

GQG Partners International Quality Equity Fund

Fund Commentary

Life and investing are both rife with uncertainty. While this is true every year, it's been much more acute in 2020. We all strive for certainty because it makes decision-making easier. It has been said, however, that the only place to find certainty is in death and taxes. Since we are trying to delay or avoid both of those options, perhaps the question we should be asking is: Do we forecast or adapt? In theory, these are binary decisions. In practice, however, the two approaches are not mutually exclusive — we can plan to go to the beach, but we also can alter our plans and adapt to the conditions when the rain hits.

When the investing landscape changes, we (GQG Partners) really have two choices: maintain our prior positioning, which comes wrapped in a warm, comforting “long-term investor” blanket, despite the changing environment; or, we can “switch” our holdings, conditioned upon the new information. While investing is a probabilistic exercise, its outcomes are undefined, and therefore we can never know *ex ante* what the “right” decision will ultimately be. Additionally, just because something sounds nice in theory, we know that in practice, theories are violated the vast majority of the time. Take a look at some of the news flow during Q3 2020, where several large, well-known companies saw their shares appreciate simply because they announced stock splits.¹ Now we know that in theory a stock split adds no value, as the share price declines commensurate with

the split to leave market capitalization unchanged. But in practice, these things happen with relative frequency because exogenous, unaccounted for variables exist.

With the differences between theory and practice in mind, let's illustrate the complexities of portfolio construction in the real world through an interesting, entertaining and often misunderstood concept — The Monty Hall Problem.

What Can Monty Hall Teach Us About Investing?

Monty Hall was the long-time host and producer of the show *Let's Make a Deal* for nearly three decades. Over his hosting tenure, his most famous game, “Big Deal of the Day,” required a contestant to pick one of three doors. Behind one door was a grand prize, generally a car, and the other two doors contained “zonks,” or duds, which generally were goats. To kick off the game, the contestant was asked to select a door — let's say door number one — and then Monty would open one of the remaining unselected doors, which would always display a goat. At this point, only two doors remained and the contestant was now presented with a conundrum: switch doors or stay the course (which is the exact same question we pondered earlier).

Clearly, unlike investing, the outcomes of this game are defined and known ahead of time. There's a prize behind one of the doors and goats behind the other two. Even though the contestant doesn't know which door contains a car, the odds are already calculated for us. In investing, we're not given such predefined outcomes nor are we given the odds of success. We may end up with a goat; we just don't know it with any certainty. However, much like investing, agreeing upon the underlying probabilities of staying or switching comes with a lot of misunderstanding. In fact, many well-trained PhDs in mathematics disagreed with the answer to the problem!² This was well documented in the 1990s by Marilyn vos Savant, who holds a Guinness World Record as the woman with the highest documented IQ, in her *Parade* magazine column where she opined on what we now classify as “The Monty Hall Problem.”³

The answer, which is not intuitive, is that the contestant should “switch” two-thirds of the time. This was so misunderstood that when vos Savant revealed the proper answer, it set off more than 10,000 letters from laypeople and mathematicians alike, insisting that the odds were 50:50 once a door was opened. However, as we highlight in Exhibit 1, the odds are unchanged regardless of which door Monty opens. Because there's only a 1/3 probability of picking the car correctly, when presented with the option to switch, one should switch more often than not (unless one

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has a preference for goats over cars, then it's a win-win-win). Because this is in no way obvious, it just feels wrong in practice. There are also only two doors remaining, so it's easy to believe that the odds must be 50:50. Despite the probabilities being defined, many contestants chose to stay with their original choice. So in light of evidence to "switch," many stayed. Some of the decisions most easily could be explained by a contestant's own psychology, whether it be the principle of consistency (well documented by Dr. Robert Cialdini) or due to the endowment effect, which highlights that once something is "owned," it then commands a higher value in the mind of its owner.

EXHIBIT 1: THE NON-OBVIOUS ANSWER

BEHIND DOOR 1	BEHIND DOOR 2	BEHIND DOOR 3	RESULT IF STAYING AT DOOR 1	RESULT IF SWITCHING TO THE DOOR OFFERED
Goat	Goat	CAR	Wins goat	WINS CAR
Goat	CAR	Goat	Wins goat	WINS CAR
CAR	Goat	Goat	WINS CAR	Wins goat

Source: Marilyn vos Savant, "Ask Marilyn," Parade, December 2, 1990, 25.

