

THE QUALITY PULSE

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ISSUE 04

2 OCTOBER 2026

7 MIN READ

The Discipline of Staying Invested



Why patience is an active investment decision

A new investment idea can make an existing holding feel less exciting. A weak quarter can make selling feel prudent. With prices moving every day, leaving a portfolio unchanged may feel like failure.

Yet when a business continues to develop as expected, an investor may gain more by giving it time than by making another trade.

That sounds simple. It is not. The real challenge is determining whether a company still deserves that time.

PATIENCE IS NOT INACTIVITY. IT IS A CAPITAL-ALLOCATION DECISION.

COMPOUNDING NEEDS TIME

The case for patience begins inside the company. A strong business can deepen customer relationships, improve products, expand distribution and reinvest the resulting cash over many years. These benefits accumulate gradually.

New products take time to scale. Investments need time to earn returns. Competitive advantages are strengthened through thousands of operating decisions rather than a single quarter.

This is particularly relevant for Quality investing. High returns on invested capital matter because they allow a company to create value from reinvestment. A strong balance sheet provides the resilience to continue investing through difficult periods. A durable competitive advantage helps protect those returns from competition.

But all three require another ingredient: time.



INVESTMENT TAKEAWAY

A drawdown is a reason to investigate – not automatically a reason to sell or to buy. The distinction has to come from the economics of the business.

Evaluating every investment through the lens of the next quarter risks selling while the long-term investment case is still being built.

The share price provides little help in distinguishing between the two. It reflects fundamentals, but also expectations. A stock can fall despite continued operating progress because expectations were higher, interest rates changed or enthusiasm for a sector faded. Valuation still matters. But a weaker share price alone does not demonstrate that a company's ability to create value has deteriorated.

THE DECISION COST OF SELLING

The obvious costs of portfolio change are commissions, spreads, market impact and, depending on the investor, taxes. The more important cost is less visible.

Selling a Quality company means giving up the future returns of a business that is already understood and replacing them with the prospective returns of another investment. That effectively requires two decisions to be correct:

- 1 The existing holding no longer offers a sufficiently attractive prospective return.
- 2 The proceeds can be allocated to an alternative offering a superior prospective return after considering business quality, risk and valuation.

The second decision is easily underestimated. A new company may offer faster growth but a less durable competitive advantage. Or the better outlook may already be reflected in a higher valuation. Before replacing an exceptional business, the hurdle should be higher than finding another appealing story.

WHAT DOES THE EVIDENCE SAY?

Cremers and Pareek studied U.S. equity funds and institutional portfolios and examined the interaction between Active Share and holding duration. Among highly active managers, those with holding periods of more than two years were the group that generated significant average outperformance in their sample. An equally weighted portfolio of mutual funds ranking in the top quintile for both Active Share and holding duration generated a five-factor net alpha of about 2% per year. [1] Highly active managers who traded frequently did not show the same result.

The implication is subtle but important: the evidence does not reward inactivity. It points towards conviction combined with patience.

EXAMPLE: INDITEX 2022 - PRICE SIGNAL OR BUSINESS SIGNAL?

Inditex is a Spanish fashion group and one of the world's largest clothing retailers, whose brands include Zara, Pull&Bear, Massimo Dutti, Bershka, Stradivarius, Oysho and Zara Home

Inditex provides a useful case study because the concerns facing the company in 2022 were real. Following Russia's invasion of Ukraine, Inditex shut its operations in Russia and Ukraine. Inflation threatened consumer purchasing power and raised costs. Supply chains remained under pressure. Inventory added another concern: at the end of the first quarter, inventory was 27% above the previous year, partly because Inditex had deliberately brought inventory forward to improve product availability.

The share price reflected those concerns. Inditex ended 2021 at €28.53. By 30 September 2022, the shares traded at €21.28 – a decline of approximately 25%.

A decision to sell would therefore have been understandable. But the more useful question is not what subsequently happened to the share price. It is: what did the operating evidence available at the time actually say?

TWO DIFFERENT SIGNALS

MARKET SIGNAL	BUSINESS SIGNAL
Share price –25% by Sep. 2022	9M sales +19%
Russia & Ukraine closures	Net income +24%
Inventory +27% in Q1	Net cash €10b
Inflation and consumer concerns	Gross margin 58.7%
Supply-chain uncertainty	Operating performance remained resilient

SOURCE: INDITEX [2]; MARKET DATA [6]

These figures were not conclusive. Parts of the comparison benefited from pandemic restrictions in the prior year. Inventory could still have required discounting. But they changed the nature of the investment question. The relevant issue was no longer simply whether the risks were serious. It was whether those risks had permanently impaired Inditex's ability to respond to fashion demand, reinvest capital and create value.

