, "Oh, boy, something else is up here." That's the really important insight, I think, in holding that entity, at least at this valuation.

Sanjay: Yeah, I think culture to me, to a large degree, is how much of a leash do you want to give a company, when there's change, when they face an issue is, do you want to give them time to figure it out and maybe stumble along? Or, do you want to cut bait right now? I think that's where if you have a lot of conviction in the culture, you don't think that decision becomes clear, and gives you a little way to calibrate that, as opposed to just doing it in a vacuum. I think that's much more difficult.

Bill: I had liked Wells Fargo, I have to confess that, but I liked it as a turnaround story-- and not story. I shouldn't say that I like Scharf. I think Scharf is smart. He hired this guy, Scott Powell, I think Scott Powell's resume is worthy of deference. So far, I think that's playing out, there are other issues with the business that I probably could have understood better. A lot of the people that I respect were yelling at me, they were like, "I don't think you want to get into a cultural turnaround of this magnitude." When you're talking about managing an ecosystem, that is a Herculean task, to turn around a business that's going through that much. I guess there's so many headwinds from so many ways, so I can totally understand why when I said I think this is a turnaround, people said, "No, that would just be a never touch to me." I think those people were probably right even if this one time does work out as I thought, but I have not reallocated capital to it. So, I obviously don't believe that I want to be in that kind of soup, so to speak, in the ecosystem.

You mentioned Peter Kaufman. He sat down and he read all the big ideas write in the science journal and whatnot. Have you done anything like that in your time? Or, is that something that you borrow other people's ideas from? Sometimes, I look to Shane Parrish for a lot of this.

Sanjay: Yeah, he's great. Some of these, we built on our own, but, yeah, we lean on everyone, we look for inspiration anywhere we can find it. There's lots of some of this new stuff, like, it's not necessarily new but network effects and so on, you're just seeing new people emerge or under the radar that you can lean on. I think that's the balance you try to strike as far as building an internal IP also looking elsewhere, to people you've talked about already people, you've had in the podcast of learning about new business models and how they relate or don't relate to the past, but we talked about scrappiness already. But I think you have to strive to stay safe, keep those insights fresh, especially in those more dynamic industries.

Bill: Yeah, I would agree with that. I would think, as a firm, and actually, Mike talked about this, to keep the analysts hungry, and say, "It hasn't always been this way, let's keep trying to improve things." That's got to be something to manage. I think it'll probably be interesting coming back to work when everybody is. I don't know, I guess some people are in your office now, but I don't know the extent to which you guys have taken-- Do you take junior people on? Like, real junior? Or, is it mostly people that have been trained a little bit and then they come to join?

Sanjay: We take talent wherever we can get it, Bill. We're pretty open minded. We have people who are young, people are experienced, there's different tradeoffs with different-- some people have to unlearn things if they've been elsewhere. Whereas if you're fresh, there's a little more training that needs to happen. But no, we'll look for talent wherever we can get in, and there's certain qualities that we definitely look for as the starting conditions. Yeah, I think Mike talked about that on his podcast about how we really try to make sure this is a founder's mentality here where people feel like they can come in and break things and really have an impact, as opposed to stay around the edges and shape something that's already in place. There's a balance there, you don't want to overhaul everything every year, but creating that sense of ownership at the last off site we did a couple years ago. Mike did 50-page deck on all the mistakes we've made. That's all it was, just to show that we're extremely fallible, and we make a lot of mistakes, but we're better off for it. In many ways, that's like the WCM story in a nutshell.

Bill: That's awesome. I admire that so much because I just think so few people do it, that it's really something that, I think if I were young and talented and was fortunate enough to land there, that's a hell of a spring load to get a career started. A lot of people don't end up that lucky. Protect that with everything you guys have, I know you will.

Sanjay: Yeah, we try our best. Not to use the word platform, I don't like the word platform. I couldn't come up with anything better. You try to find great people who are talented, but then plug them into, like the opposite of the Taco Bell scenario. Take away all the nonsense of the industry and then provide them with compounding knowledge or let them enable them to create company knowledge. If you do that, you get the best out of people, and that's all you can really control.

Bill: Yeah, we'll empower people and then pick them up when they fail. Then Live Más. [laughs]

Sanjay: You are all over the Taco Bell. I love it.

Bill: Well, I read your letter, and I know that it meant a lot to you.

[laughter]

Sanjay: It's fun to joke about that.

