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listeningin

# Steady As She Goes

## *Neither Pandemic WFH nor CIO Succession Upends Harding Loevner*

Simon Hallett

Ferrill Roll

*I checked in with Harding Loevner's Simon Hallett recently, something I hadn't done in any depth since I interviewed the then-CIO of the institutional investment manager in these pages back in the spring of 2016. Much has changed. After sharing the CIO role for five years with colleague Ferrill Roll, Simon took the firm's Vice Chairmanship, and left the CIO headaches to Ferrill — though he's still standing by, in an advisory role, while tending to external interests. The highly successful boutique institutional investment firm's interests — and his own.*

*As a U.K. native, Simon has "football" as he calls it, in his blood. And now in his portfolio. He's the majority owner and Chairman of his hometown's professional team, the Plymouth Argyle F.C.*

*Not surprisingly, perhaps, because Simon has long been an advocate for employing the insights of behavioral psychology in the investment management realm, he anticipates great scope for using much of what he's learned in investment management in running his team. Moneyball needs no translation, Simon says.*



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*Coming off a year in which — pandemic upsets be damned — three of the larger global quality growth strategies on which Harding Loevner hangs its hat quite handily bettered the performance of their benchmarks, what Ferrill says is that his investment team is sticking to its knitting.*

*He is determined to refine HL's research edge by not deviating from the strict process-driven investment discipline on which it has long relied. But with markets unlikely to continue setting record highs from here to infinity, Ferrill admits to increased sensitivity to valuations, as well as to quality and growth. Listen in.*
***— KMW***

**Hi, gentlemen. I'm glad we can connect today** [2/12]**. There have obviously been some changes at Harding Loevner since Simon and I had one of these chats in May of 2016. First of all, where are you calling in from?**
**Simon Hallett:** I'm at my home in Eastern Pennsylvania.

**Ferrill Roll:** I'm in Wilson, Wyoming.

**Jackson Hole. Nice. How's the skiing?**
**Ferrill:** I just came out here and it's been all work and no play so far. I'm hoping to get in some skiing soon. It has snowed since last night. There's a three-day weekend ahead,  I'm told, and up to a foot of new snow expected.

**Simon:** Sounds good.

**I'll say. It also sounds like the pandemic, no surprise, has required Harding Loevner to loosen up its very disciplined and concentrated research process — at least geographically? You've broken free of your headquarters in central New Jersey?**
**Ferrill:** Yes, but we are still reliant on our very concentrated, disciplined research process. In fact, because of steps taken years and years ago — which were really driven by Simon's views about how investment decisions should be, first, debated, and then, taken — we found that our transition to WFH went remarkably smoothly.

**"It's a terrible thing to say, but the business of the investment team at Harding Loevner has gone on without a pause."**

We've been recording *all* of our investment thinking, whether it's about a meeting with a management or musings about a portfolio change, *in writing,* and storing all those written communications in a searchable database for more than decade.

**Simon:** Yes, it's been for almost 15 years now.

**Ferrill:** It has been about that, in terms of storing everything in the searchable database, but we've been recording our investment thinking in writing pretty much ever since the inception of the firm, back in 1989. In part, because we were traveling all over the world with a fairly small staff — and everyone really wanted to know what was going on. So meeting notes would get communicated as we traveled, and that just grew over the years as the staff grew — to the point that we needed to have it more organized. So we created the database.

When the pandemic hit and we were all forced to leave all of our office resources behind and work from home, Simon couldn't tell the difference between the investment debate occurring among us from all of our homes and the way our office-based investment debate had proceeded when he had been participating in it in recent years from his other home, in Devon, England. So our transition to work from home was seamless, and that was a good thing.

**Simon:** We should point out that we'd also gone through some dislocations, which we had dealt with well, but also learned from — for instance during Hurricane Sandy, a number of years ago. When Sandy took out most of the Northeast, we found we needed not just alternative backup office facilities, but that those facilities needed to be dispersed. So over the last six or seven years, we had moved towards having an emergency plan and business continuity plan that involved basically working from home. We had tested the technology. Our traders were used to working from home already.

So it's a terrible thing to say, but the business of the investment team at Harding Loevner has gone on

without a pause.

***Terrible?***
**Simon:** I say it's a *terrible* thing to say because we've been remarkably well off, while a lot of people throughout the whole world have obviously been suffering from the effects of this pandemic.

**Very unfortunately, in your ancestral land as well as here — and in every other corner of the world. The disparities are stark.**
**Simon:** Yes, actually, as I recall, the last time we spoke, I was working from my new home office in the house that we had quite recently bought in Devon. I remember you asking about the sheep outside.

BIDEN CROSSING THE DELAWARE IN THE DEAD OF WINTER

**The background noises were very rural.**
**Simon:** That area actually has been relatively lightly hit by the pandemic, but it has still led to a massive deceleration in economic activity and a massive curtailment of people's social activities. But it's a relatively sparsely populated area, so there hasn't been the same prevalence of viral outbreaks as in places with larger concentrations of people.

**That's a blessing. In the U.S. even the most rural outposts have suffered devastating bouts of the pandemic.**
**Simon:** True.

**We can only hope enough people get vaccinated to thwart the pandemic before the virus mutates too much —**
**Simon:** It's a race, isn't it, as somebody put it, between a linear progression in vaccinations and the geometric or even exponential progression of the virus variants.

**Especially since we don't have our act together on even simple things that could slow the viral assault.**
**Simon:** So far.

**And bureaucracies aren't one of them.**
**Simon:** True.

**Nonetheless, Harding Loevner came through 2020 with flying colors. Your AUM has grown quite handily since we spoke. It was around $40 billion then.**
**Simon:** Extremely handily. The last figure I saw was $84 billion. We've been beneficiaries of two things. Firstly, the increase in market prices, and secondly, the fact that our performance has continued to be pretty good in the international and global arenas, boosting our big three products. Not quite so good in the emerging markets arena. But we've not suffered from the massive migration of assets from active management to passive.

We did have modest outflows on a net basis last year, but that was the first year in which we've had those outflows for a while. We've been protected, if you like, from some of the larger trends in the industry.

