We are pleased to share the following resource for investors looking to learn from Guy Spier, one of the most successful value investors of our time. This piece is authored by MOI Global research associate Alex Gilchrist.

Note: Unattributed quotations in the following text are taken from [The Education of a Value Investor](), an acclaimed book by Guy Spier (St. Martin's Press, 2014).

Guy Spier was born in Pietermaritzburg, South Africa in 1966. He graduated with a first class degree in PPE from Brasenose College, Oxford, followed by an MBA from Harvard Business School. Before founding Aquamarine Capital in 1997, he worked at Braxton Associates (later to become Deloitte Consulting) in London and at D.H. Blair in New York.

Aquamarine

Since inception and until the end of 2017, Aquamarine Fund has returned a total of 597.6% to investors after fees versus 312.2% including dividends for the S&P 500. Over the same period, Assets under Management have grown from $15 million to $240 million, as a result of significant capital gains and new limited partners. Investments are made via the Aquamarine Master Fund, while Non-US investors commit capital via the Aquamarine Fund and US-Investors via the Aquamarine Value Fund. Each of these two funds own shares in the Master Fund.

Guy Spier is exclusively responsible for all investment decisions. Guy has invested almost all of his own wealth in the fund and along with his family constitutes the largest shareholder. For this reason, he comments that at Aquamarine "we eat out own cooking." (Annual Report 2017) This alignment of incentives of the general partner and limited partners is furthered by the absence of a management fee. Investors can currently apply to join Aquamarine based on an incentive fee of 15% with a lock-up period of five years or a incentive fee of 25% and a lock up period of two years. For the limited partners to be charged the incentive fee, a cumulative hurdle rate of 6% has to be met between the time they deposit and the time they withdraw their funds. (Annual Report 2017, p.17).

Starting to Learn

Guy started on a 'classically' successful debut in life. He studied at a prestigious English independent school, graduated with a first class degree in Philosophy, Politics and Economics from Brasenose College, Oxford and went on to complete an MBA at Harvard Business School.

Following his studies at Harvard, Guy desired to "blaze my own trail and be more entrepreneurial." Having met personally and having been promised to work directly for the charismatic Chairman, J. Morton Davies, Guy took up employment at D.H. Blair. Though as time elapsed, he found this place to be nothing more than a "snake pit." D.H. Blair was made up of two operating units, an investment bank and a retail broker. The investment bank would help create stories around companies of the "might succeed" type. "I was supposed to dress up the least sketchy of these deals in such a way that the downsides were heavily de-emphasized or ignored while the sizzle – the blue sky upside – was highlighted." From the brokerage on the 14th floor, "a swirling sea of testosterone" where hookers were rumoured to go to "reward the most successful salesman of the day," the brokers would "tout these dubious deals to unsophisticated retail investors."

Guy felt deeply unhappy in this atmosphere. "I'd lost my desire to build this sort of career, but I had no idea what to do and was afraid to leave for fear of seeming like a loser or a quitter […] Looking for an escape," he abandoned sandwiches at his desk and would leave the office at lunchtime. First "to buy a falafel or shawarma from a street vendor." Following on from this, he would "wander into Zuccotti Park," "play a few games of pick-up chess" and often on the way back "duck into a business bookshop." It was on one of these travails that he came across Graham's, The Intelligent Investor, with an introduction by Warren Buffett. Guy read this in a single sitting and was hooked.

From outer to inner scorecard

Howard Marks has frequently commented that investors have to think better and differently in order to add value. At the time however, Guy considers himself to have been an 'outer score card person.' "More than anything, what motivated me was how other people viewed me rather than how I viewed myself." The trouble with being an outer scorecard person is that it makes it hard to stick to your guns when your opinion runs contrary to the consensus. In order not to be mocked and to receive praise it is easy to capitulate, to take on the market's view. However, "Value investors have to be able to go their own way. The entire pursuit of value investing requires you to see where the crowd is wrong so you can profit from their misperceptions. This requires a shift toward measuring yourself by an 'inner scorecard.'"

Guy felt forced to walk a different path. He sensed that his time at D.H. Blair had reduced him to "damaged goods" in the eyes of the elite investment banks. The upside to this was that it forced Guy into introspection and to think of a different career path. Through the recommendation of his Swiss friend, Diana Weiss, he followed a course by Tony Robbins. Though he would normally have been dismissive of a motivation course, the strength of the recommendation encouraged him to pursue it. "Robbins convinced me that I had to break the patterns of negative thought, push through my fears, and get moving." Guy points out that it is worth noting that the only diploma Warren Buffett has in his office is a certificate from a "Dale Carnegie Course in Effective Speaking, leadership Training, and the Art of Winning Friends and Influencing People."

Learning from a long-distance mentor

Lev Vygotsky (1896-1934) developed a prominent theory in education. New skills are gained within the "zone of proximal development," with the help of a "more knowledgeable other." Materials should be challenging without being too hard. At the same time, there is an important role of knowledge being taken on through the replication of a trusted role model. Once this more knowledgeable other becomes imprinted in the learner's mind, they can reproduce the role of the more knowledgeable other, through 'private talking.'

Robbins recommends a similar process, which he calls “modelling our heroes.” Having read and re-read Berkshire’s Annual Letters, the question: “What would Warren Buffett do if he were in my shoes?” became meaningful. “I didn’t ask this question idly while sitting in a coffee shop sipping a cappuccino. No. I sat down at my desk and actively imagined that I was Buffett. I imagined what the first thing would be that he would do if her were in my shoes, sitting at my desk.”

“The minute I started mirroring Buffett, my life changed. It was as if I had tuned into a different frequency. My behaviour shifted, and I was no longer stuck.” “Thankfully, this [not having personal contact with Buffett] didn’t matter. I could get many – if not all- of the benefits of having him as a mentor by studying him relentlessly, and then imagining what he would have done in my shoes.” The process of learning through mimicking is so powerful that Guy believes this to be the explanation for Charlie Munger’s recommendation to “go through life making friends with the eminent dead.”

