

PDV *OBSERVATIONS*

A Quarterly Newsletter for PDV Clients and Friends

Traits for Successful Investing

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Investing in equities successfully over a sustained period of time is difficult. You are tying up money now to own fractional interests in companies with the expectation of ending up with an asset that is worth more money in the future. By definition, this requires your informed opinion about what will happen in the future to the companies in which you have invested.

Investment analysis, by necessity, attempts to forecast a company's future by primarily examining its past. But there is a very good reason for the standard disclaimer that the past does not guarantee the future. The past does inform but not definitively; you will have to analyze whether a company's future will roughly resemble its past or differ (perhaps substantially). Regardless of background, expertise, experience or knowledge level, everyone is fallible when trying to predict the future of companies.

Because of this, quantitative methods for analyzing companies and their future are by themselves grossly inadequate. You cannot simply do a quantitative extrapolation of a company's past to divine its future. In many ways, the necessary *qualitative* evaluation of a company is much more difficult than the quantitative. A sample list of questions you have to answer include: will the company

lose market share, see its products and services become obsolete, get into regulatory problems, take on too much debt, lose access to the capital markets when it needs it the most, and be hit with unmanageable litigation risk?

While obviously nobody bats 100% when predicting the future, certain factors or behaviors tend to increase the odds of your success. In this article, I discuss several of these factors or behaviors, each followed by supporting quotes from some of the greatest investors of all time. The list is far from exhaustive.

Thanks for your referrals!

As we conclude our twenty-fifth year of publishing *Observations*, we would like to take this opportunity to express our gratitude and appreciation to all our clients and friends for their client referrals over the past year. We always welcome the opportunity to be of service to relatives, friends, and acquaintances of our clients. As many of you know, we do not market our services to people with whom we are not acquainted. Our business has grown over the past twenty-five years primarily due to satisfied clients adding business and through their referrals. We hope you'll think of us if you come across someone who would benefit from our services. Thanks again!

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Focus not only on the quality of the company, but the price you pay. Overpaying for a fine company would turn a great *company* into a lousy, losing *investment*.

“The secret to investing is to figure out the value of something - and then pay a lot less.” Joel Greenblatt

“All intelligent investing is value investing - acquiring more than you are paying for. You must value the business in order to value the stock.” Charlie Munger

“Value investing is the discipline of buying shares at a significant discount from their current underlying values and holding them until more of their value is realised. The element of a bargain is the key to the process.” Seth Klarman

Market and equity movements are random in the short run. Avoid expecting instant validation of your investment thesis. Successful investments often take years to prove themselves. Patience is paramount for eventual success.

“Have patience. Stocks don't go up immediately.” Walter Schloss

Volatility is not risk if you have a long-term perspective and do not need to access your investment account to pay living expenses. Volatility offers you multiple points to buy low (and sell high should you choose to do so). Short-term volatility is unavoidable and mostly a result of mass psychology.

“Look at market fluctuations as your friend rather than your enemy; profit from folly rather than participate in it.” Warren Buffett

“Remember that the stock market is manic-depressive.” Warren Buffett

It is important that behaviorally and temperamentally you stand apart from the crowd and adopt a contrarian strategy *when warranted*. This does not mean you should be contrarian just for the sake of being different; your position should be backed by fundamental research and analysis.

“Everyone has the brainpower to make money in stocks. Not everyone has the stomach. If you are susceptible to selling everything in a panic, you ought to avoid stocks and mutual funds altogether.” Peter Lynch

“The investor's chief problem - and even his worst enemy - is likely to be himself.” Benjamin Graham

“Value investing is at its core the marriage of a contrarian streak and a calculator.” Seth Klarman

“We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful.” Warren Buffett

“While some might mistakenly consider value investing a mechanical tool for identifying bargains, it is actually a comprehensive investment philosophy that emphasizes the need to perform in-depth fundamental analysis, pursue long-term investment results, limit risk, and resist crowd psychology.”
Seth Klarman

“Investing is the intersection of economics and psychology.” Seth Klarman

“Cash combined with courage in a time of crisis is priceless.” Warren Buffett

“The time of maximum pessimism is the best time to buy.” John Templeton

“In almost every activity of normal life people try to go where the outlook is best. You look for a job in an industry with a good future, or build a factory where the prospects are best. But my contention is if you’re selecting publicly traded investments, you have to do the opposite. You’re trying to buy a share at the lowest possible price in relation to what that corporation is worth. And there’s only one reason a share goes to a bargain price: Because other people are selling. There is no other reason...To get a bargain price, you’ve got to look for where the public is most frightened and pessimistic...The art of successful investment is counterintuitive. The time to buy is when everyone is scared and you are a bit scared yourself.” John Templeton

“Establishing and maintaining an unconventional investment profile requires acceptance of uncomfortably idiosyncratic portfolios, which frequently appear downright imprudent in the eyes of conventional wisdom.” David Swensen

“Price fluctuations have only one significant meaning for the true investor. They provide him with an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal.” Benjamin Graham

Be cognizant of and control your own behavioral tendencies.

“The most important quality for an investor is temperament, not intellect.” Warren Buffett

“By developing your discipline and courage, you can refuse to let other people's mood swings govern your financial destiny. In the end, how your investments behave is much less important than how you behave.” Benjamin Graham

“Most people aren't cut out for value investing, because human nature shrinks from pain.” Jean-Marie Eveillard

“For most of us, the task of beating the markets is not difficult, it is the job of beating ourselves that proves to be overwhelming, mastering our emotions and attempting to think independently, as well as not being swayed by those around us.” Martin Pring

Adopt a long-term perspective when measuring financial progress. Things are never as despondent as they seem during steep market declines or as ebullient as they appear during robust market advances. Balance is key.

“Do not take yearly results too seriously. Instead, focus on four or five-year averages.” Warren Buffett

“In the short run, the market is a voting machine, but in the long run it is a weighing machine.” Benjamin Graham

Certainty is illusory and often comes at a very high price. Learn to manage rather than avoid uncertainty.

“Markets are constantly in a state of uncertainty and flux and money is made by discounting the obvious and betting on the unexpected.” George Soros

“There’s no such thing as a worry-free investment. The trick is to separate the valid worries from the idle worries, and then check the worries against the facts...” Peter Lynch

Avoid treating equity investing as entertainment.

“Although it's easy to forget sometimes, a share is not a lottery ticket... it's part-ownership of a business.” Peter Lynch

“Investing should be more like watching paint dry or watching grass grow. If you want excitement, take \$800 and go to Las Vegas.” Paul Samuelson

“If investing is entertaining, if you're having fun, you're probably not making any money. Good investing is boring.” George Soros

Stay within your circle of competence and invest in companies that you understand. You should be able to boil down your investment thesis for a company to 4 to 5 major factors.

“Our job is to find a few intelligent things to do, not to keep up with every damn thing in the world.” Charlie Munger