PRICE**VALUE**PARTNERS

Two strategies that actually work

"In investing, what is comfortable is rarely profitable."

- Rob Arnott.

First, here's what *doesn't* work. Trying to decode the big macro thesis doesn't work, at least not for us. Stanley Druckenmiller may be able to, but as football supporters could doubtless tell us, there's only one Stanley Druckenmiller. Expecting either the financial media in general, or higher profile investment gurus in particular, to help us doesn't work either. Note, for example, the Gell-Mann Amnesia effect to which Ben Hunt alludes in his recent commentary:

> Briefly stated, the Gell-Mann Amnesia effect is as follows. You open the newspaper to an article on some subject you know well. In Murray's case, physics. In mine, show business. You read the article and see the journalist has absolutely no understanding of either the facts or the issues. Often, the article is so wrong it actually presents the story backward—reversing cause and effect. I call these the "wet streets cause rain" stories. Paper's full of them.
>
> In any case, you read with exasperation or amusement the multiple errors in a story, and then turn the page to national or international affairs, and read as if the rest of the newspaper was somehow more accurate about Palestine than the baloney you just read. You turn the page, and forget what you know.

(The original quote is by Michael Crichton.)

As to gurus in particular, no mention of the topic could possibly be complete without referencing Jim Cramer, by way of example. On 29 February 2000, Cramer issued the following guidance to his followers at TheStreet.com:

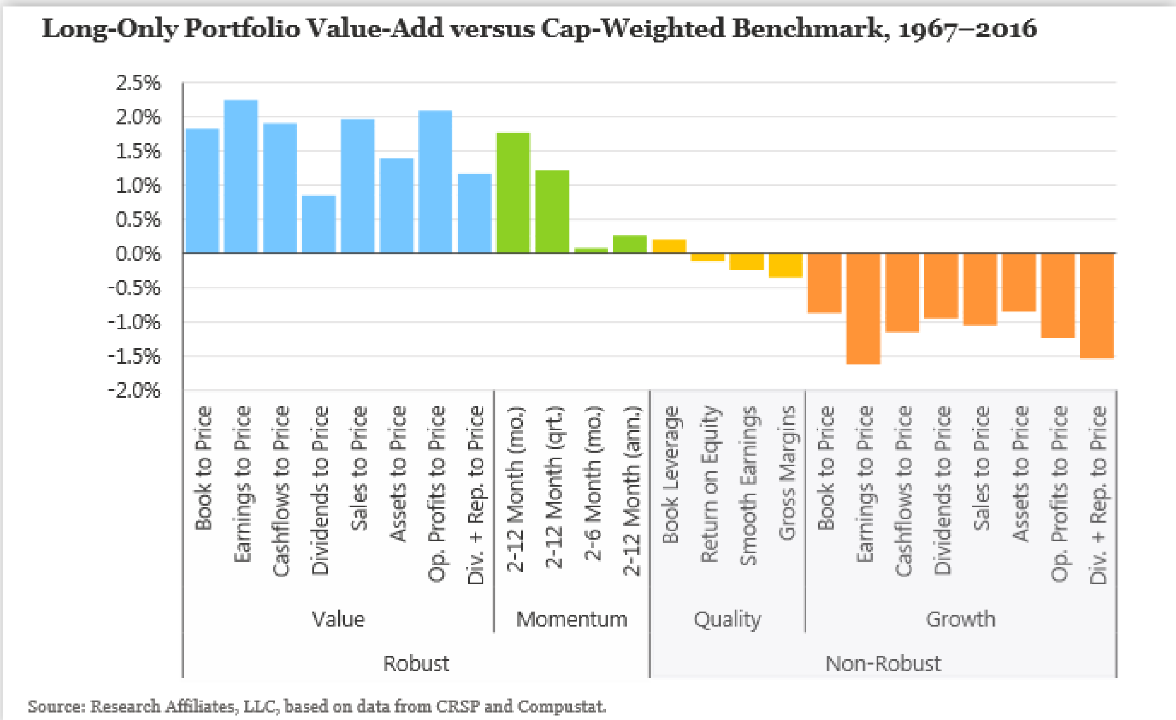
> You have to throw out all of the matrices and formulas and texts that existed before the Web. You have to throw them away because they can't make money for you any more, and that is all that matters. We don't use price-to-earnings multiples anymore at [his hedge fund]. If we talk about price-to-book, we have already gone astray. If we use any of what Graham and Dodd teach us, we wouldn't have a dime under management.

