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DECEMBER 2011

Follow the Leader...Sometimes

Tony Blair once noted, "The art of leadership is saying no…It is very easy to say yes." His observation is entirely suitable to most any enterprise – especially the investment business. At Hamilton Point, we have learned that the discipline to say no, especially when uncomfortable with the company's management, can make all the difference. Whether buying individual stocks and bonds generated by our original research, or the related selection of outside managers, the identification of solid management and enterprise culture is an inviolate step in Hamilton Point's quality-focused process that helps us avoid certain investments that can be tempting if looked at only from a quantitative view.

Grooming Talent from Within

A great example here is to look at a company that was once well-managed but has lost nearly all luster over the past 10+ years – **Hewlett Packard (HP).** This company was an absolute "darling of Wall Street" throughout the 70's, 80's and 90's. When longtime leader Lewis Platt announced his retirement in 1999, only one candidate from inside the company was reportedly considered to take his place. At the time, it struck us as odd that such a mighty company would need to look outside for someone to run the company. By comparison, most truly well-managed companies with superior corporate cultures like, say, **United Technologies** or **Proctor & Gamble** have multiple executives perpetually groomed as successor CEO.

HP ultimately hired Carly Fiorina—a rising star at fast-paced **Lucent**—who misread terribly the strong cards she was given. Like so many management "stars" she hastened to do big things quickly including a failed attempt to buy EDS and a more strategically puzzling offer to buy Compaq in early September 2001—the latter of which sent HP stock down over 18% in a single day.

In November 2001, the eponymous shareholder Walter Hewlett announced that the family would vote its shares against the merger by saying, "*….HP brings no value to low-cost computing and…should not chase profitless revenues.*" Upon his announcement, the stock popped up over 17% intraday as the market clearly agreed that in this case saying no to Fiorina's plan was better than yes.

With Fiorina's further persistence, however, the merger with Compaq went through and set the company on an erratic course ever since. When ousted in January of 2005, her legacy was that HP's stock declined 44% on her watch while the S&P 500 fell just 3.4%. Since then HP has had three other outside CEOs, the latest of whom is Meg Whitman. In the "for-what-its-worth-but-doesn't-surprise-us" column, Fiorina and Whitman were estimated to have recently spent a total of $176 million unsuccessfully running for political office in California.

Beware of Egos

A contemporary example of a company with outsized risk at the top would be Jon Corzine's recent **MF Global** debacle which will result in one of the biggest bankruptcies of all time. Corzine's record was already checkered when he joined this financial services giant in 2010 and it should surprise few that he promptly made reckless bets of firm assets—in this case, on European bank/country debt—only to see the firm collapse a few weeks ago. His history of bravado and grandiosity is well documented. After his ouster as Vice Chairman of (you guessed it) Goldman Sachs in

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1999 he spent $100 million of his own money to win a U.S. Senate seat in 2000 and, five years later, the Governorship of New Jersey. Upon losing his re-election bid, arguably for a lack of effective leadership, he joined MF Global last year. He allegedly used his influence—after all, he was rumored to be the next Treasury Secretary—to obtain an exemption from passing the customary Series 7 and 63 exams that, with rare exception, every other stockbroker in the nation must take in order to engage in the brokerage practice.[1] He also reportedly lobbied the Chairman of the CFTC (Commodity Futures Trading Commission), who (you guessed it again) worked with Corzine at Goldman Sachs, to delay implementation of disclosure rules that would have made disguising certain bets he was taking more difficult. Sadly, the SEC and the CFTC are now trying to find $1 billion in customer funds that went missing under his watch.[2]

There are many lessons here for investors. One is to be extra cautious of outfits that are not organized well enough to develop leadership succession internally. Another is to be wary of organizations with touches of megalomania/turmoil at the top. When you think of the truly tenuous legal relationship a minority shareholder has when investing in shares or debt of a public company, it becomes clear how important it is to delegate to those you are sure have interests aligned with your own.

Easy to Ignore…for Wall Street

Despite this fact, it is rare to read a Wall Street research report on a public entity and note any serious mention of the quality of its senior management or the tone of the company's culture. At Hamilton Point, when evaluating a new investment, we consult our broad network of financial and operating contacts to ask the paramount question, "so what do you know of XYZ's management and corporate culture?" While rarely something you will read about in print, most every company's corporate culture is well known by those that have either worked there or competed or done business with them; and it is not that hard to check this qualitative measurement out with some good old fashioned research. So why does Wall Street seemingly pay so little attention to this critical factor?

In our opinion, it is a combination of two things. First, in much of the investment industry there is a preference for quantitatively focused research – i.e. earnings estimates, target price projections, price to earnings ratios, etc. We find this research useful, but regard it as only a piece of the puzzle. Secondly, we believe there is the critical issue of independence – a recurring problem for Wall Street. After all, how can analysts write negatively of the management team their firms are trying to gain access to for corporate and investment banking service fees? The Internet bubble and the mortgage security/financial crisis made that omnipresent conflict abundantly clear, but despite the uproar with each major incident, little has changed, as Mr. Corzine's "leadership" should remind us.

Put in the context of Tony Blair's quote, Wall Street and many large investment houses are simply too busy giving easy "yeses" to be more critical of the hands that are feeding them. In contrast, at Hamilton Point, we have always reminded clients that a large part of the value we believe we bring to the table is what we keep our clients out of when trying to position portfolios on a high quality basis. In short, we remain thankful for the independence that affords us the flexibility to say yes…or sometimes no!

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Hamilton Point Investment Advisors is an independent and independent-minded wealth advisory firm. Please contact us for a complimentary review of your portfolio. In addition, visitors to the firm's website, www.HamiltonPoint.com, can read past investment newsletters.

1. "FINRA Head 'Not Apologetic' About Corzine Exam Waiver," Reuters. November 14, 2011.
2. "Mr. Corzine and His Regulators," Wall Street Journal. December 1, 2011.