Becoming a professional value investor

Having found what he wanted to do in life, Guy approached famed value firms such as Tweedy, Brown and Ruane Cunniff. Although they did not have any openings, Carley Cunniff was receptive to Guy and keen to meet him. At what was still an early stage in his development, this kindness was instrumental in guiding him further down the value path.

Although no Sequoia shares were available on the open markets, Guy found a seller through Ebay. While he bought the shares at a 4x multiple of net asset value, their ownership provided much more than just financial gains. Attending Sequoia Shareholder Meetings brought him into contact with an illustrious set of value investors including Lou Simpson.

At the same period, although not yet a Berkshire shareholder, Guy started to attend the Berkshire Annual General Meeting, by way of invitation of a friend. Seeing his son’s passion for investing, his father, Simon Spier, encouraged Guy to break out on his own. In so doing, he entrusted his son initially with about $1 million and a year later with his life’s savings. Two of Simon’s business associates invested alongside. Aquamarine started trading on the 15 September 1997 with approximately $15 million AUM.

As Guy discarded his old outer scorecard judges, he made way to be influenced and learn from other investors with superior insights. “It’s difficult, if not impossible, to become successful on your own. The greatest opera stars have singing teachers; Roger Federer has a coach; and Buffett meets regularly with like-minded people.”

Guy provides an example of the benefits of standing on the shoulders of giants: “A few years earlier, I had paid close attention when Buffett explained at a Berkshire meeting why he no longer owned Freddie Mac: he and Munger had spotted the early warning signals when lending standards and accounting disclosures began to deteriorate beyond their comfort level. I had also read some brilliant investment letters by hedge fund manager Michael Burry in which he cogently explained why there would be a disaster in housing and related financial markets. This is an important benefit of remaining in the right intellectual environment: clearheaded investors like Einhorn, Buffett, Munger, and Burry had helped to keep my eyes wide open.”

Beyond just avoiding mistakes, Guy confers with Charlie Munger’s advice to young investors (Daily Journal Meeting, 2017), to improve their game by studying other players. It follows that if an investor can replicate important elements of the process of someone who beats the market, they ought to stand a good chance themselves. ”I read other managers’ letters. I look at the positions they own. The lists of portfolio securities that other managers own are very useful because it means the investment has already passed a very important filter. I think that whenever something in Seth Klarman’s portfolio is trading below the price that he paid for it, it is worthy of looking at, and at the same time, it performs another function. To get better at investing you want to study the moves of the masters.” (MOI, 2009)

Guy writes that he was able to “surround myself with a ‘mastermind’ group of investors who would become life-long friends and trusted sounding boards […] Our forum, which we dubbed “the Posse,” met once a week to discuss stocks. It included investors like David Eigen, Ken Shubin, Stein, Stefan Rosen, Glenn Tongue, and occasionally Bill Ackman. Through it, I also met Joel Greenblatt and became a member of the Value Investors Club. The Posse met one morning a week, and at least one of us had to come prepared with a stock idea, which the rest of us would debate and dissect. This expanded my knowledge beyond anything I could have learned from a textbook or MBA course.”

The continuing value of fostering relationships with inspiring people, has continued to be a benefit to Guy throughout the years. He credits conversations with his close friend Mohnish Pabrai, for a series of good investments he made during 2009: “All of these investment ideas emerged from conversations that I had with Mohnish, and I benefited immeasurably from his analytical brilliance.”

“Tell me where I’m going to die, so I won’t go there.” –Charlie Munger

Perhaps through modesty, Buffett has more frequently to claim his heightened rationality as being instrumental to his success rather than his intellect. Without the psychology to follow through, high quality analysis is unlikely to be correlated with investment gains. Developing awareness of one’s self is all important to the intelligent investor: ”In other words, our brain constructs our reality, and it may not be doing so in an accurate manner.”

“If there’s anything I want you to take away from this is that the rest of us should do really well by just paying attention to our own weaknesses and trying to work at reducing the influence of our weaknesses.” (MOI, 2018)

Making fewer mistakes than the average is likely to result in fewer cases of capital loss and thus be a significant aid to outperformance: ”Indeed, those of you who are acquainted with me know that I have spent more than my fair share of time studying “why smart people do dumb things.” Through hard work and constant attention, I believe that I will commit, over an investing lifetime, less than my fair share of these. Although this is something that remains to be seen, I intend to invest a great deal of effort in proving this both to myself, and to you, for our mutual benefit over the coming years.” (Annual Report, 2003)

Dan Kahneman and Richard Thaler have refashioned economic thinking by explaining the psychological effect of ‘nudges’ that can create a bias to think ‘fast’ rather than ‘slow,’ resulting in irrational decisions. Guy explains to MOI members the implication for investors: ”Whether it is the fight-or-flight or the expectation of pleasure centers, the effect of both is to short-circuit rationally considered thoughts. They undermine the path of the brain that can make weighted, careful judgments about probabilities and about expectations. My perception is that it is the rational neocortex from which flow the very best investment decisions. Unfortunately, the world in which we operate is a minefield of opportunities to get caught up either by the fight-or-flight or by the pleasure center. So to the extent that somebody will talk about an investment being good when one is trembling with greed – I would not subscribe to that because trembling with greed implies that your greed and pleasure mechanisms in the brain are dominating the rational side.” (MOI, 2009)

However developing awareness of one’s own reaction, is the best means to take precautions and avoid this ‘short-circuiting’ of the brain: ”Once we recognize that that’s an issue with us, we can get going on finding the solutions. The solutions are actually not that hard. It’s just the awareness that my brain is different to other people’s brains. My brain does this and, therefore, these are the consequences in conversations, in social situations and obviously in investing and investment research. There’s one interesting way in which the way my brain works in that I’ll forget all sorts of details that are insignificant to my brain like where I put my keys, but I’ll hyper-focus on things that are super interesting to me. Some people’s attention is like a deflated football filled with sand. You throw it down and it just sits there, just there wherever it goes or wherever you want it to go. My attention much of the time is a bit like a bouncing golf ball. That’s about as long as it will stay in one spot.” (MOI, 2018)

For the professional investor though, these nudges to irrationality might not just come from the market but from other limited partners: ”I had an experience with an investor who was admonishing me for holding too high much cash. The investor claimed that they were not paying me to hold cash balances. Well, that created a pressure on me to get fully invested. The person making the investment wanted me to show that cash was being put to work. I was responding to the situation rather than to the logical and rational dictates of having a prudent amount of cash. I was responding to the actual demand of the client. To the extent that I did respond to that pressure, I was acting less like a principal and more like somebody that was putting together a marketing story.” (MOI, 2009)

Environment

Based on the investor’s personality, it is therefore extremely important to create an environment conducive to a sound investment process: ”But I was wrong: as I gradually discover our environment is much stronger than our intellect. Remarkably few investors — either amateur or professional — truly understand this critical point.”

