Diary of a Private Investor Update #3 8 May 2018

Stock pickers love regaling us with stories of their coups, of the shares they bought that are now worth many times what they paid for them originally. They seldom tell us of their clangers, of the shares that have fallen in value since purchase. I now understand their reticence to admit mistakes. It is painful to recall one's failures for posterity.

I bought shares in WPP, the advertising group, in March 2017, at £17 a share. They seemed good value at the time. The yearly dividend was 56.6p, so the dividend yield was 3.3%. Diluted earnings per share were twice that, at 113.2p a share, and had increased by an average of more than 14% a year for the previous seven years. The company planned to continue paying half its earnings in dividends in future.

My aim is to get a 7% per annum return on my investments. A dividend yield of 3.3% meant that earnings only had to grow by 3.7% a year for the return on my WPP investment to exceed my target, assuming I held the shares forever. I had no intention of holding the shares forever. The sums get complicated when we allow for sale at some future date, but the basic principle is that I would earn more than 7% a year if the dividend yield at time of sale was less than 3.3% and less than 7% pa if the dividend yield at time of sale was more than 3.3% – all on the assumption that earnings (and dividends) grew by an average 3.3% per annum during the holding period.

There were a lot of "if's" in this. The first was the assumption that earnings would grow by 3.3% pa on average. Like other advertising agencies, WPP faced challenges on several fronts. Facebook and Google were grabbing a bigger share of advertisers' spend, sometimes bypassing the agencies entirely; major advertisers such as Proctor & Gamble (makers of Gillette, Crest, etc.) and Unilever (Ben & Jerry, Dove, etc.) were making big cuts in their advertising budgets, largely at the behest of activist investors. I was aware of those threats, but the prospects for global growth were good and I believed that the big agencies could keep growing, albeit at a slower pace than previously.

By June 2017, the share price had fallen to £15.49 a share. I still believed in my original investment thesis, so I topped up my holding by about 50%. WPP was now my sixth largest exposure in a highly concentrated portfolio (my two largest holdings each account for well over 20% of my equity exposure).

The price kept falling through the summer and I started to go cold on WPP. On top of the challenges outlined above, consulting firms such as Accenture and Deloitte were muscling in on areas that were formerly the preserve of the established agencies and were taking business from them. I sold a small portion of my holding in August at £14.23 a share and resolved to sell the rest on any sign of a rebound in the price.

There was no rebound. I kept revising downwards the price at which I was prepared to sell, but the price kept falling faster than my lowered expectations.

Results for 2017 were released on 1 March 2018. Growth in Diluted Earnings per share was 6.4%, ahead of my 5% target, as was the dividend increase of 6%, but the management statement accompanying the results was downbeat and the shares fell 8.2%, to £12.60. Then, on 3 April, came a bolt from the blue. The Board announced that Sir Martin Sorrell, WPP's chief executive and guiding light ever since he founded the business 33 years ago, was being investigated for alleged "personal misconduct", adding that the amounts involved were not material to WPP. I couldn't believe it. This was the same man who had been pilloried by shareholders and press a couple of years previously for his exorbitant pay packet of £70 million. Was he trousering more of the company's money to top up his pay packet? Maybe the competitor who famously called him an odious little shit some years ago had the measure of the man known in some quarters as the Napoleon of the ad industry, presumably because of his stature and his ambitions for global domination. Sorrell resigned shortly afterwards, and the Board dropped its investigation, much to the chagrin of some shareholders, myself included.

The price dipped briefly below £11 a share. Like a rabbit caught in headlights, I didn't know whether to stay or run, eventually doing a bit of both: I sold about 30% of my holding on Friday 27 April, at £11.48 a share, only to regret it almost immediately: the share price rebounded strongly to £12.45 on the Monday, when results for the first quarter of 2018 were announced. My only consolation was that I hadn't sold the lot at the lower price.

This morning (8 May), the price had risen further, to £12.82 a share. The prospective dividend for the current year is 60p, implying a dividend yield of 4.7%. Despite the attractive yield, I have lost faith in the company. I sold the rest of my holding at this price, bringing the curtain down on my short but costly relationship with WPP.