March 10, 2016 ~ Martin Whitman, CFA, Third Avenue Management LLC, New York, NY

Ben Graham Centre (BG): You once held the position that you would not invest in companies overseas, but later changed this position as you felt the opportunities to find undervalued companies. In light of increased globalization, do you think that it will be more difficult to find equities trading at a substantial discount, and if so when do you think that time will come?

Martin Whitman (MW): Not only do I restrict investments to companies whose common stock trade in well-regulated markets, but I don't think I get involved in companies that don't publish in English, and aren't audited by the Big Four [accounting firms]! So the thing I'm talking about is really a very narrow universe of where to invest satisfactorily. It's certainly unsuited for most world-wide investments. My God, we would *not* invest in Russia, we would *not* invest in China unless there were American depository receipts. We just don't do it. Most investments just aren't on our radar screen. I think it's important, if you want to follow what we do, you're really looking at a relatively narrow choice of investments -- you don't do emerging markets, you don't do companies that are not well financed. If they're not well financed, then you're a creditor not a stock holder.

BG: A question concerning Third Avenue Focus Credit Fund. This is a Fund that decided to suspend investor redemptions as well as liquidate. This incident followed from a period of very heavy withdrawals, during a period of heavy decline. I was wondering, why do you think liquidity was not monitored closely enough to prevent this situation?

MW: ***(from his team)*** *We're not going to answer any questions about the focus fund this evening -- sorry.*

BG: Regarding diversification: Can you elaborate on why you don't think diversification is appropriate for value investors?

MW: If you want alpha, you have to concentrate. A very important fact of investing is control investing, distress investing, first and second state venture capital. If you're in those areas, you don't diversify. In terms of value investing, I say as I've often said, diversification is a damn poor surrogate for knowledge, control, and price consciousness. Academics diversify because they don't know anything about the companies or securities, they're not interested in control, and they certainly are price unconscious. They say the price of the market is the right price, so *they* should diversify. But you folks [students that are taking George's Value Investing course], in doing what you do in investments, is to gain knowledge, price consciousness, and perhaps some of you will graduate to control investing, distress investing, or active investing.

BG: You mentioned there was an overemphasis on macroeconomic factors when people are doing analysis on companies. When you're looking at companies, and

especially portfolios of common stocks, to what extent should those macro trends be analyzed.

MW: We try to be realistic. I think in the type of investing we're doing, the bottom-up deserves more weight than the top-down. I don't mean you stick your head in the sand and don't worry about the macro. I'm now really only managing my family's money, and wherever we're very heavily invested in Hong Kong companies with a big presence in mainland China, I would be sticking my head in the sand if I didn't say "boy we could be wrong about china" but I would be if we're wrong, it's not for economic reasons. Rather, it's going to be because of political unrest and violence in the streets. I'm aware that may make me very wrong about the investment in China. If it were you, how much weight should I give it? I don't give it a lot of weight because I concluded the probabilities are that China's more politically stable than the United States, and less politically stable than Canada. We deal with probabilities. I don't mean to ignore it, I mean to down weight it compared to conventional analysis -- compared to Graham and Dodd.

BG: With distress investing, what do you feel are the major challenges in today's environment that make it more difficult than in the past?

MW: I think there has been a revolution in the US and Canada compared to when I was very heavy into distress investing. Now, both in the US and Canada, it has become more economic to prepack a reorganization or even a liquidation or a sale of troubled companies or assets, and the big revolution now, from the 80s, is that much of the uncertainty of uncontrolled chapter 11s has been eliminated. Now, you've got a whole constituency (which I was really the only member of in the early days!) that really long to own. You go into an investment in the US and Canada and say to yourself "Gee I really don't know if this is going to be a performing loan, but if it isn't a performing loan, then I'm happy to give up my credit for the common stock", and that's been a big revolution in distress investing -- a willingness to give up credit positions for ownership interests. By the way, I don't think people realize how big of a revolution that it is, but it certainly is occurring!

BG: What sort of lessons did you take away from the subprime mortgage crisis?

MW: Boy did I learn lessons from that! I wrote about it, but I had some pretty poor investments during the time. The lesson I learned is if you're not well-financed, then there's going to be money defaults. Not only in real estate, I guess we may be in North America facing an auto credit crisis, and then the big thing I learned is to be much more wary than I was before 2008, and you should too. Fortunately, it's really not all that relevant to today's seminar because this seminar focused on the common stock of extraordinarily well financed companies!