This environment should seek to reduce the nudges to irrationality: ”Of course, the goal in life is to project one’s psychological energies in an appropriate manner, and in an appropriate place. The most appropriate antidote to this that I have found is to consistently seek to place myself within environments and relationships that have a tendency towards self reflective rationality, and to seek to avoid and reduce exposure to relationships and environments that detract from this." (Annual Report, 2006)

Distractions, however, can come from many places: "The main way in which I deal with these distractions is that I do not take calls from sales people. Period. Will I miss some opportunities? Certainly. But over a long period, it will help me avoid an awful lot of investment pain." (Annual Report 2006)

Advising a fellow investor working within a more institutional setting, through an MOI forum, Guy urged: "I would argue that you have probably for very understandable and some very good reasons created an environment that makes it very hard to be contrarian because you have the weight of opinion." (MOI, 2018)

Guy has been supported by the trust his limited partners have demonstrated him. This is most poignant in the example of his father, Simon. Despite Aquamarine suffering total losses of 47% in 2008 and Simon seeing that "nearly half of his life savings had been vaporized," "he didn't withdraw a dime, even though he could have yanked out his money at short notice."

Guy has taken active steps to create an ideal environment: "It's also good to have a library behind you, it's also good to have Charlie Munger staring at you. There are many ways in which we construct our environment to improve our decision-making of which the checklist is one element of it." (MOI, 2018)

However, the most notable of these is moving from New York to Zurich. "We're all wired a little differently, but New York – with its restless energy, competitive spirit, and pockets of extreme wealth – accentuated some aspects of my own irrational nature that aren't conducive to good investing." In comparison to New York, Zurich shares some commonalities with Omaha. "Occasionally people ask me, "But isn't it boring there? My answer: "Boring is good. As an investor, that's exactly what I want."

"Following my move to Zurich, I focused tremendous energy on this task of creating the ideal environment in which to invest – one in which I'd be able to invest more rationally. The goal isn't to be smarter. It's to construct an environment in which my brain isn't subjected to quite such an extreme barrage of distractions and disturbing forces that can exacerbate my irrationality."

Discovering that he has Attention Deficit Disorder in 2004, helped Guy further improve his work process: "To deal with my ADD, I needed to develop an array of simple work-arounds – for example, installing big clocks in my office to help me keep track of time, having a clear desk so that I wouldn't get distracted, and putting objects in the same places so that I wouldn't lose them quite so often. In hiring a personal assistant, I specified that a key part of the job was to watch over me so that I wouldn't mess up simple tasks like catching flights, remembering appointments, or closing the front door when I left our office building. All of this focus on building work-arounds and circuit-breakers into my everyday life proved to be incredibly helpful – not just in dealing with my ADD but also in becoming a better investor."

Circle of competence

Though a trained economist, Guy stays true to the value investing tradition of avoiding macro-economic predictions: ”Although I find that analyzing businesses is hard, to seek to heroically predict the market’s gyrations is infinitely harder – indeed to my mind, impossible. At the right times, smart looking people with the right qualifications will show up with smart sounding predictions that will make you want to give them your money. But that does not make them right, and it does not make them any better investors.” (Annual Report, 2004)

He prefers to stay away from the patchy areas between speculation and investing: ”I want to earn you a decent investment return by purchasing part ownership in businesses. In the past, banks have tried to entice me to engage in complex transactions and I had no trouble resisting. Businesses are the wealth creation engines of society, not derivatives.” (Annual Report, 2011)

Guy draws a distinction between an investor’s perceived and actual circles of competence: ”The vast majority of people that I observe start off in their investment career thinking that their circle of competence is bigger than it really is. What we all experience over time is that the circle of competence becomes smaller. We self-define ourselves, we become clearer about what it is and it becomes narrower and narrower, so in a certain way my invest circle of competence is smaller and narrower than it was or I might perceive this. The actual circle of competence has probably grown, but the deceived circle of competence is…sorry. I perceive myself to know a lot about a little. To just know a lot about all sorts of things 20 years ago or even ten years ago and now I realize how little I know and, therefore, I’m a lot more careful about where I’m willing to invest and I’m not willing to invest.” (MOI, 2018)

Having the responsibility of investing his father’s savings, the risk of capital loss resonated extremely with Guy. The weight of this responsibility made him very careful of where he stepped: Even before coming into contact with Charlie Munger’s writings, I was somehow blessed with the knowledge that the most damaging thing about the ignoramus is when he does not know that he is ignorant. The key is that the minute we become aware of our own ignorance, of our own limitations, we cease to be ignorant. Lacking precise knowledge about my circle of competence, I have consciously tried to define my circle more narrowly than I truly believe it to be – in order to forestall any major mistakes.” (Annual Report, 2003)

Guy explains in practical terms what it entails to stay within one’s circle of competence: ”By following the dictum of “invest in what you know,” I have tried to limit Aquamarine’s investment world to things we can understand. This means focusing on companies that produce financial reports in English and are domiciled in countries with internationally recognized accounting systems. From there, we eliminate multiple industries that are overly complex or in which “creative destruction” tends to move faster than we can keep up with.

