Introduction

Too much of a good thing...

In the seminal 1984 article, 'The Superinvestors of Graham-and-Doddsville', Warren Buffett highlighted the spectacular success of a number of investors, who curiously all followed a value investment strategy of some sort. Although many of them operated as individuals and their portfolio construction methods as well as investment infrastructure differed slightly to fit their individual preferences, they shared a common feature – the way in which they selected the stocks.

He concluded as follows (emphasis added):

'Some of the more commercially minded among you may wonder why I am writing this article. Adding many converts to the value approach will perforce narrow the spreads between price and value. I can only tell you that the secret has been out for 50 years, ever since Ben Graham and Dave Dodd wrote Security Analysis, yet I have seen no trend toward value investing in the 35 years that I've practiced it....'

As Mr. Buffett’s own investment success hurled him into the leagues of the richest men in the world, newspaper articles followed, as did books explaining how to copy him. Attendees to the Berkshire Hathaway AGM grew exponentially, to an estimated 40 000 this year. These days the Buffett experts abound – all ‘knowing’ they know more about Buffett than the rest, despite the fact that everybody has read the same books and blogs.

Jason Zweig of the Wall Street Journal, in a recent blog called ‘What you should – and shouldn’t – learn from Warren Buffett’, pointed out:

'Too many investors try to mimic Mr. Buffett by copycatting his stock picks and parsing every syllable he says and writes. They miss the forest for the trees. To learn from Mr. Buffett, concentrate your energies on figuring out what you stand for as an investor, who you are, what you know and what you don’t. Be inflexible on those principles. Then change and learn and grow relentlessly as you put them into practice.'

Berkshire Hathaway recently celebrated 50 years under Buffett-and-Munger rule. The event was marked by a special shareholders letter from The Sage and his partner, which contained a lot of wisdom. The main message could be paraphrased as follows: '[If you want to be as successful as Charlie and I have been, then...] rather buy great businesses at a decent price, than decent businesses at a great price'.

When my colleagues and I sat down to put our current investment thinking to paper for this edition of REVIEW, this exact point crept into our articles in various ways.

In 'Dark Days for Contrarians' Piet Viljoen highlights the extreme valuations – on both sides – that have developed in a number of prominent South African stocks, and how these have been influenced by the ‘Quality’ and ‘Smart Beta’ themes. As the title suggests, these extremes have made it very difficult for contrarian investors to stay the course.

In ‘On Secular Trends – a Value Investor’s Perspective’ Linda Eedes discusses the difference between share prices that have continued in one direction for a while and an actual secular trend. She points out how we at RECM incorporate these into our thinking. As always, the answer isn’t obvious.

Johannes Visser investigates the shift in RECM portfolios from predominantly ‘quality’ businesses three years ago to having significant exposure to more cyclical names. ‘From ‘Mean-Reverting Heaven in High Quality’ to ‘Hard to Predict, Ugly and Cheap’ is a longer than usual read, but really worth it. An added bonus at the end summarises our thoughts on ‘quality’ once and for all.

Richard Court highlights the uncomfortable reality that value investors face in the form of rights issues by investee companies. ‘Capital Allocation by Another Name – Investing for Rights Issues’ highlights our approach and provides some examples.

In his second contribution to this issue, Richard explains in ‘You Did WHAT?!’ how global value investing comes together in one of our current portfolio holdings – Gazprom.

We’ve come a long way from the Superinvestors days. Mr Buffett openly acknowledges that he has moved on from Graham and Dodd – the base on
which he built his investment empire and which generated some of the best returns of his career. Investors have been embracing Mr. Buffett’s new religion vehemently in the last number of years – enthusiastically buying great businesses at any price. Yet his conclusion from thirty years ago rings as true today as it did then – buying cheap, unloved stocks is as emotionally difficult now as it’s always been. I’ll leave the last word on the subject to Mr. Buffett from the final paragraph of the Superinvestors article:

‘There seems to be some perverse human characteristic that likes to make easy things difficult. The academic world, if anything, has actually backed away from the teaching of value investing over the last 30 years. It’s likely to continue that way. Ships will sail around the world but the Flat Earth Society will flourish. There will continue to be wide discrepancies between price and value in the marketplace, and those who read their Graham & Dodd will continue to prosper.’

I hope you enjoy this edition of REVIEW as much as we enjoyed writing it. Please get in touch if you want to discuss any of the ideas.

And yes, even though it has been a tough time for us value investors, we’re still enjoying ourselves as much as always.

Happy investing.
Jan van Niekerk