INVESTING

# 'Value' is where you start

## Revisiting the basics

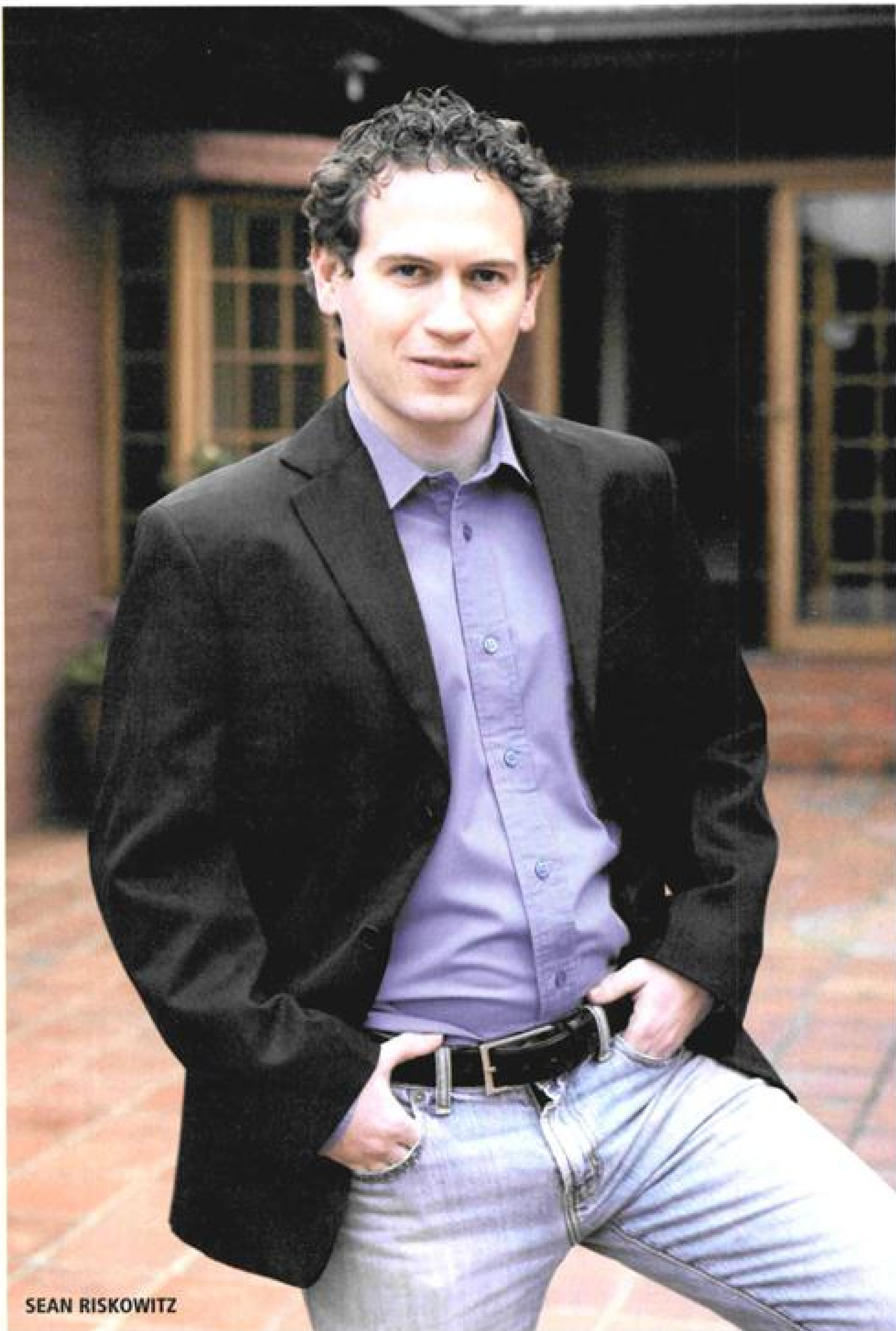
**THERE'S NO QUESTION** that technology stocks worldwide are hot at the moment. When you're seeing extreme multiples paid for stocks going through initial public offerings (IPOs) you can't help but think back to the Internet bubble. The prices being paid make it very difficult for investors to get their heads around this concept of "value" but at times when markets are frothy it's always good to go back to basics.

As Simon Dingle's cover story highlights, the tech Titans currently offering the best "value" are many of the older stalwarts.