What is left is a subset of industries and companies small enough for us to understand (Consumer Brands, Education, Credit Rating Businesses, etc.), yet large enough for there to always be more opportunities to explore. From there, we spend significant time and energy getting to know as much as possible about every investment we make and allocating our time and attention appropriately, according to the size of the position. Oftentimes, the key to avoiding investment land mines is not how much you know, but rather eliminating the things that you don't know that can surprise you." (Annual Report, 2007)

Upfront communication from management renders it easier to ascertain whether a company falls within one's circle of competence: "Obviously, what we're looking for are companies where all of that is explained in a very clear way and wherever you push or wherever you go to a footnote, it becomes clear very quickly and you get the sense these are people trying to communicate what's going on to you." (MOI, 2018)

"If I have to meet the CEO to understand why I should buy the stock, that's a serious warning sign. It should be clear enough from all of my other research. […] The trouble is, senior managers — particularly CEOs — tend to be highly skilled salespeople."

By prioritizing the reduction of any capital loss risk, Guy prefers to stay clear of situations he finds hairy: "For the most part, I have found that I want to pay up for a great business at a decent price, rather than invest in a situation that is dirt cheap, but which, in one way or another is "hairy." Over the past 5 years, I have passed up a number of these sorts of opportunities which would have increased our returns significantly. My willingness to pass on these and to pay up for better businesses has earned us decent returns, not outstanding returns." (Annual Report, 2003)

Committing to a long holding period will direct focus towards an analysis of the fundamentals and help to steer away any temptation to speculate: "The Rule: before buying stock, make sure you like it enough to hold on for at least two years, even if the price halves right after you buy it."

Good quality ideas should allow for a sufficient margin of safety so that extraneous assumptions can be avoided: "I spent time getting comfortable." The investment should leap out to you. If you are trying to get comfortable with something or it takes too long for you to get comfortable with it, then it is probably not a good investment. You shouldn't have to get comfortable. That implies to me that I would be stretching. (MOI, 2009)

Guy posits positive re-enforcement through reflective learning: "Probably anybody who has had one or two successful investments in their portfolio, who has experienced this aha moment when they go, "Oh my God, I totally get why Bank of America's unbelievably cheap," or "I totally get why I need to own at the right price every single credit rating in this business around the planet if I possibly can." There's such a reward, a mental reward when we get to those aha moments. Maybe that's what we're looking for and it's not just that I need to spend a little more time with this to get comfortable. It's like, "Oh my God, I totally can see why I get this and the market doesn't and why there's huge margin of safety in this. I can define this into my circle of confidence." Once they've had one or two of those moments, they know what they're looking for." (MOI, 2018)

Liking a company can lead to bias, where the investor inadvertently walks out of their circle of competence: "I would love to own those companies, but I just don't think they meet the very narrow, carefully set criteria that I set for myself that I know will work over time."

(MOI, 2018)

A timely example of this: ”In Amazon’s case, I would have to make some dramatic accounting adjustments to remove the company’s growth capex and replace its ultra- low gross margins with the more reasonable margins it would make if it ever stopped underpricing its products. In other words, I would have to torture the income and cash flow statements to develop a picture of what Amazon would look like if Bezos decided to run the business in steady state, milking it as a cash cow instead of endlessly growing it at a loss.” (Annual Report, 2016)

Risk

“The mathematics of losing money is absolutely devastating – because the more you lose, the harder it is to get back to where you were.” (Annual Report, 2006)

Guy upholds the importance of a margin for safety: ”If I invest when it’s undervalued, I can be wrong about a whole host of issues and still make a good return.” He distinguishes between price and value: ”Just because stock prices fluctuate does not mean that something dire is going to happen to the underlying business.” (Annual Report, 2004)

A low price can compensate for a known risk: ”The critical point is that we need to be compensated for such added risks by requiring an extra-low valuation. I did that with Crisil and Alaska Milk, but not in Brazil. That was a mistake.” (Annual Report, 2017)

Identifying which elements of an investment thesis are unknowable, allows the investor to determine whether an investment falls within their circle of competence. Hidden unidentified elements might lead to the investor falsely believing an investment falls within their circle of competence. Unfortunately, it would be impossible to be aware of this. ”As Buffett has said, diversification is an insurance policy against ignorance. I’m not worried about what I know that I don’t know, since I can guard against that. I’m worried about what I don’t know that I don’t know — and diversification is a protection against that.” (Annual Report, 2014)

Just as Howard Marks, Guy seems to have been significantly impacted by the thinking of Nassim Taleb. Taleb likens the elements that you don’t know that you don’t know to black swans: ”In his book *The Black Swan: The Impact of the Highly Improbable*, Nassim Taleb describes how traditional risk metrics consistently underestimate the impact of significant, seemingly improbable unforeseen events. In an example out of the book, consider the turkey that for one thousand days is fed three solid meals a day and is generally well taken care of. In an investing analogy, the volatility of that turkey’s experience of life is pretty low, and life has a pretty good “alpha,” in that things have been going along well. Then, one fine autumn day, around one thousand days after its entry into this world, the turkey is slaughtered for Thanksgiving. Nothing in that turkey’s life could have prepared it for its ignominious life-result. No backward-looking measure of risk (Standard Deviation, Beta, Sharpe ratios, etc.) during that turkey’s life would have predicted the result.”

“For me, avoiding negative black swans comes down to investing in businesses that are likely to survive any social, economic, political, or natural disaster I can imagine. This means investing in companies that: are run by honest management, have a strong balance sheet and/or significant financial flexibility, enjoy enduring assets that are exceptionally hard to impair and nearly impossible to replicate, are geographically diverse, and have a "moat" that is growing wider over time."

