

How To Diversify Your Portfolio and Transfer Wealth Across Generations Without Financial Advisory

Everyone knows the 3M company but amidst the mass media frenzy about new new stuff like Facebook, Amazon, Apple, Netflix, Nvidia and Google (FAANG), it has been largely forgotten as a stock investment.

From my Bloomberg I can look back all the way to 1980. From that year to 2016, 3M stock price delivered a compounded annual return of 9.4% and an average dividend yield of 2.94%. Combined, that is an annual return of well over 12.4% over 36 years.

Look at your own portfolio. Look at all the funds you have invested in. Look at all the stuff you have taken on (fixed income, forex, commodities, special situations, etc) as prescribed by your financial advisors.

Did you achieve 12.4% pa over 36 years? If you did, your \$1 invested in 1980 is now \$40. Congratulations!

But I'm afraid this did not happen to most of you. Sorry about that!

I'm going to use 3M to illustrate the following points.

1. Equities as an asset class is often perceived as riskier than others but there is one sector within equities that I will argue is safer than everything else including fixed income and real estate.
2. If you invest in a world class, global scale company that is from this sector, you are already fully diversified, hedged and all the macro economic issues and challenges taken care of.
3. This sector is resilient in the face of even a global financial crisis because frequently, these companies do not have high financial leverage. (Caveat : In recent years, it has become less true in the US and Europe)

What is 3M really? It is a deep physics, chemistry and material science company. Everything they do is about manipulating the atoms and molecules of nature to create functional materials that we can use in our daily lives.

With each passing year, 3M piles on more patents, a bigger library of chemicals and processes, more knowhow. All this knowledge is cumulative. The company is now 115 years old. All that accumulated intellectual property is practically unassailable. There will never be another company like 3M anywhere else in the world. Certain segments of their business can be separately attacked but there will never be another company that can challenge 3M on most fronts simultaneously.

This is the nature of science and intellectual property. The strength is cumulative over time. In contrast, for real estate companies and banks, big or small has no bearing on vulnerability to debt crisis storms, as we all learnt in 2008. The underlying strength is not cumulative over time, not the way it is for a science and intellectual property company.

We don't see it but science is all around us. From the moment the alarm clocks wake us up until we read that book at night to lull us to sleep, science enables everything we touch and use. It is like oxygen to our modern day life.

But there are times you do not need a bank's products and services. There are times you don't need real estate products. In fact, most of the time you don't!

Science is safer and more enduring. Science, for modern man, is a NEED, not a WANT.

Science is often equated with technology. Investors are often frightened by technology.

Consider the world of intelligent appliances. In the beginning, it was mainframes and the name was IBM. And then, it was mini-computers and the name was DEC. When the PC revolution arrived, the names were Apple, Compaq, Dell, etc. And then, the mobile phone revolution came and the names were Nokia, Ericsson, Motorola and Blackberry. And of course, we had the smartphone revolution – Apple and Samsung.

The repeated cycles of emergence and fading away creates the impression that technology companies have no staying power.

But while it is true that the front end marquee names change with every technology revolution, **if one delves into the names of the companies who make the component and process materials as well as the production equipment, you are likely to find that many of the companies who enabled IBM and mainframes are today still enabling Apple/Samsung and smartphones.**

The companies that make component and process materials as well as the production equipment are the true science companies. Like 3M, they are almost always involved in the mastery of manipulation of nature's atoms and molecules.

But not every science based company is the same. A global company like 3M with \$30 billion in revenue every year, has to manage its short term and long term finances as well as plan for the future according to what they perceive global macro-economic trends are going to look like. To do so, they have a team of experts at their headquarters who are advised by the biggest banks in the world and who have access to financial and macroeconomic experts at the highest levels.

In fact, all the things that your financial advisor is trying to help you do – diversify, plan for future macro-economic trends, capture global patterns like consumption & technology, etc – all this is being done for you already inside a company like 3M. Although they do it for purposes specific to their business needs and their reaction time is slower (they run real business, not shift around in markets!), over the long term, the outcome should not be any different.

All you have to do is hand over your money to 3M (by buying its stock) and you don't need a financial advisor.

Even when financial advisors talk about fixed income, it is being done for you by 3M. The billions in cash that pass through their hands are optimised for currency, interest rates and duration for their corporate needs. Although 3M's fixed income returns may not necessarily be transmitted to shareholders as dividends, it would implicitly get built into the shareholders equity and hence, the stock price – over time, of course.

Unlike fixed income, a business like 3M isn't a dead instrument. Every day, 90,000 people go to work for 3M, to create value for the shareholders. This happens in good times, bad times, in bull cycles, in recessions, etc.

When interest rates go up, you don't have to think about hiding in short duration fixed income instruments or move downwards to ever lower grade bonds. 3M will figure it out for you and they can solve the problem of rising interest rates simply by borrowing less!

When interest rates go down, you don't have to think about whether to shift money from fixed income to equities. 3M will be taking advantage of the easier monetary environment to boost its underlying business – for you.

But of course, only global scale companies do this. That fascinating \$500m science company that you just got tipped of about by your financial advisor provides no such protection.

Deep science companies also have a characteristic unlike almost all other businesses. In leveraged business models like real estate and finance, you can grow faster if you have access to more capital. And the easiest way to have more capital is to borrow more. This is true in most business including commodities, consumer goods, consumer services, etc.

However, the speed at which science can progress is dictated not by quantity of capital, but by the basic laws of nature. It doesn't matter how money you have, that whisky in the barrel ages at its own speed because the microbes that age the whisky don't care about money.

Because of this, a lot of deep science companies also have very low levels of debt and in many cases, run on large piles of cash. In the US, this is becoming less true because in recent years, a lot of corporate management has been seduced into consuming those cash piles and even taking on debt in order to pursue share buyback programs and outsized dividends – all to satisfy Wall Street's nonsense. Despite this, the sector, even in the US, still has relatively low balance sheet risk.

When you look across the landscape of deep science companies, you can see that the long run rates of returns are more than satisfactory.

Corning, the master of glass, has delivered about 9% per year since 1980.

Applied Materials, the biggest maker of semiconductor production equipment, has delivered 13.9% pa since 1980. They only started paying dividends in 2005, so you could have added on 1.7% every year after that.

Although the ordinary person knows Fujifilm as a photography equipment maker, the company has long ago re-invented itself as a deep science company. That is how it not only survived the digital camera and smartphone revolution, it is now bigger than it was at the peak of film photography. (unlike Kodak which never stopped thinking of itself as an imaging company). For Fujifilm, I have records going back to 1974. The average annual return during the last 42 years (incl. dividends) is >8% in Yen terms.

Shimadzu, a 142 year old maker of scientific instruments, has generated 7.4% pa incl. dividends for the past 42 years.

I'm not going to offer a long list of examples.

Suffice to say that when one studies deep science companies in developed countries like US, Japan and Germany, it is surprisingly not difficult to find companies that demonstrate the sort of longevity, sustainable return and low risk that anyone thinking about trans-generation wealth transfer would be very pleased to have. All without any of the conventional CFA/MBA groupthink that all the financial advisors endlessly tout.

If you are trying to get rich from investing, these science companies may be too staid and unexciting. But if you are trying to generate a meaningful return with relatively low risk across generations, in my opinion, all that Wall Street financial advice is meaningless. Just deploy your portfolio across a basket of world class, global scale, deep science companies.

Only if you can't figure out what a deep science company is, then my advice is go seek out fund managers who specialise in this area and pay them to do so for you. In the long run, it will still be cheaper and more effective than your typical financial advisor.