Bill: Yeah. Well, I'm sure it wasn't to live through. I've got to ask, is there anything else that you want to talk about?

Sanjay: One of the things that's interesting to me, maybe we haven't talked about is, what makes a great investor? What's interesting to me about investing is, it requires a set of qualities that are opposing at face value. You need to be, for instance, disciplined, and you need to be flexible, or adaptable. You need to have conviction, but you also have to embrace cognitive dissonance, you need to be able to focus and need to be able to multitask. I think one of the more interesting ones to me is, and I thought a lot about this lately is, you need to have that grit, everyone would love to talk about grit, but just like work, ethic and perseverance. I think you also need creativity. I don't think you traditionally find both of those in the same person, or it's very few people who have both. Because grit in many ways is like give it 110% type thing while creativity is almost the person who gives it 80% or 90%, like you have to let things flow in, you have to take a step back. There's this notion of creative laziness, which is finding the lowest part of the fence before you cross it, or instead of just rushing to answer a question, asking is this the right question. That's something we try to find, but also nurture, like how do you draw that balance between grit and creativity? I think creativity is another underdiscussed trait of investing that doesn't get enough attention that I don't think we've necessarily figured out the secret sauce there. I think it's something you have to think about. If you truly want to have original insights and original thought, you have to build a team and enable them to be creative.

Bill: Do you journal at all?

Sanjay: I do.

Bill: I have found that helps. Somebody told me once to just walk into the office and just start writing in the morning, and don't stop for 10 minutes. I would be lying through my teeth if I said I do it every single day. When I do it, I find that I'm much clearer, and I don't know, it's very cathartic. The other thing that I think really helps me is, I am really best when I'm up in the mornings. If I can work at a certain time, I find that my mind is much, much better at certain times. To try and to structure my life around that has helped.

Sanjay: Yeah, I think you're exactly right. I think journaling, understanding when you're at peak productivity, when you're at the most creative, some people it's morning, some people it's night, when you're best at focusing. In the end, it's just self-awareness. If we were to hire for one quality, it'd probably be just keen, keen self-awareness, because I think you could do a lot with that. Journaling, if done right and you actually keep it up, which is hard-- I look at my career, my progression, and it's a function of just journaling, making mistakes, learning from those mistakes, and now making new and different mistakes. It's an iteration over time, but unless you have that ability and system to reflect, I think it becomes much more difficult.

Bill: Yeah, the nice thing about a journal is you can't go back, and you can't have revisionist history. It's actually written down and you can actually see what you thought, you can actually see how you thought about it. It's the same reason I enjoy when I actually have a reasonably good idea to write it up, because even if I don't take a position, it's nice to see whether or not I think that it played out as I thought. Then, I've also gotten in the habit, when I get serious about something of trying to premortem it.

Sanjay: Pre-mortem is something we do as part of our thesis. I think it's incredibly valuable. That's actually, partly if I was to look at my career where I made the biggest leap was just truly being able to own the pre-mortem. I think if you do that as like a risk section, it's not the same, but if you really, truly simulate and visualize what could go wrong, it's just all the defensiveness when things go wrong melts away, because you've owned that possibility. I agree on the journal-- The fun part of journaling is you can call out Mike Trigg, when he starts to say, I said this, I'm like, “No, look at your journal.” I'm trying to institutionalize journaling here. Sorry, Mike, you said that. You got it wrong.” That's always fun.

Bill: I had something similar. I was talking to somebody about Nordstrom. I said, “Remember when we missed it,” and they pulled up a screenshot. They didn't miss it and I was being revisionist, to say the least, neither of us had the confidence to think that they'd make it through.

Sanjay: Do you consider a Twitter as a form of journaling for yourself?

Bill: Yeah, I guess, yes, I do. I overtweet. Okay, so that's my weakness. I guess that what I consider Twitter as much of a journal-- If Twitter had a really good search function, boy, what a journal it would be. Same in the direct messages, but I'm hopeful that those are coming. I consider Twitter part journal and part networking machine. It's been a very weird experience for me, because I enjoy people, I enjoy face to face, I was never really that into social media. Here, almost everything that I have created content wise, and my network has been because of Twitter. Sometimes, people will say like, “Why do you talk about it so much?” It's like, “Well, it's pretty much my life.” I don't know-- it's clearly not. My wife and kids matter more, but it is impossible to decouple what I have become as an investor, and what I'm doing professionally from Twitter. They are the platform that has enabled all of it.