Delivering the keynote speech at the 6th Annual Internet and Electronic Commerce Conference in New York, on the same date, Cramer added, in relation to his 10 favourite internet and technology stocks:

> We are buying some of every one of these this morning as I give this speech. We buy them every day, particularly if they are down, which, no surprise given what they do, is very rare. And we will keep doing so until this period is over -- and it is very far from ending. Heck, people are just learning these stories on Wall Street, and the more they come to learn, the more they love and own! Most of these companies don't even have earnings per share, so we won't have to be constrained by that methodology for quarters to come.

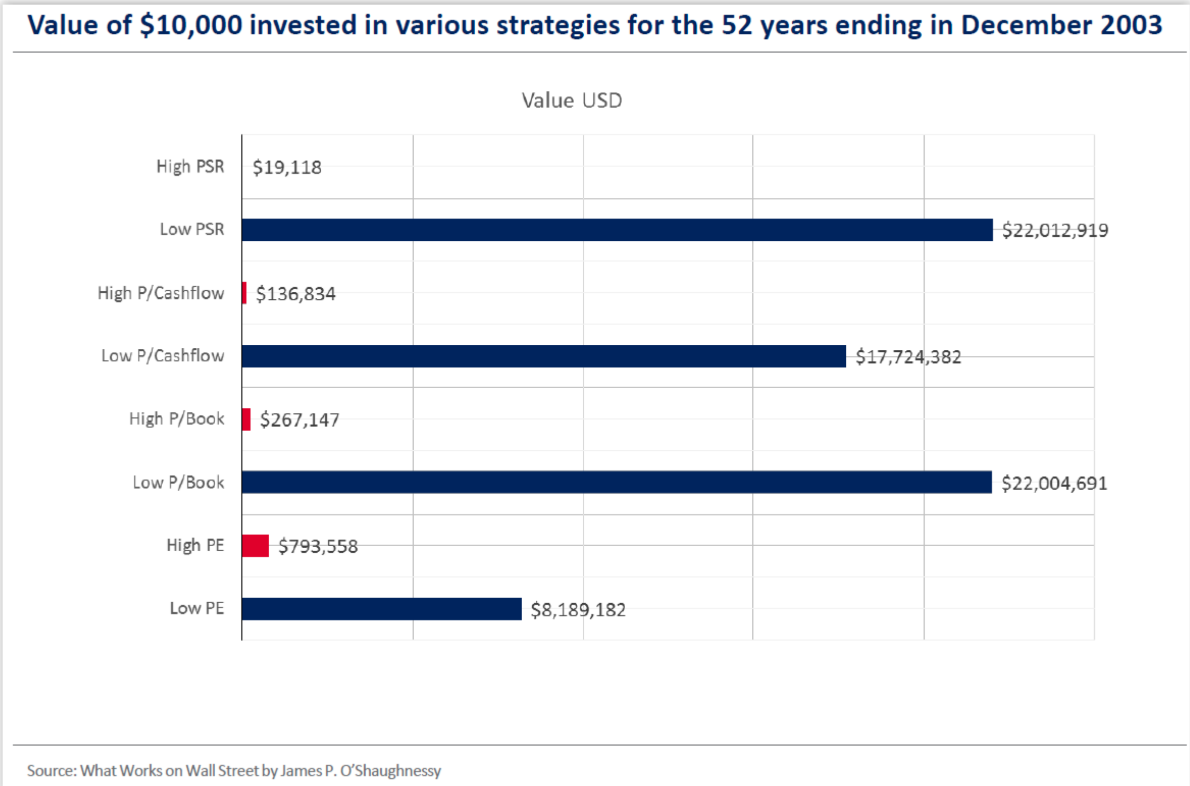
The Nasdaq peaked within a month of this advice and would go on to lose 80 percent of its value over the following two years. Buying internet stocks in 2000 may have felt comfortable, but it wasn't exactly profitable, at least over that subsequent two year period.

So what does work ? If a recent 50-year period is any guide, the two styles known as 'value' and 'momentum'. Research Affiliates crunched the data for the period 1967 to 2016 which are shown below in relation to the S&P 500 index.



'Value' – which we would define in this case simply as buying good stocks cheaply – was the single best performing strategy over the period, typically adding value every year versus the market. 'Momentum' – which we would define here as simply following trending stocks – was the next best performing strategy. Interestingly, both 'quality' and 'growth' ended up ***destroying*** value versus the market return.