BG: Could you share with us an investment that didn't go as expected for you, and what sort of lessons you took away from that?

MW: Probably the worst investment I made before 2008 was in MBIA [Municipal Bond Insurance Association], a credit insurance company that was all tied in with residential mortgages. I attribute the bad investment to my not paying attention, my stupidity, my being seduced by the management. You have to be very careful. I've sold most things that were involved with mortgages before, but I didn't sell MBIA. It was a terrible mistake.

BG: As the distressed market in the US becomes more sophisticated with more sophisticated players and clearer law, does that reduce the opportunities for great returns, and will distress investors start looking for distressed debt in other countries?

MW: On the principles that I've outlined to you today, the common stocks have never been cheaper or more attractive than they are now in my 66 years in business. Therefore, I'm really not that interested in distress. I wouldn't suppose that distress is a very attractive area today. Especially upstream oil and oil service companies. The reason being: you can pretty easily measure the asset values. And, both in the US and Canada, they tend to be easier to reorganize than your normal run-of-the-mill company. One reason is that they are not labor intensive; you don't have pension plans and union problems. The second reason is that they don't incur a lot of trade debt, so all you have is secured lenders who you reinstate and unsecured lenders who get all or almost all the equity. I think there are large opportunities. In the analysis of distress, I used to have a two pronged approach. First, what are the probabilities that a performing loan will remain a performing loan? Therefore you look at: is the yield to maturity, and you can start at 15% and go north from there. You analyze the situation and see what the probabilities are as a performing loan. The second thing you weigh is the probability of a money default. There you estimate what the work out would be, the time it would take against a dollar price you would have to pay for the bond. I suspect if you look, you'd find a lot of things with a high probability of money default, and the returns look pretty good on a workout. One of the big exceptions by the way is in the USA, no one can take away a creditor's right to a money payment for principle interest or premium unless that individual creditor so consents, or a court of confident jurisdiction (a bankruptcy court) aggregates the rights to the money payment. Though this is not true in Canada! Several ventures that I looked at, by the requisite vote of the class accredited company forced to give up the right to a money payment.

BG: How do you convince your investors to stay with your value approach when growth stocks seem to be doing exceedingly well?

MW: People have made billions and trillions of dollars doing what we don't do! And it's always going to happen. I present this to you as a good, comfortable way to be a passive investor. I would hardly say that it is the only thing to do, but it's a good thing to do. It's a very comfortable approach to follow. It's got a very high probability of giving you satisfactory returns. Is it going to make you the kind of money that you could make if you could go public with a venture capital IPO? No. Does it have the same potential as does the ownership and control of income producing real estate where you don't pay any taxes and you get non-recourse long term financing? Probably not. At the times

we're out performed by other techniques, believe it or not, we suffer redemptions! Value investing is not the exclusive road to riches, it's just a nice way to go!

BG: A problem that a lot of inexperienced investors usually faced when looking at bargains or going for contrarian plays is the differentiation between a bargain and a value trap. Can you explain how you identify value traps and differentiating them from quality investments?

MW: Forget it! Value traps can happen to individual securities. They can't happen to portfolios. Bad analysis can exist for a portfolio; value traps can't.

BG: Do you have any advice for the young value investor starting today?

MW: If I had my druthers, and I had my choice for training, I'd go into investment banking, management consulting, being a bank loan officer, then you can graduate to other things. One of the things I think is extraordinarily important, that any student associated with me to have studied accounting, and to be very well versed in financial accounting. If you haven't done that yet, be sure to do it before you graduate!

BG: What is the most important lesson you've learned in life and in investing you've learned in the last 60 years?

MW: The most important lesson, since all of you will be very successful: make sure you give something back. That's certainly the most important business lesson, and the most important personal lesson. My kids are taken care of, when my wife and I die, most of our money is going to charity, and a lot of it goes now. I think the most important thing you can learn in business, is that you're really not doing it for yourself, you really ought to contribute to society. And in terms of analysis: being in the securities business, and being an investor, try and be very well educated and think for yourself. It's always important at the end of the day to have the courage in your own convictions.