**So it's not just that global and international investors have been slower than U.S. ones to dump active managers for passive?**
**Ferrill:** We think it's more a result of the fact that our preferred investment philosophy has kept us in the high-quality growth end of the market spectrum — and that has been the style enjoying a tailwind, performance-wise. The ravages of the trend to pas-

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sive investing that have occurred in the rest of the market have really been hitting the value style and the core managers much more fiercely. So we've been protected by our style. But our style, of course, is a choice.

**And you still pick your quality growth names, I assume, strictly based on intense and disciplined bottom-up research?**

**Simon:** Yep, 100 percent. I may have talked about this when we spoke five years ago, but it bears repeating. The investment philosophy at Harding Loevner has always been — as Charlie Munger has put it, "find a bunch of good companies, and then sit on your rear end."

We've continued to try to find high-quality companies that grow their cash flows, earnings, and revenues over long periods of time, and to be long-term investors in them, at advantageous prices. Portfolio turnover remains low, at around 15% - 25% annually. But the firm remains very much committed to long-term investing in high-quality, long-duration growth companies.

**To enjoy the compounding of that growth?**

**Simon:** Sure. Compounding that growth is what it's all about. We also run very diversified portfolios. We believe in the merits of diversification and we pay attention to prices, but at its core, what we do is invest in quality companies that grow. And we stick with them long enough to compound the benefits of that.

**Yet there have been some obvious changes in your shop of late.**

**Simon:** You're absolutely right. People have changed, albeit people change slowly; the process has changed, albeit the process changes slowly. The thing is, our investment philosophy has remained constant over 32 years now.

**I'm wondering what you're doing, Simon, now that Ferrill is the sole CIO, after working as co-CIO with you for several years.**

**Simon:** Watching over everything very lightly, as Vice Chairman. I'm not watching over Ferrill. No. Ferrill is the Chief Investment Officer. I work at his command. The background here is that nearly five years ago, we split my job as Chief Investment Officer — I had become CIO back in 2004, when we had only about $1 billion of assets under management, and a dozen or so investment professionals in the entire firm.

Today we have about 40 investment professionals. We have tens of billions of dollars in assets. We have clients all over the world. You can get our investment strategies through all distribution channels. It's a much more complex business to be chief investment officer of today, than it was back in '03.

And time was marching on. I was starting to develop a few outside interests — after having basically joined Dan Harding and David Loevner in their startup — and not being able to pursue other interests for years. So we split the CIO job in half about four and a half years ago. Then, as things emerged more quickly than I expected, Ferrill stepped up and really imposed himself on the job. That may sound as if it was quite an unpleasant experience —

**Ferrill:** Actually, the job imposed itself *on me*.

**Simon:** Yes, and it *was* a very pleasant process as far as I was concerned. Ferrill simply started to become the true — the emerging leader, let's say — of the investment group. So we decided about a year ago that we'd entirely pass that responsibility over to him. I still wanted to remain involved with the firm, so my basic job now is to keep an eye on things, to let Ferrill know if I see things going on that I think he should be aware of, to give him advice when I think it's appropriate. But, above all, to be *available* if there's anything that Ferrill needs from me. At the same time, I've been spending more time doing external stuff. I will be the person who goes and sees clients, but I won't be as heavily involved in the day-to-day basics.

My full title now is Vice Chairman of the Executive Committee, so I remain involved in the executive leadership of the firm. But Ferrill is very much the Chief Investment Officer and accountable to the firm for what the investment team gets up to.

**Ferrill:** Thanks for that!

**It sounds you're sticking with the ethos Simon described to me five years ago — one of closely tracking accountability for research and investment decisions.**

**Ferrill:** Absolutely. That is a core tenet of our culture. People are accountable for their decisions, and their decisions are measured objectively and mostly transparently. If you don't have objective measurements and you don't have accountability, you can't be sure who are the ones contributing and who are the ones holding you back.

**Or how much of a role luck is playing in your outcomes —**

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**Ferrill:** [Laughs] Yes. That's very difficult to disentangle — luck versus skill. It takes a very long time to disentangle those.

**Michael Mauboussin has made quite a career out of it, it seems.**

**Simon:** Actually, it's funny you say that. Michael is known to the firm. He's been in to talk to us a couple of times. He and I chat occasionally — probably because we were introduced by Rick Schmidt, one of our portfolio managers and an old friend of mine. Rick and Michael got to be friends while both were studying at Georgetown University.

As I mentioned, I frequently find myself representing the firm externally, and when I talk about our investment process, I talk about skill and luck. I also talk a lot about Michael Mauboussin and I'm very careful to say that when I was Chief Investment Officer, almost everything that we introduced in terms of our investment process can be found somewhere in the books of Michael Mauboussin. And you can get all his advice, his collected works, for about $50.

**It's actually quite an impressive oeuvre. I've been lucky enough to feature Michael as an interviewee. It's one of my favorites.**

**Simon:** His books are a tremendous bargain. I mean, somebody asked me, just the other day: "Who's the most interesting person you've ever come across?" And I said it was Michael. He's probably been the person most influential on my investment thinking, certainly when I was chief investment officer. He heavily influenced my thinking about how to structure an investment process. I'm perfectly happy to give him the credit for that. I describe myself — not as a theorist of these things — but as a consumer of other people's theories.

I think what we've done effectively as a firm — and Ferrill gets credit for it; everybody at Harding Loevner gets credit, including the people on whom the process is imposed — is collectively recognizing the importance of *process*, recognizing the importance of acknowledging your behavioral flaws. Critically, what we've also done, from top to bottom, at Harding Loevner is *accept* that a structured investment process, a disciplined one, is one that restricts your freedom. Our analysts know that there are certain things they're just not allowed to do, because it would be contrary to the process — and it's important that everybody buys into that. But again, everything we do is described somewhere in Michael's work.

**Yet your investment process, as you outlined it five years ago, didn't sound particularly remarkable.**

**Simon:** Right. Pretty much everyone in the business goes through the same four basic steps — qualifying companies for investment, researching the companies, valuing those businesses and then building them into portfolios. What's different about us is that our process is highly structured — a discipline applied across all markets, by all of our analysts and PMs, and genuinely long-term.