The next piece of evidence on the part of the prosecution (or is it defence ?) is the work done by James O'Shaughnessy in his book *What Works on Wall Street* (our edition being the third edition published in 2005). O'Shaughnessy crunched the data over a similarly extensive period of US stock market history, 1951 – 2003, and analysed the returns from owning the 50 highest and lowest scoring stocks by category (price / sales; price / cashflow; price / book and price / earnings), and then rebalancing those 50 stocks each year. Assuming a starting $10,000 invested in each category, the results are shown below:

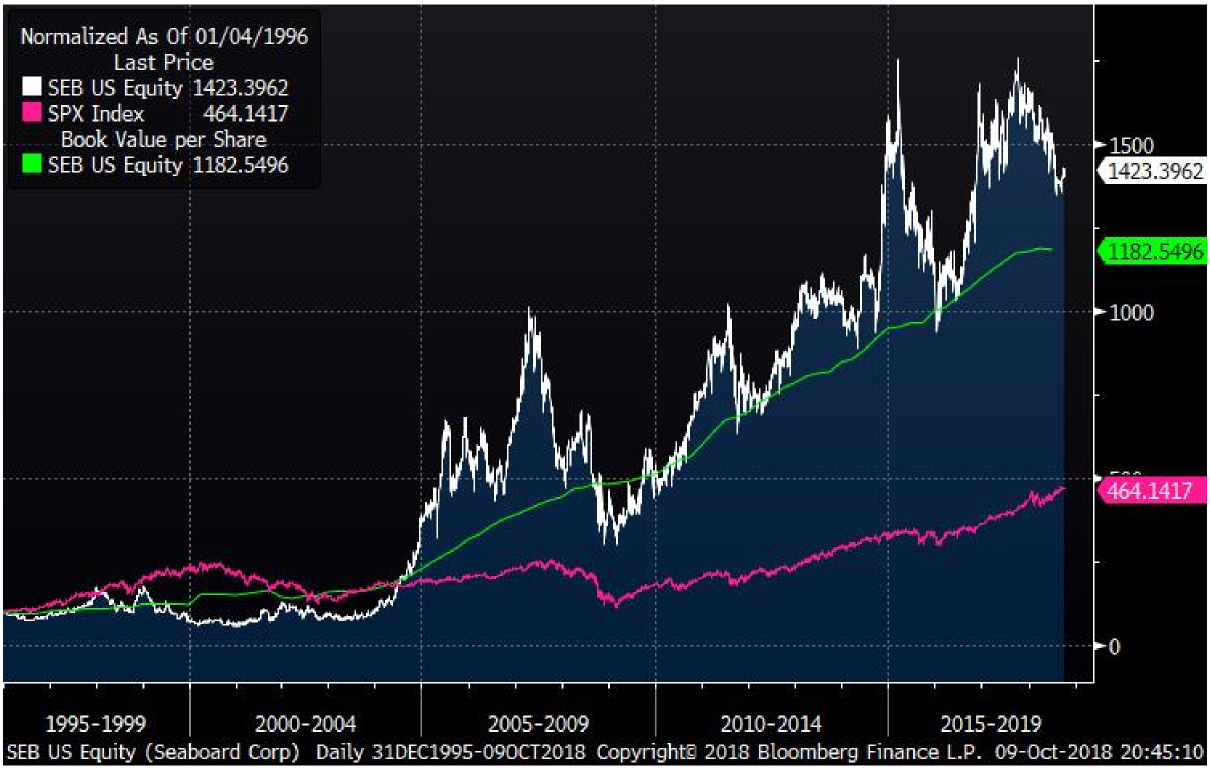


There may be more conclusive proofs of the merits of value investing over growth, at least with regard to the period in question, but we haven't seen them. $10,000 invested in the highest price / book stocks ended up being worth $267,147. Whereas $10,000 invested in the lowest price / book stocks ended up being worth over $22,000,000. There is a legitimate question as to whether the nature of the US economy in particular has changed as a result of new technologies and the capital-light structure of many 'modern' businesses, but there's also a legitimate question as to whether either mean reversion or human nature are somehow profoundly different in 2018 as opposed to in 1948.

Our third chart highlights the relevance of discipline in the stock buying process. It shows the 1995 – 2018 history of Seaboard Corporation, a stock that in the interests of full disclosure we own within our own fund, the VT Price Value Portfolio. Seaboard is a diversified agribusiness which operates internationally and which is part-owned and managed by the Boston-based Bresky family.

