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The limited choice from Buffett's buffet

"Abraham Lincoln once posed the question: "If you call a dog's tail a leg, how many legs does it have?" and then answered his own query: "Four, because calling a tail a leg doesn't make it one."

- From Warren Buffett's 2018 letter to shareholders of Berkshire Hathaway.

The Financial Times led their weekend edition last week with a front page splash: 'Buffett backs Britain..' If you dug a little deeper, the truth was somewhat more prosaic. The world's most famous investor wasn't actually putting his money where his mouth was, so much as lending moral support to a financial market that many claim is being 'artificially' discounted by issues relating to Brexit. With all due respect to Mr. B, and noting that regardless of the article he has yet to commit any meaningful new capital to the UK, he is probably understating UK political risk. We would suggest that the FTSE trades where it does – at no huge discount to other stock markets that we can identify – not so much because of overblown Brexit chatter (the FT is fiercely Remain), but rather because both domestic and global investors have no great enthusiasm for a possible future government led by two unashamed Marxists.

Two weeks earlier, the FT carried an interview with George Roberts and Henry Kravis, the co-founders of private equity specialists KKR: 'KKR founders set sights on Japan conglomerates':

> The founders of KKR have declared Japan their "highest priority" in the world outside the US as conglomerates like Hitachi, Toshiba and Panasonic jettison non-core subsidiaries and create potential gold mines for private equity..
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> George Roberts said that he currently felt "more comfortable investing in Japan than I do in China" — remarks that come despite the significant investments and resources KKR has channelled into Hong Kong and the mainland over the past decade.
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> But after many years of disappointment, corporate Japan is now in a phase of fundamental change, said the KKR founders as the company held its annual partners' meeting in Tokyo for the first time. Mr Roberts said the push for improved governance and transparency initiated by the administration of Shinzo Abe now had the momentum to survive beyond his time as prime minister.

> "This [Japan] is our highest priority right now other than the US . . . this is the best value today. If you look at value to price of stock and cost of capital, it's here," said Henry Kravis.
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> Of the six deals that KKR has done in Japan since establishing its office in Tokyo 13 years ago, four have involved carve-outs from Japanese conglomerates that have finally admitted a distinction between core and non-core assets. KKR, he said, was approaching Japan in 2019 with the playbook the firm used in the 1970s and 80s as US conglomerates like GE went through similar realisations. Around a decade ago, said Mr Kravis, he met a chief executive at a Japanese company who proudly told him it had 2,000 subsidiaries.
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> "I asked him how many of those were core to your business and he said '2,000' — that is where we were eight years ago. Today it is totally different."
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> KKR is hardly alone in identifying potentially huge deals in Japan: Bain Capital's $18bn purchase of Toshiba's memory chip unit last year was a landmark of scale, but the steadily increasing flow of carve-outs, say bankers, is behind a spate of recent arrivals by US and European P[rivate] E[quity] firms..

False dawns in Japan have scarred plenty of investors. Could it really be different this time ?

Japan represents our single largest country commitment, both in our fund and in our managed accounts. We clearly believe, like Henry Kravis and George Roberts, that it ***is*** different this time. Jan Pstrokonski is the manager of the Samarang Japan Value Fund, which invests in undervalued small- and mid-cap Japanese companies. Here is what Jan wrote in a recent commentary:

> I would like to emphasise the quality of the companies we are able to buy, thanks to the continued generosity of the short-term trading community involved in smaller Japanese companies. Our investees' R&D into new products, and their perspectives for new services, are not easily captured by current statistics, but these efforts are signs of quality companies that have bright futures.
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> We have been buying more of some companies at ordinary valuations that would surely be very expensive in the West. We have been increasing our exposure in one sewage consulting company that is now developing drone systems which it can provide to utilities for a recurring fee. We are adding to another company that is rapidly growing cashflow from monthly broadband contracts, then using that cashflow to invest in IoT services such as security cameras. We have been adding to one small company that is the largest intermediary of accommodation for salarymen on business trips. Our largest logistics investment has a lock on all the major industrial chemical tanker storage sites in Japan, and is now investing into a new and parallel business with significant tailwinds. Our largest chemical industry investee has a dominant position in raw materials for UV-protective cosmetics, which have high barriers to entry and are growing quickly in Asia. None of these businesses has valuations indicating any kind of future potential.

> While picking out which quarter will be weaker or stronger is a difficult game, it is much easier to predict that undervalued and practically unknown companies that are doing their homework will be worth more in the future.

Warren Buffett – within Berkshire Hathaway – is sitting on over $100 billion of cash. As he has himself frequently conceded, the scale of his business undoubtedly inhibits future returns. As the FT interview observed,

> With $700bn in assets, $112bn of that in cash and cash-like investments, only vast investments can meaningfully improve Berkshire's profits. The publicly traded stocks Buffett can sensibly buy number no more than 100, he says. Buying companies outright is no easier. A billion-dollar company that immediately increases in value by 50 per cent hardly helps at all: "Making $500m sounds great and $1bn sounds like a big investment, but [$500m is] less than a tenth of a per cent" as a contribution to Berkshire's assets, Buffett notes.

Warren Buffett may be constrained by the enormity of his asset base, and he may even be considering investing elsewhere in the Anglosphere, i.e. in the UK. Those of us with more modest levels of investment capital to deploy can invest on a geographically unconstrained basis where we can fish in a far broader investment pool, and take advantage of a much more populous, not to say compelling, investment universe.

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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.