"Here are some things that I was not paying enough attention to in the run-up to the crisis: concentration of risks; hidden leverage; always carry plenty of cash – at all levels of the operation; and awareness of how my environment is structured. It also means, as I indicated previously, staying within my circle of competence and running a portfolio with minimal or no leverage." (Annual Report, 2007)

Diversification

A 5-10% sizing offers a good balance between upside and downside: "What I do is I try to remain not fully invested, but the majority of the portfolio is exposed to companies that I like and I'm not trying to manage the cash in the portfolio, so there's been some of cash built up through a couple of sales and some new money coming into the fund. When I make my next investment, I'll be using a proportion of that cash to make the investment. How much of that cash will I use? The happy number for me is a 5% position, and what's interesting about a 5% is that if 5% is halved, you've only lost 2.5% of your portfolio, which is very likely to be survivable. A 50% loss, rotational loss on the investment is not the end of the world. At the same time, a 100% gain of 5-10% of your portfolio is meaningful in terms of contribution to performance." (MOI, 2018)

"If I had real guts or courage or less desire for a safe performance, I would be selling down some of the small positions and buying into some of the bigger positions, but I'm trying to account for the fact that I don't know enough to be as concentrated as three stocks, for example. What I'm trying to do now is if I buy a new position, I don't want to make it less than 5% and I probably need to have an enormous amount of conviction to take it over 10% as an initial purchase price. It seems to me that that 5-10% range is large enough that an idea has a significant impact if it goes up, but if for some reason I get it wrong, the idea is not so big that it'll have a devastating impact on the portfolio." (MOI, 2014)

Guy acknowledges that higher returns demand higher risk and that diversification reduces both. Given the high level of diversification of the Aquamarine portfolio, this makes Guy's investment returns all the more outstanding.

"Thirdly, from time to time, I have been offered "lay-ups" – where I see a great business, with great management at an outrageously cheap price. In these cases, I have been mistaken in being unwilling to act in a concentrated fashion. Because truly excellent investment ideas are so few and far between, it is extremely important to bet big when one finally comes along. My natural conservatism has limited my willingness to do this; as a result, I have kept "second best" ideas in the portfolio because they have added diversity. That diversity provided insurance against ignorance – but also limited our returns.

Of course there is a silver lining to my conservatism. All along, I have never even taken the slightest chance of losing your capital. This is not surprising. Most of you are known to me personally, and it would be very painful to me to lose your money." (Annual Report, 2003)

Investment style

Guy's investment style focuses on identifying the sources and sustainability of cash generation in the business that creates shareholder value: "We look for companies that can generate a great deal of cash relative to the price of the investment. Companies that generate more cash than they need can generally weather most economic/market cycles and offer many ways to increase the value of the stock. In addition to being attractive acquisition candidates, companies with strong cash generation enable management to make accretive acquisitions, increase dividends, repurchase shares, and/or take other actions to increase shareholder value." (Annual Report, 2007)

At the same time, he seeks to buy into this value, at points in time when it is hidden and the market behaves inefficiently: "Companies that are feared, disliked, misunderstood and sometimes even mis-managed, can often generate very attractive returns. In particular, companies that are reporting (temporarily) below-normal returns and trading at very low multiples can, as a result, offer both margin improvement and multiple expansion, if and when the business improves." (Annual Report, 2007)

Guy sums up the cornerstones of Aquamarine's investment strategy (Annual Report, 2007):

- The Miracle of Compound Interest
- Don't Lose Money
- Enjoy the Journey
- Create Proper Incentives
- Avoid Leverage
- Stay within Your Circle of Competence
- Invest in Better Businesses
- Pay Attention to Price
- Understand Behavioural Finance
- Be Prepared for "Black Swans"
- Watch the Basket

Guy is able to benefit by adopting this hybrid approach elsewhere in life: "In retrospect, I've come to see that this is a smart strategy for life: whenever I have the chance of doing something weird and uncertain but potentially high upside, I try to do it."

An essential component to understanding the value of the firm to the investor is the strength of the firm's proposal to its customers: "Similarly, I need something to make me step back and say, "Who is the customer? How are they funding these purchases? Is this an easy purchase for them to make or do I need to do more analysis there? Hopefully that's helpful." (MOI, 2018)

Customers seek value from their purchases. While fashion might create periods where customers are less sensitive to price, this implies that most businesses will in the long-run have to be price competitive. Guy concurs with Bruce Greenwald (2001), that being the low-cost producer is perhaps the greatest durable advantage a business can have: ”Time and again, it has been an enduring lesson to me that business flows to the people who charge the least and offer the most value for money -especially when it comes to undifferentiated products. There are a number of unusual businesses that have had many years of profitable growth by adhering to this strategy -including Walmart, Costco, IKEA, Vanguard and many businesses from within the Berkshire fold.” (Annual Report, 2010)

Guy observes, the emphasis that Buffett too, gives to being the low-cost producer: ”I was fascinated to read in Buffett’s most recent letter that even Mid-American’s electric power generation business in Iowa, has followed this strategy so successfully that in some cases, houses located in the Mid- American service area may well sell at a premium as a direct result of lower utility bills.” (Annual Report, 2010)

However an investment thesis has to be founded on multiple strengths: ”My answer is “all of the above.” The nature of a good investment idea is that it puts together new facts in old ways or old facts in new ways. You need to have the mental flexibility and creative ability to see something new and see why it fits together in a certain way. I think that the answer in my case is to look at everything, to do everything in a certain way, and to reserve a lot of time for thinking.” (MOI, 2009)

If the work has been done to understand a business model, then it makes sense to look for a another company with the same business model somewhere else in the world. After having realised a significant gain in investing in Moody’s, Aquamarine invested in a series of other rating agencies including Duff & Phelps and Crisil, India. (Annual Report, 2009) ”Whenever I find an interesting business anywhere in the world, I look globally to see whether I can invest in the same economics elsewhere.” (Annual Report, 2011)

Process

The goal in valuing a business should be to pay as much as a knowledgeable owner would: ”I don’t think there should be any difference between the valuation that one would face in the private business or the public equity.” (MOI, 2018)

However, having the skills to invest does not equate to having the skills to actively manage a business: ”What I’ve learned and seen from the people around me who’ve gotten control of whole businesses is that management is a whole different set of skills to investing. Very, very difficult skills and in many ways, much harder than investing. Well, not in many ways, it is much harder than investing. No question about it and probably there are less financial rewards. You really have to work hard within a business in business to make it run well. That’s why our hats should go off to people like this group that run AmBev and who took over Restaurants International. They do incredibly hard, heavy lifting with making businesses have good, high profitable returns. I’m not sure that I have the skills to do that and I’m not being falsely modest. Different people have different skills.” (MOI, 2018)

This still does not mean that valuation is easy or simple: ”While valuation is always subjective, we start with the current stock price and measure what that value implies for the growth and longevity of the business. By doing so, it is much easier for us to form an opinion about whether the market is being overly optimistic or pessimistic about the prospects for the business.” (Annual Report, 2007)

