

The SELECT Strategy: Looking for “Economic Castles”

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Previous quarterly commentaries have explained Exencial’s SELECT Strategy, which is designed to identify and purchase equity in leading U.S. companies with strong financial statements and ethical characteristics.

The SELECT Strategy also seeks out companies that possess competitive advantages that keep competitors from penetrating their profitable operations. Legendary investor Warren Buffett himself follows this strategy.

“In business, I look for economic castles protected by unbreachable ‘moats,’” [Buffett has been quoted](#) saying. Most often, such companies have leading positions within their industries, and as a result, are capable of maintaining superior profit margins and attractive returns on invested capital.

One SELECT Strategy name that fits this description is **Walt Disney**. The company maintains operations in theme parks, movie franchises and the ESPN cable network. Another moat holding is **Facebook**, with its global social networking sites that serve more than [1 billion daily users](#). Lastly, we also like **S&P Global** for this reason, as it maintains a leading fixed income rating service, market indexes and specialized financial data.

Moats and strong financial statements are significant because when economic expansions and bull markets [become long in the tooth](#), average companies struggle to excel. For instance, as the Federal Reserve raises short-term interest rates, it becomes more costly for heavily indebted companies to boost income. Instead, they spend more gross profit servicing their loans.

As the economy expands and growth begins to slow, business conditions become more competitive. Companies with greater sales and income are usually in a better position to promote their products and invest in the future. Oftentimes the development of new businesses, whether by organic expansion or acquisition, creates greater opportunities for continued progress, even through recessions. However, in our experience, it takes financial stability and excellent leadership to sustain this progress long-term. Thus, companies with high-quality characteristics appear to us best positioned to execute strategies for sustained success.

These are some of the reasons we believe a SELECT approach to individual U.S. equity selection makes sense. Now that the economy has improved for seven years and the [S&P 500 has climbed 215 percent](#) – trends that can only last for so long – it is a good time to be selective and search for companies bolstered by an economic moat.



Sources:

1. Warren Buffett on castles and moats: www.signalvnoise.com/posts/333-warren-buffett-on-castles-and-moats
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3. Long in the tooth: www idioms.thefreedictionary.com/long+in+the+tooth
4. S&P 500: www.finance.yahoo.com/q?s=%5EGSPC

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