CEO Point of View

by Glenn Carlson, CFA

Over the last year, a few holdings filed for bankruptcy, triggering some clients to ask why we didn't sell these positions earlier. Other clients asked why we purchased these stocks in the first place.

The answer to both questions is identical. We have an investment process that we follow in all markets around the world. And the process is fairly simple: if a stock's price is less than our assessment of the business value, we likely will buy it or continue to hold it.

Based on our experience, we believe this process generates ample opportunities for reward, countered by fewer opportunities for loss. Over our history, our repeated investment in what some perceived as "high risk" securities often delivered gains that ultimately were multiples higher than our original purchase price. We believe adherence to our process can generate similar opportunities in the future.

We think investing in undervalued businesses makes sense. We recognize that sometimes, however, it is difficult to do as undervalued often means unpopular. But we do it – and we do it consistently. And this is the essence of the value we seek to provide for our clients. When a company is in trouble, near, or even in bankruptcy, it may be more difficult than usual to make a "good" estimate of its intrinsic value. But our clients pay us to make the best assessment we can, and then act accordingly.

If we sell a security because "the market is worried," or because we may "look like idiots," as one client suggested, or we're worried that clients will fire us, then we are violating our process. And just as important, we are violating the trust our clients place in us. Avoiding such opportunities because there is a possibility of a negative outcome would be compromising our job as value investors, and doing a disservice to our clients. That's why we typically *don't* sell these holdings as a knee jerk reaction. We assess the probability of reward versus the risk of holding and make the determination based upon facts as we understand them.

Our goal is to get the best results over time from a *portfolio* of what we believe to be undervalued stocks. We firmly believe this approach "wins" in the long run. We've seen it repeatedly over the last 30+ years. When we buy, we expect there's a chance the price will go down for a while. If that happens, we typically buy more – averaging down our cost basis. We don't want or expect many stocks to fall precipitously, but we know that statistically this can happen. And our experience and research studies suggest that we will own some stocks in the portfolio that go bankrupt. It has happened in the past. It likely will happen again. Is this embarrassing? Sure. Does it mean that our original business value assessment was wrong? Sometimes. But is it a mistake? Should we do something differently? No – we remain true to our process.

Let's be clear – we are not satisfied with marginal results. We seek to deliver exceptional results. And we think the only way to be exceptional is to be different. Act different. Look different. Think different. Often, we hold stocks that other investors wouldn't. Frequently, our investment process points to opportunities where other investors may only see risk and the potential for negative developments. Our recent investments in Delphi, Delta, and Dana Corp. are good examples. By now, you may know that each filed for bankruptcy. But when we purchased them, our research indicated that the risks associated with these companies were greatly outweighed by the potential for reward, and that the market was being overly pessimistic toward these companies. Further, from a *portfolio* perspective, when these holdings were added to a diversified group of securities, the potential for reward exceeded the potential portfolio risks. Unfortunately, in these cases, the potential risks were in fact realized and these three holdings did not work out for us.

We're willing to look like "idiots" in the short term. We're willing to accept our business risk in holding such companies (i.e., our clients may get frustrated with such decisions and may fire us). We're also willing to talk candidly about holdings like Delphi, Delta, and Dana Corp. Why? Because we believe in our investment process. We have confidence in our commitment to Ben Graham's core principle of being different. And we are sanguine in our ability to deliver exceptional results over the long term by maintaining this investment discipline.

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