In order to be able to go through a sufficient quantity of materials, it is important to prioritise the research process: ”Something like annual reports, certain kinds of annual reports is where you ought to skim through it or just test read a few of the footnotes and see what they say.” (MOI, 2018)

The format of a publication is another element that helps render the research process more efficient: ”I also read a number of industry publications. The publications vary at any time depending on the particular industries that I am interested in and what subscriptions I have decided to subscribe to. One subscription that I have right now is to The Nilson Report on the credit card industry. Based on my interest in following the U.S. banking sector I recently subscribed to The American Banker. I also recently subscribed to The Oil and Gas Journal. These are all interesting journals that don’t necessarily throw up investment ideas per se, but they throw up background information. While a lot of this information is available on the web, it is very nice to look at it in the form of a publication.” (MOI, 2009)

The audited accounts offer a very important although not comprehensive set of data: ”Most companies are these complex systems that are generating data and we need to remember the data they’re generating is just one small subset, some fraction of the data they’re generating of what their activities are. One very important piece of data is the audited accounts. Those audited accounts leave clues as to what kind of decisions and the ways in which those companies operate.” (MOI, 2018)

Reading between the lines can allow the investor to glean additional insights: ”You’re not going to come to a clear conclusion on what the culture is, but you’re going to see signals of where the culture’s going or what kinds of people are making decisions by seeing how they put their accounts together and seeing what kind of shortcuts they do or do not take or what kinds of policies they use, whether their footnote are understandable or not.” (MOI, 2018)

“When I review financial statements, one of the questions that I ask myself is whether or not the management is being aggressive in its presentation. Is it seeking to make the reality look slightly better than it really is, or is it quite happy to have the presentation under-state reality? When bad news happens, does management dress it up, and seek to hide it? Or do they come right out and state it – as soon as possible? The more promotional the management, the more likely they are to have investors who are permissive and gullible. The more honest the management, the more likely they are to have investors who think sensibly like owners.” (Annual Report, 2002)

Incentives

John Mihaljevic (2013), illustrated the search for good management as looking for the jockeys you want to ride with by first avoiding those you don’t want to. Understanding management’s goals and how they measure their success is the key to determining the alignment with the investor: ”We want to be around people that are not just playing the game, but they love to play the game. They love to play the game for the sake of playing the game because if they play it well, within a short period of time they're going to have more money than they know what to do with. If they do it out of a desire to keep the wealth away from the poor, then they'll lose the motivation to take care of shareholder firms in the best possible way. I think it's a really interesting checklist item. It kind of forces you to make the distinction between the personalities of people like Jeff Bezos and Bill Gates when he ran Microsoft and Elon Musk would maybe fall into the Jeff Bezos category." (MOI, 2014)

Being on one's front foot in terms of attentiveness to management incentives that run contrary to long term value for the business. Particularly in smaller firms, the majority share owner might not perceive the business as having any purpose beyond providing for them: "When you go down below a billion dollar or maybe a half a billion dollar market cap, what's really important is to realize that for many of the top management and directors of those kinds of businesses, they're role as a director or senior management may combine with their retirement plan and the idea that the management is separate from the business is actually a false distinction within those companies and so you're absolutely right in being concerned about being a minority in those companies. Therefore, some combination of the valuation and the ethics and the willingness of the majority shareholder to treat the minority fairly has to be very, very, very, very strong." (MOI, 2018)

On the other hand, the power of a good management is so great, that an approach centered around seeking "jockey stocks" is a viable investing strategy. (Mihaljevic, 2013) Guy tells the story of John McGrath and Arol Buntzman, who had founded Educational Video Conferencing Incorporated (EVCI). After EVCI went public, its fortunes changed. The two founders spotted another more promising business, Interboro College, New York.

"As I look back, an important part of the story that emerged for me was having seen that EVCI with its original business was not going to succeed, John and Arol could quite easily have wound up the business, and acquired Interboro through a different entity with a fresh start. But this was not how they wanted to treat their investors. In the age of Enron and Worldcom, Arol and John were working very hard, in very trying circumstances to make their investors whole." (Annual Report, 2004)

Case study: Alaska Milk

Summary: In 2007 invested $1.9 million into Alaska Milk, by 2011 worth $9.2 million, representing a 4x+ or a 40%+ compound annual return. Upside: 80% market share in the Philippines. Purchased at a reasonable P/E of 7x. Milk consumption a normal good with Philippine GDP growing at 6% per annum with a long runway. Risk factor 1: Price of condensed milk powder not produced locally. Catalyst: Price of condensed milk had increased and could not be passed on to Philippines due to low incomes and high elasticity, reducing margins. Milk powder prices would have to fall in the absence of a limit on the number of milk producing cows. Risk factor 2: Philippines number 129 on Transparency International's Corruption Perceptions Index. Offset to 2: Scuttlebutt research on the company. Management responded transparently regarding Aquamarine's concerns. Fred Uytengsu, President and CEO of Alaska Milk, had also been Chairman of the Young President's Organisation in addition to attending Berkshire Annual General Meetings.

"In 2007, I invested a total of $1.9 million into Alaska Milk. In early March of this year, the company announced that it would be sold to Netherlands-based Friesland Campina, the 5th largest global milk producer. Over that time, our position had grown to $9.2 million not including dividends. Overall, we had an annualized return of 40%, and the investment was a 4 bagger. (If only they all turned out this well.)" (Annual Report 2011)

"[A]t 7x current earnings, the valuation made sense, as did just about everything else. Alaska Milk is the Carnation Condensed milk of the Philippines, with an 80% market share."

"In a country at the income level of the Philippines, the vast majority of the population cannot afford a refrigerator, so evaporated and condensed milk, which does not require refrigeration, is a cost effective way to give a family affordable nutrition. Even then, the statistics show that only a minority of the population could afford Alaska Milk's products. While the Philippines had not grown at China's 10% per year, 6% per year was a decent rate of growth which, over the ensuing decades, would enable a multiple of the existing consumer base to afford Alaska Milk's products. With English spoken by a decent proportion of the population and a Spanish and American colonial history, and in spite of the world's focus on China as being the only opportunity in the Far East, I was (and still am) very positive about the prospects for the Philippines. Indeed, since making the investment, the country has become grouped into a new frontier: The VIP countries, Vietnam, Indonesia and the Philippines."

