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*“How can you make investment decisions amid uncertainty?”*

When clients ask us this question, we appreciate their concern. We realize that it can be difficult to focus on the long term when short-term factors are creating a turbulent market environment. In recent months, credit markets have experienced an increasing frequency of defaults and lower levels of liquidity. Amid the subprime mortgage fallout, the U.S. housing market has seen a pronounced drop in demand, high levels of unsold inventory, and an increase in foreclosures. Media coverage of these events seems to emphasize that the fallout is unclear, that conditions may worsen, and that the total impact will not be known for some time.

Yet in the face of this uncertainty, Brandes Investment Partners® is purchasing companies in industries such as homebuilders, savings and loans, and commercial banking. Given these new purchases, it's understandable for clients to wonder whether we are “buying too early” or making ill-advised investments, given the potential for continued deterioration. How can we determine fair values for companies when the total impact of such events may be still unknown?

We've found that, in difficult times, stock prices tend to exaggerate the prevailing uncertainty. We also believe that opportunities are created where individual stock prices fall below a rational assessment of business worth. Keep in mind that our assessment of business value is conservative and not precise. The intrinsic value estimates we develop for individual businesses are dynamic. Often, we describe our intrinsic values as a “neighborhood,” not a specific address. To help us develop our intrinsic value estimates, we look at normalized measures over long-term business cycles. We believe in reversion to the mean and seek to take advantage of short-term price declines that can create long-term opportunities.

Let's look at the homebuilding industry in the United States, where we have invested in select companies, as an example. The industry is being impacted by a number of adverse events, including:

- Falling demand for residential homes
- Related fallout of the subprime mortgage markets
- Diminished liquidity in the credit markets

The final impact of these trends cannot be determined with certainty. It is not known how long it may take homebuilders to sell excess inventory: three years? Five years? Defaults for home owners with adjustable rate mortgages may increase. In addition, tightened lending standards may decrease future demand.

Amid this uncertainty, stock prices for U.S. homebuilders have experienced notable declines. Based on our analysis, many of these companies have declined below our estimates of their fair values, enabling us to purchase shares at what we consider compelling prices.

Among some firms, only a small segment of their businesses may have exposure to home building. If, for example, this segment represents only 10% of the company, yet the stock price declines by 40% amid concerns over housing

demand, the stock price decline can be seen as overly punitive, and may result in an opportunity to invest in an undervalued stock. We've witnessed this scenario unfold for select companies, and we've purchased shares of these companies at prices we believe offer compelling value.

Our company-by-company analysis gives us a broad perspective on individual industries. We realize that some companies face severe challenges. In some cases, stock price declines have matched erosion in business value – some stocks are cheap for good reasons. However, some stock prices have fallen well below what we believe they are worth.

When the relative difference between stock price and assessed fair value is great enough, the investment decision is not dependent on precision. As Benjamin Graham observed, "... the margin of safety is, in essence, that of rendering unnecessary an accurate estimate of the future." (*The Intelligent Investor*, pages 277-278.)

Similarly, if a professional basketball player walked into your office, you might not be able to gauge his or her exact height. Does the player stand six foot eight inches? Six foot ten inches? Perhaps seven feet? One does not need a precise measurement of height to assess that the player is significantly taller than a person of average height.

We believe the same logic applies to assessing firm value. We believe we can determine a firm's value without forecasting precise quarterly earnings projections five years out or building ambitious econometric models. Our analysis of a company involves careful scrutiny of fundamentals, balance sheets, operating performance, and potential scenarios affecting the firm or industry. As a result, when we identify a company trading at a discount, or margin of safety, of (for example) 40% to estimated fair value, we are not hesitant because the uncertainty surrounding economic events may eventually reveal the margin of safety to be 35%. Just as one can be fairly certain of height without precise measurement, one can be fairly confident of value.

We also acknowledge we have a different perception of "uncertainty" than many others in the market. Generally speaking, we do not perceive uncertainty as not knowing the precise impact of cyclical events. Instead, we believe the true "uncertainty" investors need to be wary of involves making speculative investments in richly valued companies. We believe these companies often exhibit operating performance or profitability that is not sustainable, and as a result, these companies may be adversely impacted when operating performance reverts to historical averages. At that time, their stock values may revert to fair value – or, as market sentiment swings, notably below fair value. This conviction has kept us from investing recently in top-performing companies in the oil & gas industry.

We acknowledge that it can be difficult to assess the exact impact of adverse economic events. In fact, we believe we can't precisely predict the extent of large economic events or trends. This may sound a bit candid – an investment manager admitting an inability to make precise forecasts. Fortunately, our fundamental, bottom-up investment process does not revolve around making bold forecasts or exact prognostications.

What we do know from our investment experience is that during times of economic uncertainty many investors tend to overestimate the risks companies face and frequently misprice stocks. While we may not capture all of the risks affecting a company's business value, we allow ourselves a cushion in the form of the margin of safety

to help mitigate this risk. We have found that holding a portfolio of stocks invested using this approach can generate attractive long-term returns for our clients.

A core principle of our value philosophy is independence – the willingness to think differently. As believers in the opportunity in select out-of-favor stocks, we don't follow the investment crowd. Instead, we search for overlooked opportunities that the crowd has passed by. It's not always easy, but we believe that confidence in our research and courage in our convictions helps us to make sound investment decisions amid uncertainty, and enables our clients to be rewarded from this against-the-grain style.

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