CFA Society Switzerland

THE CHARTER

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VALUE INVESTING CONFERENCE

on 29th October in Zurich

On 29th October we were honored by the presence of three very well-known and successful value investors: Vitaly Katsenelson CFA, CIO at Investment Management Associates; Guy Spier, Managing Partner, Aquamarine Capital Management; and Georg von Wyss, Partner, BWM AG. The event was moderated by Adrian Scherer CFA, CIO of Limmat Wealth.

In his introductory remarks, **Adrian Scherer** reviewed the basic literature on the topic of value investing. "Security Analysis" by Graham & Dodd, 1934, taught that value investing meant identifying stocks with low price relative to intrinsic value, which was to be estimated based on fundamentals (price to earnings ratio, dividend history, sustainability of earnings etc.). In 1949 Benjamin Graham introduced formally the idea of buying stocks at a discount to intrinsic value, i.e. with a "margin of safety". In 1977 came the explanation of the value premium, after observing that the lowest quintile of low price-to-earnings stocks offered a risk-adjusted outperformance of 4.5% per annum. In 1993, Fama and French introduced the 3-factor model, adding the size factor (market capitalization of the firm) and the value factor (book to market ratio) to the equity market risk for a stock. Current practice encompasses macroeconomic factors and investment factors like size, momentum and value. But, as Adrian concluded, if value investing is so simple, why don't value investors push up the price of value stocks and thus eliminate the value premium?

Our first invited speaker **Vitaly Katsenelson** gave us his personal insights to the theories and rules that seem to govern the field of value investing. Value investing is not simply to "buy undervalued stocks". That in fact is investing in "statistically inexpensive" stocks or "one dimensional investing".
Vitaly finds that three broad lessons can be learned from Warren Buffett and Charles Munger, of value investor Berkshire Hathaway. Firstly, Warren Buffett adds two other dimensions besides price to his analysis of investments: growth of the company and quality of its proposition. These factors must be considered – even if

the stock is not statistically cheap. Secondly, Buffett is often labeled as a "buy and hold investor". This is correct, as he normally has a low-cost basis, owns large blocks of stock, and sometimes is bound by the promise made when he buys private companies to not sell them. However, the lesson to extract here is that one should know when to sell: Buffett sells if he feels that he has to based on the company's fundamental characteristics. If the company still has value based on the three dimensions (price, growth and quality) he keeps the stock. If not, he sells it. The third lesson from Buffett is that he does not really "ignore the macroeconomy"; he identifies structural issues, the "climate changing issues", those that go beyond the next six months and have the potential to change the economic or business landscape.

According to Vitaly, the real lessons to be extracted from the referenced literature are different from those generally understood. Firstly, one buys a whole company and not a stock. Secondly, the risk is not the volatility of the investment, but the permanent loss of capital. And thirdly, the margin of safety is a varying figure that will depend on the growth and quality dimensions.

As for Vitaly's particular way of analyzing a company, he applies models that are very tailored to the subject and then "tries to kill" the company. He models its value in the worst case scenario, reasoning that news is already priced in and if the company still has good value in the worst case scenario, then it will be a good buy in the rest of cases. How do successful value investors manage the risk of getting lost in the complexity of their own research? Vitaly solves it creatively by applying two models for each analysed company: "the tablecloth model" which can be huge and complicated, and "the napkin model" which is simple and shows the economics of the company at a glimpse. If he cannot summarize the case in a napkin model, he does not buy the stock.

For the second speaker of the event, we welcomed **Guy Spier** (who we feature in an interview also in this issue of The Charter). Guy started off by questioning the name given to this discipline. As it is generally understood, shouldn't "value investing" rather be called "cheapness investing"? He points to human values like trust, social contribution or the search for true value. He pointed out to the audience that the last financial crisis brought strong criticism to our profession, and that investment managers should show leadership in the move toward a greater presence of social values in our decisions. For him the real meaning of value investing should be becoming a person with real values. Guy presented himself as a passionate advocate of Zurich as a center of excellence in value investing, supported by a culture of trust and of solid financial analysis. He finds much intellectual creativity outside the two large banks and, as he dislikes group decisions in investing, he invited the audience to look for a nurturing environment outside of institutional funds and big investment houses.