To be able to shout about some of the stupidity that I had-- if I go back in my early feed and some of the ideas that I have, you talk about making yourself want to cringe. I'm really grateful for it, because I read somebody’s thread once, and he said I've made every mistake that there is to make in investing. I've bought into cyclicals of peaks. I've tried to time financials. He went through all of them. Thank God, they happened because if they didn't, and I was successful on that, I still might be looking for those things. For me, I try to not be defensive when people come at some ideas I have. I can't help it, and I also can't help myself sometimes from dunking on some of these really momentum stocks that I think people are like-- I don't know, who knows, we'll see when the-- end of the day when this test score is tallied, we'll see how it all works out. I would probably be better served just shutting my mouth in certain instances. But on balance, I think it's been a huge benefit. Seeking Alpha has done it for people, Vic has done it for people. I just think a community where you're sparring mentally and accepting that pushback is the spirit of the game as opposed to something to offend you, I am an island, so to have that has been invaluable to my life. If I was at a firm, I would want that kind of environment.

Sanjay: You view this, the podcast, as an extension of that?

Bill: Oh, yeah. What I want to create with the podcast is, I want to have an investor series of interviews. I want to have real professional investors, sit down and either listen, or I'm probably going to do some written extensions from these things. Something that Whitney Tilson had done back in the day that I liked was *The Art of Value Investing*. He basically just compiled quotes from value investor insight that he had and some other things. I just want to provide people a good map of really interesting thought, because what am I going to tell you about investing that you don't know? I can't tell you anything that you don't know. I might be able to have a guest that you find really interesting. If I can contribute to the financial community in that way, that's awesome for me.

Sanjay: Yeah, I think you're doing a great job, I think the notion of keeping these conversational, as opposed to, I'm sure I talked a ton, but as opposed to just one way and lowering the just the spiel element or all that and just making it a conversation, I think, gives you a better window into how people think, in the end is what you're trying to do.

Bill: Yeah, I think so. I think that there's this mystique about a lot of investors that people want to put up, I think it exists everywhere. Anywhere that there's a lot of success, it's like, “Oh, is that person, even human?” What I have found, more often than not, that the person is human. I think something conversational, is relatable in a way that a lot of formats are not.

Sanjay: Yeah, I struggle with the ego thing. I just don't know if you have any self-awareness around the history of the industry, the base rates, who the star managers were 10 years ago, 20 years ago, and where many of them are today, I just find the whole superstar ego thing very comical, with that kind of backdrop of how few people have sustained durable success over multiple decades. Yet, you have a three-, five-year good period in office, then that ego develops. That's actually coming from Morningstar was very helpful.

Bill: Why so?

Sanjay: You've got a window into the fund to realm and analyzing mutual funds and seeing who the superstars were at the time and seeing the ups and downs, and just understanding that this is hard, and the base rates are decidedly against you as you extend that timeframe. Once you have that outside view, I think you just almost definitionally have to stay humble.

Bill: It's sort of terrifying to me, because I'm out here running my own capital. I'm not competing against you, per se. There are trades that we would be on the opposite side of, and it's like, on one hand, I'm proud of what I've done. On the other hand, I'm terrified that I'm just the part of the sample that's gotten lucky. I'm more terrified of that than the former. I don't trust that what I've done is replicable. I think that's actually a good quality. I think that's the thing that keeps me thinking about whether or not-- I don't ever want to be the guy that satisfied with how I've done something. I think that the day that I do that is the day that I'm about to get waxed in the market. But I also don't really trust an index, and that may not make a whole lot of sense to people, because I think over time, indexes might make sense, but I don't-- there's something about a momentum buying strategy blindly, not caring about valuation that I find offensive. Even if when I really break it down, it probably does make sense why the momentum exists, I just don't know that I could trust an index if things went really wrong. I think that for me, getting through the trying periods is far more important than outperforming in the good periods.

Sanjay: Yeah. I would agree with that, for sure. I do think people get too carried away and that thinking there's one way to do things. In the end, to me, it's about alignment, have a strategy or philosophy that aligns with both your belief system, but probably even more importantly, your temperament. If you want to have a 10-stock, very concentrated portfolio all in one sector, that's fine. You've just got to be ready for those 40-- ask yourself, can I really sit through those 40%, 50% periodic drawdowns that will occur? If you think you can, or you know you can, then that's totally sensible for a lot of people. I think the behavioral finance people really get that wrong is, there's a little bit of laughing at everyone else type thing. It's like, how did you behave during Q1 of last year? Did you live up to your ideals or not? If not, maybe you should think more about portfolio construction. I just think it depends on the person or the team or the firm and just making sure that alignment's there as opposed to thinking there's just one way to do things.

