AN INTRODUCTION TO VALUE INVESTING

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First off, **what is 'Value Investing'?** In its most basic form, value investing may be described as buying toonies for loonies or buying an item for 'pennies on the dollar'. Other, more practical examples that may help conceptualise the strategy are buying straw hats in the winter or buying snow shovels in the spring.

Perhaps my earliest, most basic and practical experience with 'value investing' was when my mom would buy Christmas wrapping paper *after* the Holiday Season. This transfers over to my father who has a reputation in business as being a 'good buyer'. Waiting for the opportune time to buy may be viewed as being cheap, frugal or difficult to deal with. However in business, not unlike the stock market, the price paid can go a long way to determine the future success of an endeavour.

Why is this important to investors? In all of these examples, the *value* of the underlying 'asset' didn't go down just because the price did. In fact, as followers of the value approach understand, there is an *inverse* relationship between price and value. *As price goes up value goes down - AND as price goes down value goes up.*

All of us have likely exercised the fundamental trait of a value investor - buying something while it is on sale. However, while we all like a bargain, a remarkable few take the same approach when it comes to buying and selling stocks. In fact, many participants approach investing in the *opposite* way, finding strange comfort in buying after prices rise and selling after a severe drop (when the actual inherent value has gone up, not down!).

The concept of buying stocks at bargain prices is attributed to the late Benjamin Graham, known as the 'father' of value investing. How did he earn such a moniker? In 1949 Graham first published *The Intelligent Investor*, which has since become widely recognised as the definitive book on value investing. In the book, Graham posits that stocks should be bought with a 'margin of safety'. This entails buying often unloved securities when their shares are trading at a discount to their real or intrinsic value (i.e. 'on sale'), thus providing

the purchaser with the requisite margin of safety. Since his work in The Intelligent Investor, many market participants and portfolio managers have adopted the 'value investing' approach.

Does value investing work? According to Wikipedia "Numerous academics have published studies investigating the effects of buying value stocks. These studies have consistently found that value stocks outperform growth stocks and the market as a whole." But let's not just take Wikipedia's word for it. Perhaps the best known practitioner of value investing (and a pupil of the late Ben Graham) is Warren Buffett.

In his 2014 letter to shareholders, Buffett revealed that Berkshire Hathaway (Buffett's holding company) has achieved a compounded annual gain of 21.6% per year since 1964 – a span of 50 years! This compares to a compounded annual gain for the S&P500 Index of 9.9% per year over the same time frame (please note that most professional money managers don't outperform the index – let alone double it!). The result is an overall gain for Berkshire shareholders of a remarkable 1,826,163% vs. 11,196% for the S&P500.

As further testimony, in Canada we have our own example of a very successful value investor. Prem Watsa, the Chairman and CEO of Fairfax Financial, has been described as 'Canada's Warren Buffett'. Like Buffett, Mr. Watsa was so enthralled with the book '*The Intelligent Investor*' that he later named his son Ben, after the book's author.

While nowhere near the household name of Warren Buffett and Berkshire Hathaway, Mr. Watsa's Fairfax Financial has achieved similarly impressive results. Over a span of close to thirty years, Fairfax has grown at an incredible compound annual rate of 19.8% per year.

As the saying goes the proof is in the pudding. Quite simply, in my twenty-plus years of active and direct involvement in the investment industry I have not seen any other approach that has achieved anything close to these results. While many other investment philosophies and strategies exist , in addition to the numerous which have come and gone - none have stood the test of time like that of value investing. Despite all of my studies, I cannot tell you who is the 'Warren Buffett' of technical analysis, or who is the 'Prem Watsa' of day trading.

In conclusion... buying the shares of good quality businesses while they are temporarily on sale simply makes sense. Meanwhile, many market participants - most with a product or gimmick to sell – seem to want to overcomplicate investing. Further, most investors make their decisions based on market forecasts, i.e. predictions about the future. The future is unknowable, and as such it should come as no surprise that these professional prognosticators have a dreadful historical track record. Yet the case for value investing, despite its proven long-term track record, often seems to fall on deaf ears.

Absent from this commentary is any math, ratios or minutia regarding the details of how to identify value stocks. Rather, my hope here is to provide you with the basic premise behind my chosen path; the value investing style of portfolio management. Determining whether or not the shares of a company represent good value is my job.

On that note I sincerely thank you for your trust and confidence.

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