"I did have two concerns though: one was the price of condensed milk powder. It is a key commodity input for Alaska Milk however, because of the climate in the Philippines, it is not produced locally. Condensed milk prices had been driven up on demand from China, a drought in Australia and a reduction of subsidies in the EU. With low income levels in the Philippines, it was not easy to pass these cost increases on to the consumer without their affecting sales volume, so profit growth had been depressed. The key and simple insight here was that there is no long-term constraint on the global number of milk producing cows, so I was certain that condensed milk prices would eventually come down, and the current, depressed income would be a temporary phenomenon."

"The second concern was more troublesome: although I had no personal experience, I grew up with stories of the 2,700 pairs of shoes in the wardrobe of Imelda Marcos; at last check, the Philippines ranks number 129 in Transparency International's Corruption Perceptions Index, below Mexico, Syria, Iran and Argentina, to name a few."

"Against this was some very striking first-hand evidence: the starting point, and most important, was a set of annual reports easily available for download on the company's website which is a testament to clear and straight-forward reporting; the desire to report honestly and transparently on the business results just leapt off the pages."

"Since I could not quite believe what my eyes were telling me, I went on a search for disconfirming evidence. I seized upon a footnote to the annual report that mentioned a condominium that was being rented out by the company. This was possibly evidence of self-dealing, meaning that the management had engaged in transactions between the company and themselves that were to their benefit, and to the detriment of the outside, minority shareholders. When Dan and I posed this question to the company their answer came back overnight: a clearly written, and detailed response from the CFO explaining that this was a company-owned office condominium that housed the head office, with a clear history of ownership and relevant rental payments."

"In short, I think that it was a no-brainer to see that this company had the highest fiduciary standards, but if this was not enough, there were even more clues. When I presented Alaska Milk as an idea at an investment conference in Mexico City, Mohnish Pabrai, then in the audience, told me that Fred Uytengsu, the President and CEO of the company, had been the Chairman of YPO International, and that it was extremely unlikely that someone would get to be Chairman of the organization if he did not check out in multiple ways. Moreover, based on our conversations, Fred made the effort to attend Berkshire Hathaway meetings and presented his company to the Rentrop German Value Investing Group. This was all evidence that Fred subscribes to the right set of fiduciary values, just as his annual reports show that he lives by them. While they are still up, I urge you to take a look at the reports. You can see them here: http://bit.ly/alaskamilk."

"This experience is also a testament to the fact that the fiduciary gene can be found all over the planet. If you get the chance to invest with Fred, or do anything else in business with him, you have my blessing and encouragement—he has proven to be a phenomenal CEO and partner, and I am sure that his future partners will also do well." (Annual Report 2011)

Case study: Fiat

Summary: In 2012 invested circa $10 million. By 2018, worth $70 million, a 7x return. Market Cap of company $6 billion. Upside: Sum of the parts value: Ferrari worth sales price on its own; Fiat owned a significant share in Chrysler. Possibility to increase distribution of Fiat Brands in US via Chrysler network and Chrysler brands in Europe via Fiat network. Risk 1: Chrysler had emerged from bankruptcy. The market was bearish. Catalyst 1: Reduction in US production costs as a result of renegotiated union contracts. Risk 2: European car sales had suffered greatly in the Great Recession. Fear that Tesla would take over car world. Catalyst 2: Automotive industry is cyclical. Electronic and self-driving technology available to Tesla, equally available to other auto companies including Fiat. Risk 3: Italian management, CEO Sergio Marchionne and Chairman John Elkann viewed with suspicion by the market, interested to enhance personal wealth. Catalyst 3: Marchionne educated in Canada & Italy; had already demonstrated good capital allocation by purchasing Chrysler assets at very low prices. Elkann, is a Warren Buffett fan and regular attendee of Berkshire AGMs.

"I wish I had such precise sense of what something is worth and a precise sense of the discount, but I don't. Maybe other people do, but I just don't believe it's possible. When I'm making an investment, it's partly where's the downside and where's the upside? What is the worst that can happen here? What I'm looking for is an upside where I can't even see the end where it can be worth many, many times more. Just to give you an example, I believe that at the time I invested in Fiat, the whole of the price that I was paying for Fiat was represented by the value of their Ferrari subsidiary. That subsidy is going to be spun out in the not too distant future. What is the rest of the company worth? I don't know. It was certainly worth the same as my purchase price, perhaps two or three times that. So I could see a 3x or 4x return. You could argue that's a 75% discount. I don't think I'm seeing it like that. I'm just saying there's huge upside and a very, very unusual upside." (MOI, 2018)

"The short story on Fiat Chrysler is that, in June and July of 2012, I bought two million shares at an average price of $4.90 per share. Today, when I include the Ferrari and other spinoffs, that investment of about $10 million is worth more than $70 million. In retrospect, the investment looks simple and easy — a comfortable victory. But you should know that, at the time, buying Fiat did not feel simple, easy, or comfortable."

"I started intensively researching the automobile industry at the behest of my friend Mohnish Pabrai. We've debated many potential investments over the years and have often disagreed about the merits of different companies. So when he first started talking to me about Fiat, I felt a familiar sense of revulsion at the idea that I might actually invest in what was probably the least-liked automobile company on Earth. Back then, it was the eighth-largest player in the field, hopelessly lagging behind rivals like Toyota, General Motors, Volkswagen, Ford, and Hyundai. My expectation was that I would quickly and easily prove Mohnish wrong."

"His logic for the investment started with the fact that Fiat was extraordinarily cheap. With a market value of $6 billion, it traded at roughly 5% of revenues. Then again, if you do a screen for companies with low price-to-sales ratios, you can usually find a dozen or so that trade at this sort of level. The problem is, they tend to be value traps — companies that seem cheap on the face of it, but are destined for the corporate graveyard."

