



# THE INVESTOR'S GUILD

## Learning to fly: All Weather's process safeguards

*In this article written exclusively for the Investor's Guild, I spoke to All Weather Capital's CIO and founder Shane Watkins about how the firm has borrowed key elements of its process from the aviation industry.*



For Shane Watkins, the CIO of All Weather Capital, one of the most important biases to guard against in investing is overconfidence.

"No one ever intentionally sets out to make a bad decision. They are always confident of a positive outcome, and yet negative outcomes eventuate more often than you would think," Watkins notes.

In his view, this is not a flaw, but a feature of the human condition.

"Humans are naturally optimistic. That is why we've survived many setbacks as a species," Watkins says. "So, we tend to err on the side of optimism, yet statistically, our optimism is frequently misplaced."

This is illustrated by the fact that the biggest mistakes investors make are often those where they have acted with the highest conviction.

"Where you have very high conviction, you tend to marry that with a much larger position size," Watkins points out. "And so that is where you can get into the most trouble."

All Weather has implemented two significant safeguards in its process precisely to temper the potential pitfalls of overconfidence: investment checklists, and a three-person portfolio management team on every strategy.

As Watkins notes, these are borrowed directly from the aviation industry.

"In the course of studying towards my helicopter pilot's licence, I became interested in why aviation became such a safe industry," he says. "Hundreds of millions of people fly every year, and yet there are very few negative incidents.

"That led me to interrogate why this fundamentally dangerous thing like flying could have such a great safety record. And the two things that stood out were proper cockpit checklists to check off every step ahead of a flight in a systematic way, and always having a second pilot where someone checks the actions of the first person."

### **Checking it off**

He notes that checklists were not new to him. As one of the earliest employees at Peregrine Capital, Watkins was involved in introducing a system of investment checklists decades ago.

"The checklist must be completed before you make any investment, in the same way that pilots must complete a checklist before they start flying. They don't take off and then do the checklist. It's important where that happens in the process," he says.

At All Weather, the investment checklist covers a comprehensive range of considerations that ultimately ensure that the portfolio managers only take action when the investment case has been thoroughly scrutinised.

It includes elements such as how recently the team met with management; whether they understand how management is incentivised; if the business model has been documented and understood; and whether there are any obvious red flags such as the company's tax rate being significantly below the statutory tax rate.

"Those are the kinds of things we would want to go through to be sure that we have a full understanding of what we are doing," Watkins says.

The checklist is also a live, evolving document.

"We never change our investment process wholesale because our clients have bought into a specific process. But we do incorporate learnings that improve the process at the margin," Watkins says.

"Fund management is a continuous learning process. You need to keep making small improvements and adaptations as the world changes. For example, we have incorporated some changes to our process taking into account the way we are now using AI."



***Shane Watkins***

The second element – the idea of always having a “co-pilot” on every strategy – similarly aims to ensure completeness in decision making.

Every All Weather fund has three named portfolio managers – two co-portfolio managers and Watkins as the CIO.

“The reason for this is that, in my experience, sometimes there are very simple, very fundamental things that you are not immediately aware of that might be quite important,” Watkins says. “There is so much going on in the world, so much news flow, and we’re getting information from so many sources that you can’t take it all in.

“For example, I might see that a share on our buy list is down 5% and I’m tempted to buy it, but my co-pilot will notice that the reason for the fall is that it’s ex-dividend or that the CEO has resigned, or some other reason I didn’t know.

“The idea is to just have someone else checking your actions. It’s not for them to second-guess you, but to make sure you aren’t making an obvious error. Because we are so buried in information that sometimes we don’t see obvious things.”

### **Not blaming failure**

Importantly, this all happens within an environment where it is safe to make mistakes.

"Another thing about the aviation industry is that it has a culture of not blaming failure, but learning from it," Watkins says. "It's very rare to see pilots who are involved in a negative event being severely punished."

"Because if people believe that failure is going to be severely punished, they are going to try to hide it or defend it. So, we very much encourage people to understand that it's only a failure if you don't learn from it."

"We have 30 professionals in our business," Watkins adds. "If someone makes a mistake, it's much better for the other 29 to learn from that than to hide it and then everyone makes the same error again at some point. We want to know what went wrong, and what we can learn from what you did."

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