An Interview of Dr. George Athanassakos

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- **What is Value Investing in brief?**

  Value Investing is a style of investing developed in the early 30's at Columbia University by Ben Graham who showed a way and an approach to find and buy stocks that trade significantly below intrinsic value. It is a style of investing designed to help investors pick stocks.

  The process to achieve this involves 3 steps:

  - Search for value, that is, screen stocks using a number of valuation metrics such as P/E, P/B and so on to determine which stocks are potentially undervalued, i.e., have low valuations vis a vis accounting metrics.

  - Valuation of the potentially undervalued stocks to determine their intrinsic value.

  - Decision to invest using the concept of the margin of safety, that is, invest only if the stock is well below its intrinsic value (about 30% below) and do so with discipline and patience.

- **In the world of investing, there are two categories of people - the majority who are traders/speculators and the minority who are Value Investors. In terms of generating returns for a retail investor what would be the better method - Value Investing or Speculating? Why is that so?**

  Value Investing is a long term strategy with proven record of success. It requires an analytical approach, discipline and patience. Value Investors try to minimize risk. They want to protect their capital without limiting the upside.

  Speculation is gambling on the hottest stocks and the most glamorous ideas. Speculators maximize risk. They risk their capital and hope higher returns will result from higher risk. In theory, this is true, but in practice it is not so. This may work if markets are always in equilibrium and we know the expected return and risk and know how to measure risk. These are very strong assumptions. The odds are always with the house. In the long run, speculators normally lose and at worst they break even.

- **In Value Investing, there appear to be many criteria in selecting a great company, what would be more important qualitative or quantitative criteria?**

  Both are important.

  You need to carry out a qualitative analysis to understand the business, the management, the competitive environment, who has competitive advantage and who does not, and so on.

But you also need to carry out quantitative analysis to understand which company is undervalued and which is not by going over the value investing process described above. Otherwise, one may be taking valuation risk – the key to underperformance. One may buy the greatest company, but if he/she overpays, he/she will never outperform. Being analytical helps the investor avoid being swayed by emotions and rules of thumb. The investor will need to carry out the screening, the valuation and the Margin of Safety requirement to make an investment decision to buy only those stocks that are truly undervalued.

- **There are many ways of valuing stocks ranging from Net-Net, Book Value, P/E, Discounted Cash Flows and so on. How does Warren Buffett value stocks and what would be the most appropriate valuation method for a retail investor?**

  Buffett uses a cash flow based valuation, but he does not like to make forecasts, especially of growth, as the future is unknown. However, for the companies he cares about, namely companies with Competitive Advantage and a franchise, it is easier to see how the future may unfold. Such companies have a value that is determined by cash flows. This value is in excess of the value of assets. Ben Graham was more interested in companies with higher asset value than value based on cash flows and those in which he could see potential catalysts that would eventually push the value of the company to that justified by cash flows. Graham's way is much easier to carry out for a retail investor.

  Value Investing is not a rocket science; it is simple, but not easy. One will need to learn the process and then practice, with patience and discipline. It works. But it is time consuming and needs considerable skill. As Buffett has said many times, if you have neither, it is best to stick with ETFs.

- **Do value investors use different methods for different types of stocks? What are some examples?**

  Yes. For companies with Competitive Advantage and a franchise one needs to use a cash flow based valuation. This is suitable for companies such as Johnson and Johnson, Intel and so on.

  For companies in a free entry environment and with no Competitive Advantage, you will need to rely more on asset values and catalysts, as it is the case for companies in industries like the food business, department stores, apparel and so on.

- **For a retail investor, what would be an ideal portfolio of stocks that he/she should aim to hold in terms of number of stocks and industries?**

  If one has time and skill, 20-25 stocks in 4-5 industries should be sufficient. One will need to concentrate his investments in what he understands and on his circle of competence. It is difficult to understand many industries well.

  As indicated above, if one has no time or skill, it is better to be well diversified and it is best to buy ETFs.

- **For a retail investor with small capital, say US$2000-$3000, how can one make use of Value Investing to achieve his/her financial goals?**

  It does not matter how much money one starts with. One will need to learn the theory and practice of Value Investing. The investor will need to understand the value investing process and how to apply it. This will enable him to grow his capital over time. But he cannot do it by just reading the trade books that are out there, as they never tell the reader how it is actually done. One needs to take a Value Investing course or seminar by people who really understand the process and are willing to teach it - either at Ivey or Columbia. Then, the only thing left will be to practice and follow the approach with discipline and patience.

  It is very rewarding to be in control.

  If one does not want this, it is best for small investors to stick with ETFs.