Regarding his views of the practicalities of the profession, Guy's main challenge, also shared with Georg von

Wyss, is not being able to find value stocks. Guy argues that markets have become more efficient and better at pricing stocks near their intrinsic values. The index that value investors must beat nowadays is much harder to beat than the index of some decades ago when the great investors started. How does he deal with that pressure? The answer lies with behavioral rules. One: he uses others' research, he does not try to always produce original thoughts. Instead he observes what others have bought and reverse-engineers why they did that. Two: Because Guy cannot sell for two years, he must on the one hand analyse thoroughly before investing and on the other create a "safe environment" for himself that removes the psychological pressure to sell when prices fall. Three: He shuts off the stock monitor for weeks at a go in order to avoid the distraction and the pressure of daily market moves. He gives orders only after the markets have closed and he puts himself on "off-news diets". If news about an investment is important, it will find its way to him.

Our last value investor of the day was **Georg von Wyss,** who described the investment process at his company. It is characterised by intensive research, a focus on normalised earnings and multiples, discipline, and patience. The research done for each subject company is very detailed and, contrary to Vitaly, follows a totally standardised template. This analysis might take Georg and his team from a few weeks to a few months. The cost of equity is set at a fixed 10%. Intrinsic value is assumed to be reached in 3 years as this allows the analyst to look beyond current problems. As they have no annual performance reviews, there is no pressure to sell.

Then, they apply decision rules to help them stay objective and rational and to facilitate buy and sell decisions. One: a minimum margin of safety of 40% is required. Two: they sell only to switch to a better idea or because the price has reached 90% of intrinsic value and the position is too large. Three: all decisions are taken independently of the asset manager's own history with that stock. Georg and his team invest in 20–30 names located in geographical areas whose culture they understand (accounting rules, corporate governance and legal system). Economic risk is managed by avoiding excessive concentration on the factors driving investments.

We saw that every successful value investor shares a similar approach, be it in terms of discipline, patience, or quantitative filters, but that each one has his own way of analyzing companies and focusing on the particular "values" that are most meaningful to him or her. In summary, it was no wonder that our conference in Zurich was sold out. This event was sponsored by CFA Institute as a "CFA Travelling Conference" and so two of the speakers travelled to further conferences on the same topic in Frankfurt and London.

For further details please check the video of the Zurich conference and the short biographies of the four speakers.

BY HEIKKI LUOMA CFA

CFA Society Switzerland

INTERVIEW WITH GUY SPIER

Face-to-face conversation with the Zurich-based Managing Partner at Aquamarine Capital Management.

The CFA Society Switzerland hosted a Value Investing Conference on October 29th in Zurich. One of the speakers at this event was Guy Spier, the founder and managing partner of Aquamarine Capital. He has managed the Aquamarine Fund since 1997 in accordance with the investment principles that he learned from studying Warren Buffett. In 2007, Mr. Spier and fellow investor, Mohnish Pabrai, met their role model when they bid $650,100 for a charity lunch with Warren Buffett. Mr. Spier is also the author of a book, *The Education of a Value Investor*, which was published in 2014.

HL: Has moving to Switzerland from New York helped you as an investor and if yes, how?

GS: I think it has helped me as an investor, because there are far fewer distractions around here. I also don't think that I would have written the book if I had stayed in New York, as being in Zurich meant that I had the time to think about it and write it. Zurich has advantages in terms of thinking, but there are also disadvantages to living in here. For example you have to work a little harder to meet people and I need to travel more to network.

HL: You had studied Warren Buffett closely before meeting him in person, was there anything surprising that you discovered during the lunch?

GS: The least pleasant surprise was the clear evidence that he is in so many ways far smarter than I am – and I did not want that evidence. I wanted to come away thinking that he is a very smart guy but I am just as smart, but I just don't think that's the case. It was a good humility lesson to have and it was not something that I was prepared for.
The other thing that always comes up for me is his extraordinary generosity and spirit to deliver value to others. He was there for as long as the lunch would take and he

fully expected that it would be three to four hours. It was not just that he was there, but that he was enthusiastic and so happy to meet us. He was interested in what we had to say and was leaning forward the whole time.
People ask me if the lunch was worth it, but I can still remember the feeling that I had and it was both unnerving and incredible at the same time. It motivates me to behave in a similar way when I meet other people. It is easier to give that feeling once you have received it.