What's more, we insist on transparency and individual accountability in all this — and have structured our compensation system accordingly. Recording all the steps in our research deliberations, in writing, as Ferrill and I were describing earlier, has been critical to that individual accountability. Years ago, when there were just two of us making the investment decisions, accountability was obvious. But as we grew, we came to believe that individual accountability, in an institutional context, is much more important than consensus building. In fact, we talk a lot about our need for collaboration without consensus.

**What's that really mean?**

**Simon:** What we've worked to build into our process is systematic collaboration — to challenge others' ideas, rather than to try to seek agreement. We think it's much more valuable, if you have an opinion, to find somebody who disagrees with it and challenges you, rather than finding somebody who agrees with you. Overcoming confirmation bias is *that* important.

**As I recall, you talked in our last interview about the challenge of finding investment pros willing to work within a process that's not a typical star system. Collaboration, consultation and debate, *required*.**

**Simon:** Yes. It's contrary to the investment culture. The investment culture is all about genius — the cunning stock picker who's cleverer than the market — which is an extraordinarily overconfident attitude to assume.

**It's really rather stunning, when you step back and look at the tremendous research that's been done on the behavioral aspects of investing over the last 25 - 30 years, that so few of those insights are routinely put into practice.**

**Simon:** I'm constantly amazed. I joke that investing people seem to have one of three responses when told about behavioral psychology or decision and cognitive theory in general. They either say, "That's very interesting but doesn't apply to me," which is ridiculous because they're humans. Or, they say,

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"That's interesting, that means there are market anomalies we can exploit," which is perfectly valid — and people like Richard Thaler have successfully done that. But the third response, "That's extremely useful, we can learn from that research how to improve our own decision-making as a group," seems to be remarkably rare.

**Rather like the humility it takes to see that.**
**Simon:** By the way, I'm not pretending — and I think my colleagues at Harding Loevner would all agree — that we're perfect, by any means. There's plenty of room for us to get better in our decision-making. I'm not handing over to Ferrill a finished product. It'll never be finished. There are ways in which we can continue to improve.

**Ferrill:** That is another Michael Mauboussin idea, the paradox of skill, isn't it?

**Simon:** Yes, skill.

**Ferrill:** It means that our skill at what we do gets better incrementally every year. It has to, or the Red Queen will pass us by. We have to pedal as hard as we can just to stand still against our competition, and the competition is getting better all the time.

**That's what makes the paradox of skill so frustrating; there's no resting on laurels.**
**Ferrill:** Right. As passive investing essentially crowds out the active managers who have less skill, the job gets a whole lot harder for the people remaining on the playing field. It's not getting easier. Their competition gets increasingly tougher.

**Simon:** By the way, Michael credits Stephen Jay Gould, the late Harvard biologist, for that insight — at its simplest, the paradox of skill means that as average skill levels increase, *luck* increasingly determines the outcome.

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**Which is very frustrating, particularly if you want to take credit for said outcome.**
**Simon:** That's the problem. Even if you do continue to do well, it continually gets harder to demonstrate that you've done well *because you've been skillful*, rather than just lucky. So you have to not just work very hard on your level of skill, but also be able to demonstrate that there's some *causal* relationship — not merely a correlation — between inputs and output. And that is tricky.

**To say the least. Everything is a moving target, at least where your competition is other humans who are likewise honing their skill, evolving, improving.**
**Simon:** But let's hope they're only doing so slowly.

**Ferrill:** Exactly. Our competition in the future is going to be other humans and other machines.

**Simon:** True.
**Ferrill:** Run by humans, but still.

**Algorithmic competition is already here.**
**Simon:** It is. But at the core of AI, there are human beings making programing decisions, and even for those algorithms, there are *humans* who are determining the inputs.

**And contributing their biases — consciously or not.**
**Simon:** Exactly. So this is very much a part of the human condition. One of my interests, outside of Harding Loevner, is soccer. I'm the majority owner and chairman of a football club. Or rather, a soccer club, as you say here.

**I am glad you brought that up. Are you having an easier time of it than *Ted Lasso*?**
**Simon:** Yes, although actually the better analogy is that I'm *Ted Lasso*'s boss, *that* woman, [Rebecca Welton].

**Though I bet *you* definitely are *not* out to sink your team's fortunes —**
**Simon:** Not at all. Banish the thought! But I actually *have* mentioned to some of our fans that I am now a fan of a second team. My first team is Plymouth Argyle and my second team is [*Ted Lasso*'s fictional] Richmond AFC. So, I did enjoy that show's first season.

**Isn't taking on majority ownership and the chairman's headaches at a debt-burdened U.K. football club a bit of stretch?**
**Simon:** I think not. First of all, I'm a long-time and

passionate Argyle fan. As you know, my wife and I are spending more time at our house in Devon, where I have family. And I was educated at the City of Plymouth's expense, at Plymouth College, before I went on to Oxford, so I wanted to do something for the city. The time seemed right, when my ownership involvement started in 2016 — we could engineer a refinancing of the club's debt on very favorable terms. And things have taken off from there.

But I actually find that managing the team is much the same as the investment management I've done for years at Harding Loevner. The principles are the same.

**How so?**

**Simon:** The coach of the football team, the Ted Lasso equivalent, is widely considered to be *the guy* who influences the results. But the outcomes of individual contests are very much the results of an interplay of skill and luck. And the conflicts and the biases that people have in football are almost identical to the ones that they have in investment management.

**Really?**

**Simon:** Absolutely. I was quite literally saying to the football management team yesterday, *just yesterday*, that the competitive advantage our football team has is what we know about decision-making — and our willingness to implement that knowledge. And that is precisely parallel to what Ferrill and I were just saying about our investment team. They're willing to subjugate their own autonomy to rules, to structure, to discipline, and to the use of objective data — which is very, *very* rare in football. But teams that have done that at the highest level are the most successful. It is very noticeable.