Now take this same idea — non-obvious outcomes, probabilities that can be calculated but are rejected by participants who should know better — and apply it to

capital markets. Doesn't it sound a bit like style rigidity? That in light of contrary evidence, stocks that were originally bought are held onto to remain "style pure" or to create an ex post rationalization that the purchaser is a "long-term investor?" Sounds a lot like the consistency and endowment effects noted above. But of course, in keeping with our theme, this is also only true in theory and not in practice. In practice, Let's Make a Deal relied on Monty's personality and, as Monty himself recounted, he did not always offer participants an ability to "switch." Not only that, he actually offered cash for contestants to stay at times, even if the door they originally picked yielded a car!⁴

So practice is much harder than theory. In theory, probabilities are defined and there's always an answer to the question (regardless of agreement on the outcome). In practice, however, not only are the probabilities undefined, but a contestant (or in our context, an investor) is not simply dealing with one's own psychology, but that of the market in general. Sometimes the market is in a good mood, but sometimes the market is in a bad mood. So Monty may allow for the switch, but not always. Moreover, switching doesn't always pay off in practice, so one's process must pay attention to the data.

Our takeaway, then, is that it's essential to remain adaptable. That when conditions change, that when moods change, that when earnings change, it's not good enough to rely on one's initial decision. Because what's obvious isn't always correct, and what's correct isn't always obvious.

Investing is riddled with such dogmatic rules, particularly when it comes to active management or valuation multiples (just to name two).

On Adaptability

As is always the case, we want to provide all of you with clear insights into the how and the why behind what we're doing. Admittedly, the languages of conditional probability and exogenous factors aren't always the easiest things to understand, but it doesn't make their importance any less real. But as a way to end this commentary, maybe the easiest way to think about what we're doing is to think of it in the context of something we're all doing a lot less of these days: driving a car. When the road is open and the sky is blue, put the pedal to metal. However, when it starts to rain, one must reduce speed for fear of a disaster. So as the conditions on the road change, the driver's behaviour also must adapt to the present conditions, not ideal ones. Similarly with portfolio management, when the conditions change, we adjust to the market conditions we're given, not the ones we may wish for. As has been the case throughout this commentary, in theory, things operate under conditions of "the survival of the fittest." In practice, however, we believe it's those that are most adaptable to change that thrive. One species — or one investing style — could be over fit to its environment, and while it may be suitable for the current regime, this may prove costly as things change.

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So without adapting, one may end up with a goat instead of a car. Or, even worse, one may end up like a seasonal bug — only around for one season.

commitment to independent thinking, continual growth, cultural integrity and a deep knowledge of the markets.

About GQG Partners

Co-founded in 2016 by Chairman and Chief Investment Officer Rajiv Jain, GQG Partners is an independent boutique equities manager focused on global and emerging markets strategies. Protecting and compounding capital while aligning with clients is paramount to GQG Partners. Rajiv and his team seek quality companies at reasonable prices to build portfolios that are able to navigate and adapt to changing market conditions.

The GQG Partners investment philosophy focuses on four concepts:

- Earnings drive stock prices
- The market is disproportionately focused on the short term
- Quality should be the defining characteristic of the portfolio
- Risk management should be the first consideration when investing

Headquartered in Florida, GQG Partners strives for excellence at all levels of the organization through a

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Quarterly performance for the GQG Partners International Quality Equity Fund launched September 28, 2020 will be available after Q4 2020.

End Notes

1. Jamie Powell, “Stock Splits: Playing Devil’s Advocate,” Alphaville (blog), Financial Times, August 21, 2020, <https://ftalphaville.ft.com/2020/08/20/1597935078000/Stock-splits--playing-devil-s-advocate/>.
2. Marilyn vos Savant, “Ask Marilyn,” Parade, December 2, 1990, 25.
3. Zachary Crockett, “The Time Everyone ‘Corrected’ the World’s Smartest Woman,” Priceonomics (blog), August 2, 2016, <https://priceonomics.com/the-time-everyone-corrected-the-worlds-smartest/>.
4. Gerd Gigerenzer, Risk Savvy: How to Make Good Decisions (New York: Viking Press, 2014), 129.

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Published November 2, 2020