Bill: That's the part that I'm the most proud of actually is, I was adrenaline doubt. I would be totally lying if I said, like, "Oh, I was totally Zen in March, when everything was crashing." That'll be bullshit. I barely slept and didn't stop thinking about things, but I really did. I don't know how much you know about me, I had an uncle that died like a super tragic death, and it changed my family's financial outlook. What I said to my wife is-- I was underwriting commercial loans at BMO Harris, it's a great place, but I was never going to-- if I sold at a bottom, it would cost me more than I'd ever save at BMO. So, the goal here is to figure out how to get to the finish line. Then if I need to get another job, I'll figure it out, but I think this podcast might be my ticket to getting sustainable income. I am really proud of the fact that when March came, I stepped up and changed my family's financial situation in a time that was really trying. Now, I go to bed every night and I think, “Well, am I just the idiot that got bailed out and took too much risk?” [laughs] I don't think that actually. I think objectively. I listen back to what I said at the time, and I really do think that I managed it. I live in that constant fear of like, “Are you just the survivor and your bias is not reality?” I don't think it's ever a question I'm going to be able to say yes or no to.

Sanjay: I agree, but I also think it's a terrific quality to have. If you lose that, you'll just lose a lot that edge, that motivation and that hunger. I think that's a great-- well, it's difficult to deal with that dissonance, it's probably the right trade off you want to make.

Bill: Yeah, I think it's the only one that I can make to get over the finish line. The other thing that I've really had to push myself away from is, I idolize Buffett, man, I named my third kid after him and everything. When he stands up in front of a class and says, “I would have had 50% of my net worth in my best idea,” it's really important for me to remind myself, “You're listening to a true savant, and I am not him.” I bet pretty big on a pretty contrarian idea last year, and it worked out. That does not need to be every idea. It doesn't have to be how I always run my portfolio. I've learned a lot from guys like David Gardner. I've started to study Ron Baron a little bit more, and some of these guys that I think have really, really good growth mindsets. I don't quite know how Ron Baron opens his positions, but David Gardner opens much smaller. I look at how he's done it and how he's succeeded. It's like, “Okay, there's maybe a middle ground here that I can figure out for myself that I can live with. I don't need to be either one of those guys, I can just be me.”

Sanjay: Yeah. That's where the journaling and reflection helps. I think some people probably have a knack for sizing and making big bets. And other people, they audit your track record, in any honesty, you'll see, “My lowest weight’s actually had the best performance. So, I should just equal weight it.” I think a lot of that stuff's very just personal and based on temperament. Some people get too excited when you have a new idea, and they make it a big weight. Then two months later, they're not as excited about it. It's just having that self-awareness and reflection, I think, helps you shape things in the right direction over time.

Bill: Do you do any therapy at all? Are you just born with this?

Sanjay: Born with-- [laughs] I don't know. I told you, I had a midlife crisis 10 years ago. [crosstalk]

Bill: I don’t count looking at a chalupa and taking notes-- I mean I actually do, I understand what you're saying. Your EQ is high and I just didn't know if that's something that you think that you were born with, or if it's something that you've worked on over time?

Sanjay: I’ll my wife on the podcast next, she’ll answer that question.

Bill: [laughs] Well, I'll tell you what, your wife can call my wife and they can complain about both of us.

Sanjay: All right, and talk about the kids.

Bill: That's right. My wife will ask me something and I will say yes to her, and two seconds later, she'll turn around and say, "What did I just say to you?" and I will have no idea.

Sanjay: [laughs]

Bill: I know that I was present when I said yes.

Sanjay: I think we are very alike.

Bill: [laughs]

Sanjay: From my read on this conversation.

Bill: Well, man, I enjoyed it. You have anything else you want to talk about?

Sanjay: I think we hit on a lot. It's been a blast, had fun.

Bill: All right. I'm glad that you came by, man. I have a lot of respect for your firm from what I've heard, and I've heard great things about you, and you've lived up to it. So, I thank you for joining me on this.

Sanjay: Thanks, Bill. Keep it up.

[outro]