**Perhaps, if you're a fan. Can you explain to a soccer philistine?**

**Simon:** Let me try. This time last year, Liverpool F.C., one of the leading Premiere League teams in England, and arguably the world, were champions of Europe, champions of the world, champions of England. It is *not* by coincidence that they are owned by Fenway Sports Group, which is majority owned by John Henry —

**Say no more. The owner of the Boston Red Sox. So you're saying that you're applying the lessons of "*Moneyball*," to football?**

**Simon:** Correct. But there was some tension in the organizational structure that Billy Beane had to work with at the Oakland A's, as you can read in *Moneyball*. As general manager, Billy Beane was higher in the hierarchy than Art Howe, who was the manager of the Oakland A's. So if Art Howe believed that stealing bases was a good thing and Billy Beane thought it was a bad thing, the message from Billy to Art was, "You can [tell the team to] steal bases if you like, but I'll fire you."

**Every good book — and movie — needs a bit of dramatic conflict like that in the plot.**

**Simon:** True, but the result was that the Oakland A's didn't steal bases, even if there was some friction created between Beane and Howe.

When it comes to my football team, the Plymouth Argyles, I've made it quite clear that I know *nothing* about football.

**That alone makes you an incredibly unusual sports fan. Much less owner.**

**Simon:** Well, I've made it equally clear that I *do* know about decision-making. So the only thing that's non-negotiable at Plymouth Argyle is that we have instituted an assessment process, a decision-making process, that incorporates objective data. The competitive advantage of my football team, I strongly believe, is that its football management people are prepared to subjugate their autonomy to the one thing that I know a bit about — a disciplined  objective data-driven decision-making process. It's been very interesting.

**No doubt. And as majority owner, you can insist on 100% buy in. But it probably has still been as difficult as getting investment hotshots to commit to your research process discipline.**

**Simon:** Absolutely. Even more difficult, trust me.

**What? Sports stars think they're masters of the universe, too?**

**Simon:** Exactly. They all think they are Sir Alex Ferguson. [The Scottish former football player, and manager of Manchester United from 1986 to 2013, won more trophies than any other manager in the history of football.]

**And I always wanted to be Billy Jean King. Wasn't happening. In any event, you've got yourself quite a sideline. Does it keep you busier in the offseason or in season?**

**Simon:** Well, I'm not executive chairman, so I don't get into the details daily — though actually, I've got a call scheduled in about an hour with our chief executive. We have a CEO who runs the club on a day-to-day basis, and we have a very good board, which is responsible for setting strategies. So I don't get involved on a day-to-day basis, in the same way as they do, in decision-making. My job as chairman is just like being a chief investment officer. As Harding Loevner's CIO, I was in charge of people and

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process. Now, I have views about the process at the football club, just as I used to have views about the process at Harding Loevner.

**Ferrill:** You *still* have views about the process at Harding Loevner!

**Simon:** I still have views, you're right.

**Ferrill:** And I seem to ask you about those views all the time.

**Simon:** But people are freer to ignore me, these days.

**I note you said "freer" not "free." Do you two agree on the global outlook for investment here? I'm rather confused.**

**Ferrill:** We've all agreed at Harding Loevner that it *always* looks confusing — and that we are inherently bad at predicting the future. So we really try to not let our widely varying views — and by that I mean our own views differing even from those we held ourselves five minutes ago — influence other people's decisions about what they should be doing in the portfolios. That's really bedrock in this rules-based process that we've built over the years.

**Then you're all about tracking and measuring what's bubbling up from your research process and then allocating there, regardless?**

**Ferrill:** That's part of it, no doubt. But it's also the recognition that making grand forecasts about macroeconomics or entire markets is futile — nobody has a very good track record and we certainly don't have a very good track record.

So we need to rely on other ways of structuring our portfolios, choosing our investments. Because we don't rely on those unreliable forecasts. And we landed very long ago on the idea that high-quality businesses seem to persist as high-quality businesses — and ones that have growth opportunities in front of them tend to not just persist, but prosper.

**Just to be clear, quality is at least as important to you as growth. You're not talking about buying moonshots trading at infinite multiples of non-existent profits or even cash flow?**

**Simon:** No, what we look for are the kind of companies that grow earnings at 6% to 10% a year — and that don't look very exciting next to the FAANGs — but they are *consistently* growing. And, of course, 6% to 10% a year growth over five years, much less, over 20-25 years, is extraordinary growth.

**Ferrill:** So, as long as we're not overpaying for them, we'll do all right. Granted, that's a pretty simple insight, but that still underpins a lot of our process and underpins our resistance to having to act like we know where in the world we should allocate more capital or whether we should be more aggressive or less aggressive. It isn't part of our DNA — or at least, we try to make it part of our DNA *to avoid* making those forecasts or grand pronouncements.

**Simon:** And thank goodness, this year, that we don't. Imagine — here we are today, on February 12th. Just imagine that — a year ago — you had perfect foresight of the next 12 months in the economy and so on. What would you have done?

**Gone into a deep depression and funk.**

**Simon:** That's my point. You would probably have sold everything. Which, obviously, was what people did — but only for a very brief period. I know very few people would have predicted that the markets would respond more to the inevitable liquidity injection than they would to the problems that the liquidity injection was meant to address.

**Namely, a deadly global pandemic.**

**Simon:** Well, yes. It's astonishing to me. But it's a great, *great* example of how — even if you have perfect foresight about the macroeconomic background and the social background — your ability to forecast what's going to happen *in financial markets* is still very, *very* limited.

**Which is why you instead emphasize decisions you can get a better handle on — like which companies are truly quality growth vehicles and what prices you can justify paying for them? Yet I remember from our last chat that you actively discourage your analysts from checking stock prices?**

**Simon:** That's not *quite* right.

**Refresh my memory, please.**

**Simon:** We *do* look at stock prices. I know that there are growth managers today who just say, "We don't care about valuations, we just care about growth rates." That is *not* us. We care about quality, we care about growth, and we do care about the price we pay for it. When we don't like our analysts focusing on stock prices is early on in the investment process.

So we never screen the available universe by price. We try to identify attractive *businesses*. As Ferrill

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mentioned, we think quality — more than growth — but *both* quality *and* growth are more durable — less volatile, if you like — than underlying prices. So we try to establish, above all, which *businesses* we want to be investors in. Then we try to wait until prices come our way, and stick with our holdings for long periods of time.