A DRAWDOWN IS INFORMATION – NOT A CONCLUSION

A falling share price deserves attention. It may contain information about deteriorating fundamentals. But the price itself is not the conclusion. Michael Mauboussin and Dan Callahan examined more than 6,500 U.S. stocks over the period 1985–2024. The median maximum drawdown was approximately 85%. But there is an equally important second finding: more than half of the stocks in the sample never regained their previous high. [5]

That makes the lesson very different from "buy the dip". Large drawdowns occur even among companies that subsequently recover strongly. But large drawdowns also accompany permanent destruction of value. The task is to distinguish between them.

WHAT HAPPENED NEXT?

Full-year 2022 sales eventually increased 18% and net income 27%. Importantly, the inventory concern also subsided: inventory ended the fiscal year only 5% above the previous January. Over the following years, the business continued to expand.

INDITEX – OPERATING PROGRESS	FY2022	FY2025	CHANGE
Sales	€32.6b	€39.9b	+22%
Net income	€4.13b	€6.22b	+51%

SOURCE: INDITEX [3], [4]

A hypothetical sale at the end of December 2022 would have occurred at €24.85. On 28 September 2026, Inditex closed at €53.34 – approximately 115% higher, before dividends. But that return is not proof that selling in 2022 would have been wrong. The proceeds could have been invested elsewhere, perhaps successfully. And the outcome was unknowable in December 2022.

The important observation is different: the compounding process inside the business had not stopped. The share price changed dramatically. The economics of the business changed much less.

PATIENCE IS EARNED

None of this means that holding is always the correct response. Competitive advantages can erode. New investments can earn poor returns. Management can destroy capital. And even when the business remains exceptional, valuation can rise to a level at which prospective returns become unattractive.

Patience therefore needs to be earned continuously. The discipline is not "hold for the long term". It is: keep testing whether the conditions that justified patience still exist.

THE PATIENCE TEST

1 COMPETITIVE ADVANTAGE Is the company's competitive position still intact?	2 INCREMENTAL RETURNS Can additional capital still be reinvested at attractive returns?	3 BALANCE SHEET Does the company retain financial flexibility?
4 CAPITAL ALLOCATION Is management still allocating capital rationally?	5 EARNINGS POWER Has the long-term ability to generate cash changed?	6 VALUATION Does the current price still allow an attractive prospective return?

THE PATIENCE MATRIX

	BUSINESS THESIS INTACT	BUSINESS THESIS IMPAIRED
VALUATION ATTRACTIVE	PATIENCE Let compounding work	REASSESS Cheap may be justified
VALUATION DEMANDING	DISCIPLINE Prospective return may be lower	ACT Thesis and valuation have deteriorated

A falling price does not automatically make patience more rational. Equally, an exceptional company does not deserve to be held at any price. Patience sits at the intersection of business quality and prospective return.

THE ENTREPRENEUR'S PERSPECTIVE

The logic becomes clearer when the investment is viewed as ownership of a business rather than ownership of a ticker. An entrepreneur would rarely sell a successful company simply because one quarter disappointed, the economic environment weakened or another business temporarily appeared more exciting.

Public markets add one important variable: price. They also provide something an entrepreneur owning a private business does not have – the ability to sell every day. That liquidity is valuable. But liquidity does not have to become an instruction to act.

THE PULSE

PATIENCE IS NOT THE ABSENCE OF A DECISION.

Quality investing starts with finding companies capable of creating value over long periods. Strong balance sheets provide resilience. High returns on capital make reinvestment valuable. Durable competitive advantages protect those returns. But these characteristics only become truly powerful when they are given sufficient time to compound.

The evidence does not suggest that trading less is automatically better. It points to something more demanding: conviction plus patience.

Patience therefore does not mean ignoring change. It means continuously testing the competitive advantage, incremental returns, balance sheet, capital allocation, earnings power and valuation – and acting when the evidence changes.

Sometimes that analysis leads to a trade. Sometimes it leads to a more difficult decision: do nothing.

SOURCES

1. Cremers, M. & Pareek, A. (2016), 'Patient Capital Outperformance: The Investment Skill of High Active Share Managers Who Trade Infrequently', Journal of Financial Economics
2. Inditex (2022), Q1 and 9M FY2022 results
3. Inditex (2023), FY2022 results
4. Inditex (2026), FY2025 results
5. Mauboussin, M. & Callahan, D. (2025), 'Drawdowns and Recoveries: Base Rates for Bottoms and Bounces', Counterpoint Global
6. Price data Inditex: 31 December 2021 €28.53, 30 September 2022 €21.28, end-December 2022 €24.85, 28 September 2026 €53.34



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