The chart shows three distinct lines. The pink line denotes the S&P 500 index, which returned 464% over the period in question. The white line denotes the share price of Seaboard, which has delivered 1423% over the same period. Perhaps most interesting to us, however, is the green line, which shows the book value per share of Seaboard stock.

Seaboard Corp share price (in white), 1995 - 2018



Source: Bloomberg LLP

We can fairly infer a number of conclusions from the price data above, including:

1) Selecting the shares of a high quality business can, with hindsight, deliver market-beating returns;

2) Share price does, at least in this case, tend broadly to track growth in book value per share, albeit in a more volatile way (companies can clearly control their underlying operations more easily than they can control their share price);

3) While simply buying the shares at any arbitrary point in time has delivered good returns, buying the shares close to, at or below book value has delivered exceptional returns – and with a higher "margin of safety".

There may be more compelling evidence of the merits of buying the shares of good businesses cheaply, but we haven't seen it. An extra facet of Seaboard that makes it unusually interesting to us is that it isn't widely known. To the best of our knowledge, it's not followed by any Wall Street analysts.

Having dedicated three charts to 'value', it seems only fair to share a table on the topic of 'momentum'. By 'momentum' here we mean very specifically systematic trend-following, on which topic you can read much more here. A friend of ours, Chris Clarke, crunched the numbers on what could fairly be described as amongst the best investment funds in history.

Chris' criteria might sound somewhat arbitrary, but they were stringent. To make the shortlist, a fund had to have an audited track record going back at least 20 years. Most funds fail to make this cut, primarily because the manager in question either retires or his fund gets closed down or merged into another. Secondly, a fund had to have generated average annualised returns of at least 20 percent. If that sounds like an unchallenging hurdle, only 11 funds made the final cut. (Berkshire Hathaway, it should be noted, a) isn't technically a fund and b) only just made it onto the list, at Number 11.)

Of those 11 funds, fully six of them were simplistic long term trend-followers.

The best investment funds in history ?

11 Funds - 6 Simplistic Long Term Trend Followers

Notes	Fund	Class/ Share / Program	Manager	Inception	CAGR%	Max D/D	Assets $Mill's	MAR Ratio
	Eckhardt	Standard Prog	William Eckhardt	Jan-87	23.81	29.08	400	0.82
	EMC Capital Management	The Classic Prog	Liz Cheval	Jan-85	23.2	45.16	180	0.51
	Hawksbill Capital Management	Global Diversified	Jerry Parker	Nov-88	22.24	61.78	55	0.36
	Blenheim GL Markets L.P		William Kooyker	Dec-86	22.06%	41.20%	2535	0.54
	Tudor Investment Corp	BVI Global Fund	Paul Tudor Jones	Oct-86	21.76	17.07	9206	1.27
	MJ Walsh	The Standard Prog	Mark Walsh	Sep-85	21.33	43.04	75	0.50
	J.W.Henry and Co.	Financials and Metals Prog	John Henry	Oct-84	21.1	43.6	20	0.48
	Moore Capital	Global Inv Fund, LTD A$	Louis Bacon	Dec-89	20.64	18.45	7200	1.12
	Abraham Trading Company	Diversified Prog	Salem Abraham	Jan-88	20.33	31.96	520	0.64
	Gamut Investments		Bruce Kovner	Jun-86	20.31	13.45	533	1.51
End 08	Berkshire Hathaway	per Share Book Value	Warren Buffet	1965	20.30%	9.60%	?	2.11

Source: Lawrence Clarke Investment Management / Chris Clarke

Global politics seems unusually nasty and polarised. Newsflow largely reflects the partisan identity politics of a widely discredited commentariat and is in any case a gigantic distraction. Only one thing really matters, and that is price. Both 'value' and 'momentum' focus on price, albeit from wholly different perspectives (one being underlying valuation, the other being the direction of the price trend; one requires patience, the other fleetness of trading foot). In our recent interview with a private investor, the investor in question shares our view that both these strategies can be usefully combined within an investment portfolio.

At the end of Trading Places, as the protagonists have taken their riches off to their very own sun-kissed paradise island, Eddie Murphy's character asks butler Denholm Elliott what they should have for lunch: lobster, or cracked crab ? Elliott's attractive, erm, protégée responds:

> Can't we have both ?

Well, can't we ?

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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.

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.