**And you make that quality and growth determination, how?**

**Simon:** Our investment process looks at company characteristics, looks at companies' income statements, balance sheets, looks at cashflows, their competitive landscapes, so we can value them. Then, finally, once we've figured out what we think a company is worth, we ask the analysts, "Okay, you say this company is worth $10 a share. What would we have to pay for it? So considering price is way down the list of priorities in our research process.

**Ferrill:** There's a grain of truth to what you said about discouraging analysts from looking at stock prices, which has to do with discouraging them from obsessing about prices on a daily basis.

**Simon:** Yes. Very true.

**Ferrill:** You probably were remembering the fact that, when we were working in the office, for the entire research and investment department, we had two Bloomberg machines, which was a 100% increase on what their accessibility was 12 years ago, when there was one Bloomberg in the whole office.

That literally was to discourage people from paying daily and hourly attention to the prices.

**Simon:** Yes.

**Not to mention, it kept a real lid on costs.**

**Ferrill:** True, but if you're paying lots of attention to small price changes, you are *not* spending your time where it is most fruitful from the fundamental analysis point of view, which is on understanding what's changing under the hoods of the businesses. What's changing in the industry? Where are the new competitors coming from? Those things create lasting changes in the fortunes of a company. Today's fashion-induced price movement has very little bearing on the fortunes of companies, with the possible exception of a GameStop.

**Which is scarcely a quality growth company!**

**Simon:** Right. As Ferrill says, the flickering of the ticker has very little impact on a company's growth prospects or fundamentals. But it can have quite a significant impact on your emotional responses to those price changes.

**No kidding.**

**Simon:** Paying attention to stock price gyrations induces action. At Harding Loevner, we like to say that we believe in the benefit of *inaction* — whereas action tends to make you *feel* better, it doesn't do your *portfolios* any good.

**With that attitude, I imagine you don't have a lot of traders banging on your doors, looking for jobs.**

**Ferrill:** We don't need very many. But we did hire a new trader in the last year. One of a number of hires we've made entirely online. What's the term? Remote onboarding.

**Simon:** It's fair to say that the kind of trader who works for Harding Loevner is different from the general impression of what a trader is — somebody swinging his ego around, adding massive value, purportedly, to returns for underlying clients. Our traders, like our analysts and portfolio managers, are required to subjugate their egos in the pursuit of efficiency.

Their jobs are to try to minimize costs, not maximize value. And they're very, *very* good at it. So, there's the satisfaction of a job well done — and there's always a job to be done. We've grown substantially. There are inflows to be invested carefully at low overall cost, and every day we have inflows, and we have outflows. So there's always something for traders to do to help clients' net returns.

**Do your PMs set the price ranges that your traders work within?**

**Ferrill:** The trading desk is in charge of very, *very* short-term price discrimination, and the analysts and the portfolio managers are in charge of price versus value, if you will. We actually took steps years ago to divorce the two decisions. We told portfolio managers in particular to stop micromanaging trades for their portfolios once they'd decided that this would be a good week or month or quarter to buy specific shares. Holding off buying those shares, or not, as prices fluctuate, is a day trader's job — not the job of a PM with a five-year outlook mandate. So we had to actually divorce the two kinds of pricing awareness, if you will. Say to the portfolio managers, "If you were really good at day trading, would you be a portfolio manager at Harding Loevner? Probably not. So leave that to the guys who do this every day, and get out of the way." It's been that way — how long? For about 15 years.


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**Simon:** At least. I'd say it's at least 20.

**Where are you finding quality growth — at prices you can stomach — in today's markets?**
**Ferrill:** Clearly, the year of the pandemic has revealed just how many growth opportunities there are for companies who can operate almost entirely virtually. So it's been a technology and ecommerce-led market.

**Certainly, until this last quarter.**
**Ferrill:** Since last March, really. There was a big wobble in the fourth quarter, but the trends have reasserted themselves to a certain extent here in the new year. And so as you asked earlier, how do we see the markets? We see the markets as very confusing —

**That's what *I* said. Surely, *you* have a view.**
**Ferrill:** Well, we do need to look at the price of some of these totally online business models that have grown very rapidly in the last five years — and *extraordinarily* rapidly in the last year. This growth rate can't persist. There's no way, as fast as this growth is. It's being discounted as if it can go on forever, and it probably can't go on forever.

**That's a pretty good bet.**
**Ferrill:** Do you remember Herbert Stein? He used to write in the opinion pages of *The Wall Street Journal*.

**The economist, sure. He served in the Nixon and Ford Administrations. His son, the lawyer and actor Ben Stein, used to write for us at *Barron's*.**
**Ferrill:** Then you probably remember Herb Stein's law: "If something can't go on forever, it won't."

**Indeed, I do. You're implying it applies to this bull market?**
**Ferrill:** Well, if something cannot go on forever it won't. What we're trying to do is thread the needle between letting go of some of the most successful investments in our portfolios — which now appear to us to be valued beyond anything we can imagine — and finding other high-quality businesses that, for either cyclical reasons or because of an issue that we think is temporary — the market has beaten down to a valuation we find attractive. When we can find them, we reallocate to those slightly less rarified stocks, in terms of their valuations. But we're finding that process very difficult.

Every PM in all of our strategies is working to cope with those sorts of valuation dilemmas. Some of them have gotten more price tolerant — and some of them have gotten less valuation tolerant as the prices have climbed higher. So we had some variations in outcomes between strategies last year. Our Emerging Markets strategy struggled a bit last year, whereas our World strategy's performance just knocked the lights out. And our Global strategy was pretty good, coming in, in between those two.

The challenge now is how our portfolios will navigate this difficult tradeoff between growth which the market has been obsessed with while it has been contending with ultra-low interest rates, and very high valuations. We believe that the price you pay for something influences the return you get from that. There's something of a constant wrestling match between those three elements of our process — the quality of the businesses, the growth they can prospectively achieve, and the prices we're asked to pay for them.

