Investor interview:

Tom Russo

Introduction

There is a small group of investors that have managed to combine outstanding investment track records with being great teachers. The most notable example is of course Warren Buffett and Charlie Munger, but I would also include Tom Gayner and Tom Russo in that group.

Thomas A Russo is the managing member of Gardner Russo & Gardner LLC, a firm which he joined in 1989. He also manages Semper Vic Partners which he founded in 1983.

Tom has historically invested in established, highly cash generative businesses with a durable franchise. Many of these have been found in consumer goods including spirits, food and tobacco but increasingly they are also being found in 'new' segments of the market as illustrated by his investment in Alphabet. We covered this shift as well as many other topics in our conversation. Through the years, Tom has been directed in his search for opportunities by two concepts; the 'capacity to reinvest' - which is to do with the *opportunity* to invest for long-term value creation - and the 'capacity to suffer' - which is to do with the *willingness and ability* to invest for long-term value creation. Both of those concepts reflect Tom's long-term mindset and focus on underlying business fundamentals as opposed to what is fashionable at any given time on Wall Street.

There is certainly a clear 'Buffett connection' in Mr Russo's case. He was first inspired by a talk by Mr Buffett at Stanford Business School in the early 80s. He worked for Bill Ruane at Sequoia Fund. He has a close association with the Heilbrunn Center for Graham & Dodd Investing at Columbia Business School. He has a significant proportion of his portfolio invested in Berkshire Hathaway. However, there are also differences in his approach to investing compared to Mr Buffett's, notably when it comes to Tom's early interest in international opportunities.

Some of the impressions of Tom from my interview is that he is very disciplined (e.g. in terms of how he collects intelligence or in terms of how he looks at valuations), pragmatic (e.g. by focusing on certain industries he feels he understands and being prepared to change his mind on a holding) and truly passionate about what he does. Tom is an outstanding investor and a true gentleman as really came through in our conversation. We would like to thank Tom for his contribution to IBTB and for tirelessly sharing his experience and wisdom with so many other investors.

Open-end vs closed-end structures

Given Mr Buffett's huge success with Berkshire it is perhaps surprising that we have seen so few attempts to replicate the structure (there are of course some e.g. Fairfax, Markel etc). I wanted to understand whether Tom felt there are any restrictions as a result of running an open-end fund.

Tom says he doesn't feel there are any significant restrictions from running money through an open-end structure; the team at GRG 'treats the money as their own'. However, there are some aspects that need to be considered e.g. there may be certain investments they avoid making because the risk profile etc is not well suited for investors in his funds (e.g. when it comes to certain types of warrants). Also, at times the investor collective will become very focused on a topic like in the case of ESG at the moment. This means the fund manager may need to consider a number of different 'agendas' among his own investors says Tom.

There is of course a level of recognition and a successful track record for an investor like Tom that are helpful in creating 'room to maneuvre'; Tom describes this as a 'cumulative process'. The ultimate set-up according to Tom is a gifted investor being supported by a long-term sponsor like a family, however my impression is that an investor with Tom's following also enjoys huge 'stickiness' when it comes to his investor base.

Being concentrated in certain industries

Like many long-term, quality focused investors, Tom is a seasoned investor in consumer goods businesses. Historically these have been seen as safe havens with very limited change in competitive dynamics etc. However, Tom says things *do* change from time to time; one example he provides is Coca Cola.

As a result of this, Tom now looks more broadly for new investment opportunities than he might have done historically (and has e.g. initiated a position in Alphabet). This gradual shift from consumer goods to other areas of the market may very well continue and there are other benefits to this e.g. the gathering of intelligence from a number of industries that may be helpful for understanding companies you are already invested in etc. What hasn't changed, he says, is the search for *durable businesses.*

Like for many great investors, there seems to be a huge amount of pragmatism involved in Tom's approach to running money. While he still has very significant exposure to e.g. consumer goods, he is actively looking for opportunities in areas of the market where new examples of durable franchises show up e.g. technology as evidenced by his holding in Alphabet.

Shortlists and creating an 'investable universe'

We discussed how Tom structures his search for ideas.

