PRICEVALUEPARTNERS

Events

"Events, dear boy, events."

- Alleged response by the British Prime Minister Harold Macmillan, when asked by a journalist what is most likely to blow governments off course.

"I'm shorting two stocks in the U.K., but I've got a screen of about 50, and I might short all 50 if I think Jeremy Corbyn is going to be prime minister. Corbyn's a Trotskyite. Now I know my Trotskyites well and I know you don't want to be invested in the U.K. if a Trotskyite is prime minister."

- Fund manager Steve Eisman, as reported by Bloomberg.

"It breaks my heart to see (I can't interfere or do anything at my age) what is happening in our country today - this terrible strike of the best men in the world, who beat the Kaiser's army and beat Hitler's army, and never gave in. Pointless, endless. We can't afford that kind of thing. And then this growing division which the noble Lord who has just spoken mentioned, of a comparatively prosperous south, and an ailing north and midlands. That can't go on..

"When I ventured to criticise, the other day, this system I was, I am afraid, misunderstood. As a Conservative, I am naturally in favour of returning into private ownership and private management all those means of production and distribution which are now controlled by state capitalism. I am sure they will be more efficient. What I ventured to question was the using of these huge sums as if they were income.

"I know now, I have learnt now from the letters that I have received, that I am quite out of date. Modern economists have decided there is no difference between capital and income. I am not so sure. In my younger days, I and perhaps others of your Lordships had friends, good friends, very good fellows indeed too, who failed to make this distinction. For a few years everything went on very well, and then at last the crash came, and they were forced to retire out to some dingy lodging-house in Boulogne, or if the estate were larger and the trustees more generous, to a decent accommodation at Baden-Baden."

- Harold Macmillan, First Earl of Stockton, in two speeches in the House of Lords, in November 1984 and November 1985 respectively.

Two hypothetical events currently hang over the UK economy and financial markets like the distended bowels of a hugely overfed dog. One is what is popularly referred to, by the Quisling press, as a "no-deal Brexit" (variations on this theme include the ridiculous clichés "crashing out" and "cliff-edge"), all of which could more fairly and accurately be described as simply a UK exit from the EU on World Trade Organisation terms, saving us £40 billion in the process. The other is a Jeremy Corbyn and John McDonnell "government". These hypotheticals are not mutually exclusive. The former could plausibly give rise to the latter.

The subject of Brexit has already been exhaustively discussed within both traditional and social media, and we have no interest in adding to the heaped piles of ordure that have already accumulated on the topic. We merely cite, in dispatches, this missive which recently appeared in the *Financial Times* from Dr. Alan Hearne of Woodstock, Oxon:

> It is good to have Wolfgang Münchau back reminding us how structurally unstable the eurozone remains ("Italy is setting itself up for a monumental fiscal failure", October 29).
>
> At the time of the EU referendum I was the chief executive of a reasonably large international company, listed in London and doing business in European countries in and out of both the EU and the euro. Nonetheless, I voted Leave, even in the sure knowledge that politicians on both sides of the Channel would make a mess of the exit negotiations and that leaving would have a significant and negative short-term impact on the UK economy.
>
> My primary reason was that I believe the success of the EU cannot be separated from the future of the euro. The euro cannot be a success without a level of economic, financial, political and social integration that would be entirely unacceptable to UK citizens. In the event of such integration, non-euro members in the EU, including the UK, would be left on the sidelines peering in, increasingly unable to set the rules by which they have to play.
>
> The alternative, which seems more likely, is that the citizens of other EU countries also find the level of integration required too high a price to pay and resist it. This will require the EU to battle regularly with individual members that step out of line, and, therefore, unable to represent properly all its members in an increasingly competitive world. We know that the EU institutions are then likely to devote more time to internal regulation.
>
> This analysis does not suit those who would like us to remain in the EU. If they continue to pursue the second referendum, the question they should answer is, what the EU, of which they are keen to remain part, will look like in 10, 20 or 30 years' time, not what the short-term dislocation of leaving might be.

Quite so. Unfortunately, most of our mainstream media seem unable to discuss the issue sensibly, preferring instead to posture like a purple-haired young girl shrieking 'Stop Brexit !' in a Bacchanalian festival of highly aggressive social justice warrior virtue-signalling.

The threat of a Trotskyite "government" is, rather awkwardly, more difficult to dismiss out of hand. (Note, however, the influence of the purple-haired shriekers who may yet bring it to pass.)

Time to wheel out the big guns. In 2014, *Fortune Magazine* published an article by Warren Buffett, drawn from his annual letter to shareholders in Berkshire Hathaway. Here is an edited portion:

> In 1986, I purchased a 400-acre farm, located 50 miles north of Omaha, from the FDIC. It cost me $280,000, considerably less than what a failed bank had lent against the farm a few years earlier. I knew nothing about operating a farm. But I have a son who loves farming, and I learned from him both how many bushels of corn and soybeans the farm would produce and what the operating expenses would be. From these estimates, I calculated the normalized return from the farm to then be about 10%. I also thought it was likely that productivity would improve over time and that crop prices would move higher as well. Both expectations proved out..
>
> In 1993, I made another small investment. Larry Silverstein, Salomon's landlord when I was the company's CEO, told me about a New York retail property adjacent to New York University that the Resolution Trust Corp. was selling. Again, a bubble had popped — this one involving commercial real estate — and the RTC had been created to dispose of the assets of failed savings institutions whose optimistic lending practices had fueled the folly.
>
> Here, too, the analysis was simple. As had been the case with the farm, the unleveraged current yield from the property was about 10%. But the property had been undermanaged by the RTC, and its income would increase when several vacant stores were leased. Even more important, the largest tenant — who occupied around 20% of the project's space — was paying rent of about $5 per foot, whereas other tenants averaged $70. The expiration of this bargain lease in nine years was certain to provide a major boost to earnings. The property's location was also superb: NYU wasn't going anywhere..
>
> Income from both the farm and the NYU real estate will probably increase in decades to come. Though the gains won't be dramatic, the two investments will be solid and satisfactory holdings for my lifetime and, subsequently, for my children and grandchildren.
>
> I tell these tales to illustrate certain fundamentals of investing:

- You don't need to be an expert in order to achieve satisfactory investment returns. But if you aren't, you must recognize your limitations and follow a course certain to work reasonably well. Keep things simple and don't swing for the fences. When promised quick profits, respond with a quick "no."

- Focus on the future productivity of the asset you are considering. If you don't feel comfortable making a rough estimate of the asset's future earnings, just forget it and move on. No one has the ability to evaluate every investment possibility. But omniscience isn't necessary; you only need to understand the actions you undertake.

- If you instead focus on the prospective price change of a contemplated purchase, you are speculating. There is nothing improper about that. I know, however, that I am unable to speculate successfully, and I am skeptical of those who claim sustained success at doing so. Half of all coin-flippers will win their first toss; none of those winners has an expectation of profit if he continues to play the game. And the fact that a given asset has appreciated in the recent past is never a reason to buy it.

- With my two small investments, I thought only of what the properties would produce and cared not at all about their daily valuations. Games are won by players who focus on the playing field — not by those whose eyes are glued to the scoreboard. If you can enjoy Saturdays and Sundays without looking at stock prices, give it a try on weekdays.

- Forming macro opinions or listening to the macro or market predictions of others is a waste of time. Indeed, it is dangerous because it may blur your vision of the facts that are truly important. (When I hear TV commentators glibly opine on what the market will do next, I am reminded of Mickey Mantle's scathing comment: "You don't know how easy this game is until you get into that broadcasting booth.")

  And now back to Ben Graham. I learned most of the thoughts in this investment discussion from Ben's book *The Intelligent Investor*, which I bought in 1949. My financial life changed with that purchase.

  Before reading Ben's book, I had wandered around the investing landscape, devouring everything written on the subject. Much of what I read fascinated me: I tried my hand at charting and at using market indicia to predict stock movements. I sat in brokerage offices watching the tape roll by, and I listened to commentators. All of this was fun, but I couldn't shake the feeling that I wasn't getting anywhere.

  In contrast, Ben's ideas were explained logically in elegant, easy-to-understand prose (without Greek letters or complicated formulas). For me, the key points were laid out in what later editions labeled Chapters 8 and 20. These points guide my investing decisions today..

  I can't remember what I paid for that first copy of *The Intelligent Investor*. Whatever the cost, it would underscore the truth of Ben's adage: Price is what you pay; value is what you get. Of all the investments I ever made, buying Ben's book was the best..

Two final observations.

One. Irrespective of whether UK investors face the prospect of a Trotskyite "government", not all listed UK equities will lose all of their value if it comes to pass, albeit the outcome is unlikely to be exactly peachy. (We also suspect it could end up being the shortest-lived Labour administration in history. While Adam Smith was undoubtedly right to say that there's a great deal of ruin in a nation, the extent of that ruin can only ever be finite.) Steve Eisman is reportedly shorting bank stocks. Anybody ***buying*** bank stocks given the opaque and impenetrable nature of their balance sheets deserves some kind of award for bravery in the face of a monumental shift in the interest rate cycle.

Two. It is a habit of domestic investors – and their advisors – to practise what is called 'home country bias'. We feel no obligation to do so. There are plenty of foreign markets offering exceptional value today ***without*** the risk that Jeremy Corbyn or John McDonnell might be parachuted in by the purple-haired shriekers to destroy them. Robert Horrocks, for example, chief investment officer at Matthews Asia, sees a silver lining in Asia amidst the global clouds:

> Price-to-forward earnings ratios at about 12.1x for Asia ex-Japan and 12.8x including Japan compare favourably with Europe at 13.7x and the US at 17.1x. I think these valuation discounts are already a bit excessive. It is undeniable that the US has seen superior profit growth over the last seven years, but I do not expect that to be the case over the next decade, as political and wage cycles switch in the US to favour labour and switch in most of Asia to favour corporations.

Our specific favourites: Japan and Vietnam. We happen to think that Benjamin Graham would approve.

www.pricevaluepartners.com @timfprice

Tim Price is co-manager of the VT Price Value Portfolio and author of 'Investing through the Looking Glass: a rational guide to irrational financial markets'. You can access a full archive of these weekly investment commentaries here. You can access the archive of our regular 'State of the Markets' podcasts, with Paul Rodriguez of ThinkTrading.com here.

Price Value Partners manage investment portfolios for private clients. We also manage the VT Price Value Portfolio, an unconstrained global fund investing in Benjamin Graham-style value stocks and specialist managed funds.