**I forget, do you guys have the option of holding cash?**
**Simon:** We're mostly fully invested. Actually, I think one of the reasons we've done well over the last three or four years is that while we've been wrestling with this problem about the sustainability of these very high valuations, we've been wrestling with it *individually,* and from the bottom up.

**Go on —**
**Simon:** Our portfolios are the aggregation of a large number of individual decisions, and so — I think I can speak on Ferrill's behalf — as a portfolio manager, at times, he's thought, "Oh, my God, everything's too expensive. I'm going to sell one or two things." But at those same junctures, decisions made by his other portfolio manager colleagues have occasionally gone the opposite way. Not in the same stock, obviously.

But in aggregate, over the last four or five years, we have allowed our portfolios to get a little bit more value-oriented. They're obviously never going to be value portfolios, but a little bit more value-oriented, because we still expect a little bit of growth. We've never come to a view that we need to *get out of this*; that we need to get out of the high-growth sector because it's too expensive. Again, when you're making little decisions, one by one, by different individuals, and aggregating them to make up your portfolios, you're not at risk of making one very large decision that turns out to be wrong.

**You also end up with a pretty wide dispersion of company, industry and sector bets across the globe —**
**Simon:** Yep. We believe in the value of diversification — quality, growth and price in the context of globally diversified portfolios.

**So when you say you have edged a little more toward value, what do you mean?**
**Simon:** It's exceedingly unusual these days to find sustainable compounders, growing in the 6%-10% range, trading at a valuation anyone would class as "value."

**Exactly.**
**Ferrill:** What Simon was really getting at is that we're really trying to have some more, I'm going to call it, "valuation sensitivity" today, rather than a "value orientation."

**Simon:** Yes, *yes*.

**Ferrill:** We're really trying to avoid the worst valuation excesses of the current enthusiasm for rapidly growing companies. Because our experience after 1999 was that in that era's rush of enthusiasm to pursue growth in anything connected to the internet, all connection to reality eventually got lost for some of those businesses.

**No, really? You see parallels?**
**Ferrill:** Well, the stocks with the most unmoored valuations were the ones that hurt the most all the way down, after that episode. We want to look at our portfolio after any future change of market fashion, market enthusiasm, and say that we still want to be in these quality businesses at these prices. We don't want to put things in our portfolios that don't have sustainable business dynamics and growth prospects, if the market price deflates. We want to be able to be looking at buying more of the quality companies we own if their prices go down. We don't want to be in the position of panicking that we own them into or after a market decline, because we had been hoodwinked into buying them by confusing strong price momentum with strong businesses.

**So you are wary of a bubble popping?**
**Ferrill:** The difference between 1999 and now is that some of the best-performing stocks today are performing well *because* the businesses are really, really robust and delivering strong growth and free cashflows. That is a major difference from 1999.

**True. The internet bubble was mostly about stocks that — even when generating revenues — were bleeding cash.**
**Ferrill:** I think parallels with the Nifty 50 are more apt. Many of those high-flying businesses were very, very strong businesses, delivering on that good growth, and continued to be strong businesses after the crash of Nifty-Fifty. But now we're talking about 1972-'74, and I wasn't active in markets then. I was in high school.

**Braggart. I have to admit I started work at *The Wall Street Journal* in the spring of '74, just in time to witness that bear's worst.**
**Simon:** That's interesting. I was working in a bank between school and university in England, when all of that came to a head. There had been an inflationary boom in England, followed by a bust, and the entire banking system was on the verge of collapse. The bank I worked in, which was one of the big four, came within 24 hours of having to close all its doors. It got bailed out by what became known as the Lifeboat. I remember it well.

**Those early experiences stay with you. I thought markets only tanked, for the longest time.**
**Simon:** They do. And it's not necessarily helpful. They make you, I think, risk averse. And too much risk aversion is a bad thing.

**It is. Nothing ventured, nothing gained.**
**Simon:** Exactly.

**It's a balancing act.**
**Ferrill:** Yes, there's a big difference between being a risk-taker and a risk-seeker.

**You mentioned that your EM strategy lagged a bit last year. Do you see that continuing until the globe finally controls COVID?**
**Ferrill:** Well, let's not forget that half of the emerging markets sector these days — not quite — but between 35% and 40% of the weighting in the emerging market index is China, and if you throw in Taiwan and South Korea —

**That's a lot of representation of rapidly developing Asia.**
**Ferrill:** Those nations now constitute more than half of the weighting in the emerging markets index — and those countries have done formidably better jobs at managing the virus than all of developed ones.

**Let's hope we learn the right lessons from this distinctly humbling experience.**
**Simon:** Indeed, and we can perhaps also add in to those making progress against the pandemic other large markets, like Russia, which seems to have developed its own vaccine. Who really knows? But

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there's also India, which I've seen has announced that it's going to be selling a nasal vaccine against COVID-19. It's supposed to be very easy to produce, and very easy to administer. So this idea that emerging market countries are going to be slow to respond I think is a bit of a misnomer.

**Alas, that's not universally the case. I was thinking about huge populations in South America and Africa, with very little recourse.**
**Simon:** There are some places where there are big problems. Most obviously Brazil. That's a function of its leadership — just look at how poor leadership impacted the response in this country, which has hardly been world-leading, has it?

**Ferrill:** Well, it *has* been world-leading, but in the wrong direction.

**Exactly. But research, and our own eyes, tell us that whether in the U.S. or in the world's poorest nations, the most disadvantaged, under-resourced, communities are suffering disproportionately worse outcomes.**
**Ferrill:** I think what Simon and I were getting at is that many developing countries are going to continue to struggle with the virus for longer than perhaps we will in the U.S. — if we get enough vaccines into enough people.

But emerging market *stocks* are a very different kettle of fish than all developing country societies. That's a very important distinction to make always, in all investing. But it's especially important to make that distinction when you're talking about investing in emerging markets. Because those stock markets as represented by the emerging market index — or by our available universe of qualified companies in those markets that we have researched — are very different things than the average experience of someone living in any of those developing countries.

