FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

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Know Your Corporate Managers

When you buy stock in a company, you're entrusting your precious capital to the managers who run that company. They could be everything from honest and prudent stewards of your capital who maximize shareholder value and pay you increasingly larger dividends every year to incompetent or dishonest thieves who loot the company at the expense of shareholders. Or perhaps they destroy shareholder value by pursuing ridiculous ESG-related projects. So as an investor, it's important to know something about who these people are, including their values, practices and political views.

On the massive spreadsheet I use to track about 2,300 dividend-paying stocks from around the world, I've added a column for the city and state of each company's headquarters. People who work in say Boston are likely to be quite different from those who work in say Oklahoma City, so that data point provides some insight.

A stock's Beneish M-score tells me how likely it is that management is manipulating its reported earnings, which sheds light on how honest the CFO and CEO may be. If the score is too low I move on, because I probably can't trust anything else the management says.

I also track what percentage of each company's stock is owned by insiders, which tells me how bullish they are on the stock, how invested they are in their company, and how closely their interests are aligned with those of the shareholders.

From time to time I look at recent insider trading activity for each stock, including how many insiders bought or sold how many shares and when. There are several legitimate reasons why an insider would sell (e.g., to raise cash for expenses, reduce unsystematic risk, etc.), but there's only one reason they would buy (because they think the stock is undervalued), so I pay more attention to purchases, though a cluster of large sales by a number of insiders around the same time definitely gets my attention.

I look at what language the company uses in its annual corporate sustainability report, and how many times it uses certain keywords, which reflect the values and priorities of management. Oftentimes a CEO will include a statement of his own, which provides an indication of how much of the ESG Kool-Aid he's imbided.

Sometimes I'll look at a company's annual report to see where the photo of the CEO appears and how large it is. The earlier it appears and the larger the photo, generally speaking, the bigger the CEO's ego and the more I have to watch out for things like manipulated earnings, Taj Mahal headquarters and value-destroying acquisitions.

I've developed a formula that quantifies how much money a company's employees (who are primarily higher-income executives) gave to Democratic candidates for federal offices during the last election cycle in order to determine how market- and shareholder-friendly they may be. All other things being equal, the higher the donations to Democratic candidates per employee, the lower the return I expect from the company. If you want to be entrusted with the shareholders' capital, you need to support free markets yourself.

Finally, I look at dividend policy, which tells me a lot about how much management is trying to do right by shareholders. Ideally, a company will have a long history of paying a higher dividend every year. If a company reduces or eliminates its dividend, generally it means that either the company is in deep financial distress, or the executives no longer care about the shareholders. Either reason is not good.

In conclusion, it's important to remember that stocks represent a share in companies that are run by actual human beings whose ethics, values, priorities, competence, egos and political views vary widely. So even this quantitative investor doesn't neglect the human aspect in my analysis.

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