He says he does make use of a 'shortlist' of ideas that he is in principle interested in owning. However, it is still challenging to pounce when the opportunity presents itself (like it did in spring of 2020 for many companies/stocks); one challenge is to know the companies well enough to be confident to act, another is the fact that Tom would be reluctant to sell his existing holdings like e.g. Berkshire to fund these new positions.

'Downside protection'

Another characteristic Tom seems to share with many successful investors is the willingness to change his mind when confronted by certain facts.

Tom says he is willing to 'look silly near-term' in order to capture long-term upside. This includes adding to a new position on the way down only to realise that the business isn't as good as one might have thought and as a result having to sell immediately.

Tom also says he engages in rebalancing of the portfolio once positions become 'too large' (Tom has said in the past that he would typically engage in some sort of rebalancing once a position crosses 13 %; he simply seems to feel that this keeps the portfolio more dynamic). He acknowledges that he is unsure whether this activity has added value over time but it has resulted in a more diversified portfolio.

Temporary challenges vs structural decline

We discussed this topic in the context of two examples from the world of spirits companies, Diageo and Brown-Forman.

In the case of Diageo - which is no longer a holding - he became increasingly concerned about the sort of agency issues that often plague large organisations. In the consumer world, Tom says, 'focus is usually the way to go', pointing to Davide Campari as a great example of this. There was a sense that Diageo had

become too 'institutionalised' with insufficient investment levels etc. This, together with a focus on 'making the numbers', meant he sold his position last year.
In the case of Brown-Forman - which remains in the portfolio - Tom is still attracted by the increasingly global profile of the business given the growth opportunities in many international markets. With good operating leverage on top, the outlook for the company is attractive.

My impression here is that Tom's intimate knowledge of certain industries - like e.g. beverages - and companies is crucial in making the distinction between temporary challenge and permanent impairment.

Sell-side research and expert networks

Following on from the above, it is interesting to observe how Tom develops this intimate knowledge of an industry and some of the companies operating in it.

As a general rule, Tom does not use sell-side research or experts. It seems this goes all the way back to his time working for Bill Ruane at Sequoia Fund where there would be no visits from the sell-side; all the work was done in-house. Being in NYC has not resulted in too much 'noise' for Tom either - he keeps a healthy distance to Wall Street - but he says it can become an issue for some.

One issue according to Tom is of course that the sell-side has incentives that may not be (and in fact probably aren't) aligned with those of investors i.e. they are looking to encourage activity and turnover. When it comes to the use of experts, Tom is uncomfortable with some aspects of the relationship between client and expert and what this may mean for sharing of 'proprietary information' etc. Use of expert networks could perhaps accelerate learning in new industries though.

He says that we also need to accept that long-term investing requires 'leaps of faith'; we simply have to accept that businesses are 'less than perfect' but may still make very good investments.

More generally, Tom says it is simply difficult to find the time for additional sources of information given his extensive reading of annual reports, newspapers and magazines etc.

In a way, I find this to be a reassuringly 'old-fashioned' way of collecting intelligence on a business. While it may not work for everyone, e.g. without the same access to corporate management that Tom has, it is probably a very effective way of eliminating much of the noise that accompanies investing today.

Sensitivity to valuation levels

Long-term, fundamental investors come in many different guises e.g. when it comes to their sensitivity to valuation levels. I asked Tom where he finds himself on the spectrum.

To illustrate the choice facing investors, Tom used the example of Verizon and PayPal. The former is trading at a low 'optical' valuation but where this might just reflect the market's expectations when it comes to business prospects. The latter, on the other hand, reflects sustained growth at a high rate.

Tom says he falls somewhere between these two when it comes to valuation sensitivity; he doesn't want to own the Verizons of this world, with structural challenges, but he does pay attention to valuation. Having said that, a number of businesses today are doing the right thing by acquiring customers at an up-front loss etc and these can still be attractive investments.

It seems to me that more and more quality-focused investors are making this gradual transition towards accepting higher valuations for truly outstanding businesses; going all the way back to Buffett and Munger we have also heard a similar sentiment more recently from e.g. Mohnish Pabrai, Howard Marks etc.