**Distinction noted. And if I'm correct, you search for quality growth companies in those markets, essentially without regard to national borders.**
**Ferrill:** Right. Then too, when you think about relative valuations — it's true that in the last year or two, the technology and ecommerce businesses in those markets, just like in the rest of the world, have been bid up. But by and large, emerging market valuations are set outside of the tech sector, and so tend to be much lower than valuations in developed markets. So, when you combine the fact that the developing markets indices aren't necessarily representing what you're seeing on the ground in each country and their generally lower valuations, I think there's a very strong case that emerging markets are going to be a more interesting place to be in the next year than the more expensive segments of developed markets.

**Then you're betting globalization survives the pandemic and the bouts of global political insanity it has been fueling?**
**Ferrill:** Well, I hope so. I'm constantly optimistic, but we seem to be turning the temperature down a bit. Though, again, I have no crystal ball.

**Simon:** I agree with Ferrill. I think globalization is not dead. Though obviously it took a bit of a backseat in the United States over the last four or five years, and I worry that it's going to continue to take a backseat. But that genie is out of the bottle.

**You have a very broad client base at Harding Loevner, ranging from massive institutions to wealthy individuals to mutual fund buyers. What are you hearing from them?**
**Ferrill:** I don't have much of a sense of their attitudes — in part because I get sheltered from what their attitudes are. But also, I think, because we generally sailed through last year with relatively good performance in most of our strategies. Clients typically are thinking hard about where their problem children are — rather than dealing with their deepest insecurities about us, by telling us about them.

But I think most of our thoughtful clients have worries similar to ours about this kind of liquidity-driven, high-valuation market that has favored growth investors. And in our case, that our underlying quality growth philosophy has enjoyed a tailwind from that. No one can quite picture how it might end — but they're all worried that it might end. The trouble is that the alternatives don't look very attractive.

**Simon:** That's right, isn't it? I mean, we've seen in the last couple of months, I think, a bit of a different attitude from clients.

**How so?**
**Simon:** We're seeing some clients increasing their equity exposure because they need the prospect of high returns. You can have your own views about whether that's a good thing or a bad thing.

But we've also seen clients who say, "We want to bank some of the returns that we've had" in our quality-growth strategies to get more defensive. Yet,

as Ferrill said, it's very hard to say what "more defensive" assets are. And as you pointed out, our clients range from high-net-worth individuals to very large sovereign funds and everything in between. One thing we are seeing that they have in common these days — and you're probably seeing, too — is that everyone is paying more attention to what's going on in global ESG and sustainable investing.

It's interesting that it's a pressure and an interest that grew first in Europe with our institutional clients and with our Australian institutional clients, but we're now seeing it coming from Asian clients as well as — on a more limited basis — from clients in the United States. So it's truly a trend that's here to stay. But this is still very much early days for it. The whole ESG investing concept, and the whole sustainable investing universe, is still very, *very* poorly defined, very confused.

**That's an understatement. "Environmental, social and governance" considerations come in as many flavors as *Baskin Robbins*.**
**Simon:** Yes. It's all a matter of definitions, that are anything but clear cut. There have been some good pieces of late about the contradictions inherent in some "ESG" stocks. Tesla is a classic.

**That's one way to put it.**
**Simon:** Is it good for the environment or not? If I scrap my five-year-old Subaru Outback to buy a new Tesla, am I creating net carbon emissions or not? It's an empirical question that nobody can quite answer. That's just the Environmental part. What about the Social side? Now Tesla is buying Bitcoins, and Bitcoin mining is very bad for the environment. And I won't even go into the host of Governance issues that may bring up.

**Ferrill:** ESG does include G still, but it gets ignored a lot.

**Simon:** It does. There are agencies setting themselves up as evaluating corporate governance, saying they have the ability to rate companies on ESG criteria. But their ratings are all over the place. It is very, very confused.

**Well, Morningstar managed to set itself up as the arbiter of the mutual fund space, despite it's fairly arbitrary style box system.**
**Simon:** I think that's slightly unfair to Morningstar's boxes. Sure, at the margin you can argue with them — like we argue that we shouldn't be in their large-cap-growth box, because we think of ourselves as all-cap managers. But I think the boxes are at least reasonably accurate representations of where fund portfolios are invested in any given period. Much depends on how you frame the question.

**I suppose. And it *is* inevitable that any rating system will be gamed, in Wall Street.**
**Simon:** I was thinking more that, depending on your ethical views, or your sociological views, Nike is either helping alleviate poverty in the developing world by employing cheap labor under very good working conditions, relative to the alternatives, or Nike is sending American jobs overseas.

**True that.**
**Simon:** And of course both are true. So if you're running an ESG fund, do you buy Nike or short it? I don't know. It just depends on your views, doesn't it, and how you frame them? So it's very tricky. But the trend is here, and I'm hoping that this year we'll be able to think about it in a more coherent way.

**But you haven't set up an ESG fund.**
**Simon:** No, we haven't.

**Ferrill:** We have always looked at governance issues, from the earliest days of the firm, as risks that ought to be identified and considered when making an investment. Part of our quality determination. Four or five years ago, we created a very detailed checklist of issues that must be considered by every analyst for every company that they are introducing to their coverage. It includes a series of questions the analysts must answer about environmental and social concerns. So we've really added a quite robust investigation of environmental and social issues, alongside the governance issues that we've all been doing for decades, to our process.

It is an integral part of our qualitative assessment that's done for every company, and the analysts are responsible for monitoring it through time if they continue to follow that company. We did realize in the last couple of years, though, that while we had this very robust process in place, we hadn't effectively communicated about it with clients — hadn't specifically applied the ESG label to it. So at the beginning of last year we specifically tasked one of our analysts, Maria Lernerman, with following ESG as well as the Consumer Discretionary universe she was already following. In that way, we could formalize how we communicate this to clients. But we are still also making sure that every analyst is paying the attention that we indicate they should be paying to ESG issues. We really are walking the walk, not just talking it. It's an effort really built on top of our

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concepts about what constitutes a quality growth company — concepts that have been evolving for a very long time.

**Simon:** It really comes back to what we mean by sustainable quality growth. We want to be invested in companies for a very, very long time. So by definition what we're doing is sustainable investing. It's not just words. What we've done is carve out, in each of the market segments, certain investment criteria that we've long been looking at, and put them explicitly in buckets labeled ESG.