A recent report in the newsletter put together by Lentus Asset Management tells an interesting story about what happens when you get "value" wrong. The firm wrote: "Sadly for the investor of 11 years ago, his success (and more) was already in the share price back then. Eleven years on and the tech-heavy Nasdaq is just over half of what it was in the peak of 2000. An investment in any of the above companies would still be heavily under water (Microsoft -66%, Cisco -75%, Intel -61%).

"Even if you'd missed the bubble and bought those stocks a year or two after the crash, you'd still be lucky to have your capital back, let alone any share price growth. Little surprise, given those 'growth' stocks were trading on earnings multiples of 30 and over for much of the early decade – a statistical recipe for investing underperformance."

While technology stocks have been flying, many other sectors have come in for a hiding – and that attracted so-called contrarian investors. Throw in some difficult economic data and mixed ideas of what constitutes "growth" and many times investors have to wonder why they



SEAN RISKOWITZ

**BENEFITS OF VALUE INVESTING**

**VALUE TRAP?**

bother trying to find mis-priced assets.

In the accompanying text box we've broken down how *Investopedia* defines "value investing". However, that concept is further explored by leading asset manager Piet Viljoen, of RE:CM, in a recent report back to clients. He said: "It's very important to realise investment returns aren't generated by economic growth. There have been numerous studies that have shown the link between economic growth and subsequent stock market returns is tenuous at best. In fact, the dominant driver of returns is the starting valuation. When prices are low relative to intrinsic values, long-term returns tend to be high, while the converse is true when prices are high relative to intrinsic value."

One point Viljoen emphasises is many of his portfolios in fact are sitting deep in cash looking for "value". That cash – and the cash holdings of the businesses in which it's an investor – provides some "margin of safety" for it as an asset manager.

"The only thing we're actually optimistic about is mankind's ability to dig themselves out of deep holes. We have no doubt we – collectively – will be able to do so again. In the meantime, while we wait for that to happen we'll maintain large cash positions and only own stocks that actually pay us for the risk of owning them through a deep discount to their intrinsic value."

That's all well and good, but for many investors the reality is they don't enjoy the benefits of a cosy asset management office to "wait" for the right deals. They need to go out and actively find investments. So where to start?

*Finweek* put that question to local asset manager Sean Riskowitz, of Manhattan Financial, asking how he'd define "value" investing. His answer was pretty simple: "Value is buying R1 for 50c."

That sounds easy enough, but are there any easy line items that investors can look at to decide if they're getting value? Riskowitz says he looks for four factors: Horse, jockey, runway and price.

First, is it a good business with capacity to grow over time: ie, win the race?

Second, is it managed by competent and ambitious people?

Third, is there an opportunity and durable competitive advantage for the next 10 to 20 years that will catapult the business forward?

Fourth, can it be bought for 50c?

Riskowitz used that methodology when picking Namibian financial services play Trustco. Manhattan Financial was one of the early backers of the stock and has seen it run up from around 30c to more than R1/share.

Greg Hopkins, of investment firm PSG Asset Management, has actively been considering the subject when it comes to global banking groups. While many of the share prices have fallen off dramatically, including JP Morgan, over the past few years due to bad debt concerns, not everybody believes there's value to be had.

"At PSG Asset Management we've been cautious on the banking sector, both domestically and overseas, given our concerns on the significant indebtedness of global consumers, the general opaqueness of banks' balance sheets and, in SA, the high level of the housing market." The firm uses the "3M" approach to consider value, namely: "Moats, management, margin of safety."

Investors will always have their views on management but the "Margin of safety" issue is worth considering more closely. "Banks are essentially distributors of commodity products, for which they charge a small fee or spread. Regulation and the reluctance of governments to grant new banking charters do create some barriers to entry in the industry, while in some markets a form of oligopoly or low rivalry between players promotes decent margins on underlying products."

Can you apply that same methodology to your investment portfolio? Those who think they're seeing "value" should look back at the Lentus examples and maybe rerun the numbers.

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## *Investopedia* defines value investing as...

**THE STRATEGY OF** selecting stocks that trade for less than their intrinsic values. Value investors actively seek stocks of companies they believe the market has undervalued. They believe the market overreacts to good and bad news, resulting in stock price movements that don't correspond with the company's long-term fundamentals. The result is an opportunity for value investors to profit by buying when the price is deflated.

Typically, value investors select stocks with lower-than-average price-to-book or earnings multiples and/or high dividend yields. ■