HL: Given that this interview is held in your library, which investment and non-investment related books have helped you the most as an investor?

GS: I don't necessarily think that the readers of The Charter should get my book recommendations; they should get their own book recommendations. The key is to pick up lots of books and articles, but drop them quickly if they're not speaking to you in that moment. Because if they're not speaking to you, then what's the point in reading them.

I would recommend *Journey to the Ants*, which is about learning from ants and introduces new ideas about economic models. It helped me see economics as a part of biology and as a complex adaptive system that cannot be easily described with a few charts and that there may not be an equilibrium, but instead a continuously developing and evolving system.
Another book that I think is really powerful is Adam Grant's *Give and Take*. It teaches that people with better networks have better information flows. Therefore networking is very important for becoming successful as an investor and in other things. Another book that taught me about relationships and how to build them is *How to Win Friends and Influence People*. European readers should take into consideration that although the book is written for Americans, it also contains lessons for Europeans and the challenge of it is to pick up those lessons while retaining your European mindset.
On the investing side, I would recommend the publication called *The Manual of Ideas* from John Mihaljevic [〉] who is a CFA Charterholder. I think he has done an extraordinary service and there are some really incredible people that subscribe to it. John is a highly intelligent person who made an interesting decision to not want to be an investor but instead to be someone who helps other investors.

Another really useful stimulant to action is *The Art of Thinking Clearly* by a Rolf Dobelli from Zurich. He has studied some great thinkers and summarised their methods really well.

HL: What did you learn about yourself when writing the book and will you write more books in the future?

GS: I think that if I wrote another book right now, it would be a disappointment because I don't think that I would have anything significant to say. Writing the book was one of the most difficult, if not the most difficult thing I've ever done. I had to overcome massive amounts of self-loathing. It also required a huge amount of discipline and time.

That being said, I think that it is a really valuable exercise to go through and I would encourage the readers of The Charter to start writing a book. If you find it extraordinarily difficult, then that is just about how it should be as far as I can tell.

During the process, I learned that I need to spend more time thinking and less time doing. Not necessarily thinking about investing, but thinking to be a better person. There is so much heartache and wasted effort that I can save myself by just carefully thinking through stuff.

HL: What are some of the most important qualities to be a value investor and can these be learned by anyone or is it something you are born with?

GS: You should not concern yourself too much with the aspects you are born with as you cannot do anything about them. What you have in Warren Buffett is an extraordinary confluence of innate characteristics plus learned attitudes, environmental attributes which combine to create this extraordinary result. You needed to have every one of those things in place: his personality, his innate traits, his nature and how he was nurtured. His success also wouldn't have been possible without his desire. We cannot work on nature, but we can work on how we are in the environment. There we can make enormous changes.

More important than becoming a great value investor is becoming a better version of ourselves. The key is not to try to become a great investor, as it is more important to become a better version of yourself. This might not involve becoming a great value investor, but don't deprive the world of what makes you special and what makes you who you are, for the sake of becoming some version of Warren Buffett.

HL: Are you constantly thinking about investing, or are you able to switch off at home or on holidays?

GS: I think in a certain way I am almost too switched off and I should switch on a little more to the portfolio. After doing it for so long, there would be some kind of a burnout if I didn't get engaged in other things. That is valuable for me. A lot of your thinking happens sub-consciously so it is good to take a break and for example go for a walk occasionally. A lot of thinking happens below the surface, so sometimes the best way to think is not to think.

HL: Where do you get your investment ideas from?

GS: Look high and low. You get better at looking for things over time with experience but it is a never-ending process. The specific source for an investment idea is not as relevant. What is important is the process of how you got to that source and that you are constantly looking for new sources and ideas. It is smart to study what great investors are doing. It is good to follow the masters' moves, but also understand at the same time that they are not infallible.
The key is to look everywhere, intelligently and to constantly learn about the environment.