But no, we haven't launched separate products. I just don't think the marketplace is coherent enough at the moment. I'm not saying we'll never do one, but it's a funny marketplace at the moment, and I'd be reluctant to add to the confusion.

**Thanks for that! Can you say yet what post-pandemic life will be like at Harding Loevner. Everyone back in the office?**

**Simon:** No. Starting mid-July our office has been open, and we're very careful about COVID protocols. People have to log in and obey the rules and all this kind of stuff.

**Ferrill:** But it's very much voluntary attendance.

**Simon:** And at the moment, we can't see when it's likely to be back to business as usual — nor are we sure that it will ever be back to business as usual. We're beginning to strategize about what the future of work looks like at Harding Loevner, and as is typical here we have a range of views. Everything from we should have an extra day a month of permitted working from home to people who say, "To hell with the office. Let's shut it down and all just work remotely." We'll end up somewhere in the middle, but we don't know where yet.

**Okay, let me put Ferrill on the spot. How is the investment process at Harding Loevner going to change now that you're no longer sharing the CIO responsibilities with Simon?**

**Ferrill:** They're going to be the same, only more so, I hope. That's partly because I've already been doing this since the middle of 2016, so for almost five years. I'm not going to be changing my spots, and Simon is still going to be available for consultation so he's not really changing his spots. But the other thing that is a constant at this firm is that we want to continually evolve.

We always are going to keep trying to find ways to keep our edge sharp, if you will. Some of that is going to be by finding ever better ways to assess risk and identify good opportunities. But some of it also is going to be by developing better people. We've been hiring research associates now for more than a decade — and we're hiring better people than when either Simon or I got hired.

Those people are now populating our middle ranks, and that's a good thing. And the fact that our process is robust and easy to understand from the outside has meant that we've been able to make senior hires in the last year. We've remote onboarded into the research team some phenomenal senior analysts. So our people are getting better. Our process will continue to improve. The flexibility of our written debate process and ability to work remotely is likely to lead to interesting new working groups. We have such a solid base of experience in debating virtually, if you will, whether sitting in next-door offices or across the globe, that we have a fair degree of confidence that we can make people's work lives better. So, we'll see.

**How concerned are you about geopolitical tensions impacting especially your China and EM strategies?**

**Ferrill:** Obviously we're paying close attention and we do recognize that if you're investing across many markets, the dangers of government intervention in your investments certainly are high. But by the way, they're high in the U.S. and they're high in the U.K., too. Facebook and Google and Amazon face regulatory issues in this country.

**Indeed they do.**

**Ferrill:** Obviously, in China, the regulatory process is less transparent than here. Many things in emerging markets are less transparent. We try to gauge the risks of unforeseen regulatory events in every investment that we make, and the Chinese ones are no exception. It is one of the risks that we were cognizant of years ago when we set the limits on how much we would allow our emerging market portfolio managers to invest in China in a diversified, emerging market portfolio — which turned out to achieve a lot.

Last year, when China's market was rising while the rest of the emerging markets were sinking, we had, I would say, a *realistic* view of what the long-term unavoidable risks are, and we've tried to limit those through diversification. And we continue to try to identify the risks to each individual company.

**Simon:** Yes. And the specific risks of the various governments —

**Simon, I know you worked in Hong Kong years ago, before you joined Harding Loevner. Do you have any particular insight into Hong Kongers' current struggles?**

**Simon:** Not really. I left 30 years ago. Any place that puts restrictions on personal freedom is a place where people are suffering, as far as I'm concerned. So I feel rather saddened by what's going on. Hong Kong was a very unusual place for a very long time, and it does look like it's now being pulled back into the Chinese social political system rather more quickly than people who continued to live there had expected. It's clearly not what the people want; therefore, it's a bad thing. But I have only one or two friends still there; I'm not following it as closely as I used to.

**Great to catch up with you both. Thanks.**

**Welling on Wall St. interviewee disclosure.** Simon Hallett, CFA, is vice chairman and a partner, and Ferrill D. Roll, CFA, is Chief Investment Officer at Harding Loevner LP, an investment adviser based in Bridgewater, NJ and registered with the Securities and Exchange Commission. Harding Loevner is an affiliate of Affiliated Managers Group, Inc. (NYSE: AMG), an investment holding company with stakes in a diverse group of boutique investment management firms. Harding Loevner, the investment adviser, manages Harding, Loevner Funds, Inc. The fund group traces its lineage back to 1989, when David Loevner and Daniel D. Harding struck out on their own from Rockefeller & Co, where they had been managing international portfolios. Simon joined Loevner and Harding about a year later. Ferrill joined Harding Loevner as a Global Equity Portfolio Manager in 2000 and served as Co-CIO with Simon between 2016 and 2020.

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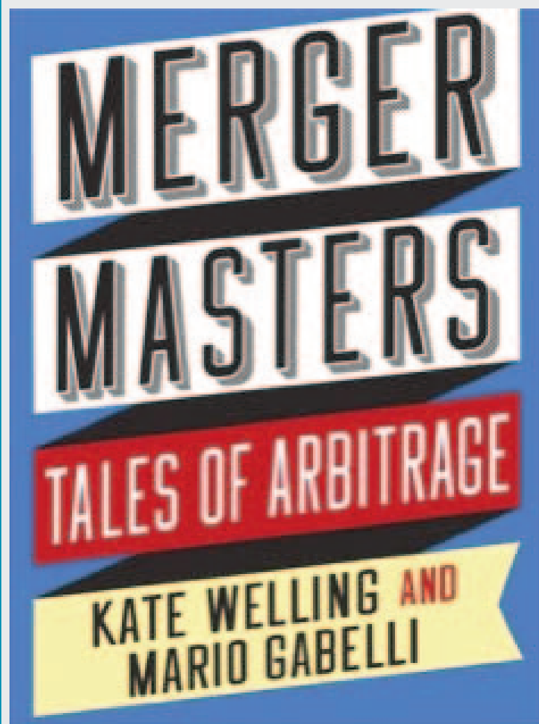


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*— Mario Gabelli*

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