"Mohnish argued that Fiat was different because there were a number of catalysts in play. Most important, it had acquired a major stake in Chrysler for pennies on the dollar in 2009 after the US car maker had declared bankruptcy. That deal meant that this also-ran automobile company from Southern Europe now had the potential to gain a global reach. American auto brands like Jeep, Dodge, Ram and others could now be sold internationally via Fiat's non-US distribution system. And Fiat brands like Alfa Romeo, the Cinquecento, and Maserati would have the potential to enter the US market via Chrysler's distribution system."

"The nature of this opportunity was largely hidden from the financial markets: US investors who understood Chrysler didn't understand Fiat, and European investors who understood Fiat didn't understand Chrysler. Mohnish and I had one advantage in that we had already done a huge amount of research on the auto industry while analyzing GM. One key insight from that research applied not only to GM but to Chrysler: both companies emerged from bankruptcy with renegotiated union contracts, which radically reduced their cost of operating in the US. As a result, Chrysler would now be able to compete for the first time on a level playing field with its Japanese and Korean rivals."

"Meanwhile, Fiat itself also contained some terrific businesses, including the whole of Ferrari and Maserati, along with leading automotive suppliers like Magneti Marelli, Comau and Teksid. Today, our Ferrari shares alone are worth about $20 million, which is double what we paid for our entire position in Fiat Chrysler. In other words, you could argue that we got Ferrari at half price and got the rest of Fiat Chrysler for free."

"We were betting that, once Fiat and Chrysler were properly integrated and running smoothly, the merged company would achieve reasonable levels of profitability. I was reassured by the fact that the person executing this transformation was Sergio Marchionne, who had been hired as Fiat's CEO in 2004 by the company's chairman, John Elkann. Marchionne had grown up in Italy and Canada, and had attended university in Windsor, Ontario, which is a centre for automobile manufacturing. A lawyer and an accountant, he became a highly respected executive and had already shown his deal- making prowess in acquiring Chrysler's assets for a pittance."

"Looking back now, it sounds like an obvious slam dunk. But this positive outlook was shared by very few people in the investment world. For a start, European car sales had suffered greatly in the global financial crisis; Italy and Spain, where Fiat was most exposed,were especially hard hit. Moreover, the Fiat car was a dated and unpopular brand. The Chrysler brand had also been tainted by the company's bankruptcy, and it was widely assumed that the North American market would remain endlessly unprofitable."

"Many investors also assumed the worst when they looked at the company's leadership. Here was the scion of an old Italian industrial family (Elkann), aided by a fellow Italian (Marchionne) who would surely run the business as a family fiefdom, blighted by bad capital allocation and dynastic dysfunction. Initially, this view resonated so strongly with me that the company didn't seem worth researching. That's the nature of received wisdom: it shuts down careful, rational examination. If Mohnish hadn't been pounding the table, I might not have done the research at all."

"But when I looked for hard evidence to support my jaundiced view, I couldn't find it. I became increasingly impressed with Marchionne, who came across as someone with unusual foresight, negotiating and management skills. I also started to see that Elkann was nothing like the rapacious Italian robber-baron I had imagined. He was born in New York, regularly attended Berkshire Hathaway's annual meeting, and revered Warren Buffett. It became clear to me that one of his aspirations was to show Italians a better way of being a capitalist."

"Finally, after dismantling all of my objections and prejudices, I bought our Fiat position. Still, it was psychologically painful for me because the market hated it so much and owning it put me at odds with conventional wisdom. Back then, Marchionne was actually an object of ridicule among some automobile analysts. My discomfort gradually eased as I watched him work steadily to turn this Italian business into a global force, and I saw clearly the enormous opportunity to globalize its brands."

"But it was never an easy stock to own. I continued to harbor doubts about my own assumptions. For example, although I thought it unlikely, I couldn't rule out the possibility that Marchionne was simply a ballsy risk-taker who just happened to have had a lucky streak of wins. And then there was the threat of technological disruption. Casual observers were convinced that the world would electrify and become self-driving in less than a decade; Tesla would rule the world and companies like Fiat Chrysler would be stuck with outmoded technology."

"My research emphatically contradicted this view. For one thing, the planet had an enormous investment in oil infrastructure and any switchover wasn't going to happen overnight. Moreover, as this transition happened, the incumbents would have many opportunities to buy in the right technology. One important eye-opener for me was when I discovered that Tesla's self-driving technology was almost entirely bought in from Mobileye."

"Why would this technology be made available exclusively to Tesla, which produced 50,000 cars a year, and not made available to Fiat, which produced nearly 5 million cars a year? As always in investing, the challenge is to penetrate beyond the noise and chatter so you can rationally assess the economic realities."

"In any case, our investment in Fiat has worked out beautifully, unfolding much as I had hoped based on my in-depth research. It's tempting to assume that this was almost inevitable and that it was a simple decision to buy the stock. But I hope you can see that it wasn't easy or obvious to me either to buy it or to hold onto it for the last six years. On the contrary, it was emotionally challenging to fly in the face of the crowd, trusting throughout that my analysis was right and that the conventional wisdom and pervasive pessimism were wrong."

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Case study: Education businesses

Summary: The education business provides insight into how Guy analyses prospective investments. Economics: School fees are paid at the beginning of each term, space can generally be satisfied based on needs from the current real estate stock, high intensity of real estate use with classes from the morning till the evening and brand economies. Incentives: All stakeholders benefit from a virtuous circle through their involvement in education.

"Secondary education businesses benefit from some very attractive economics, starting with the cash conversion cycle: School fees tend to be paid at the beginning of each term – so the company gets its revenues in cash up front, rather than having to record an account receivable and wait to be paid. Furthermore, unlike the average retail, distribution or manufacturing business there are no inventories to speak of, thus there is a low investment in working capital. The businesses tend to have a low fixed asset intensity as well: Unlike traditional colleges, for-profit colleges tend to locate near to existing businesses in business districts thus their need for space can be satisfied from the existing stock of office space.

Their real estate assets benefit from a high intensity of use, as classes can be scheduled from the morning until late at night, as well as weekends (to accommodate the many students who want to work while studying.) In addition to the scale economies that are available from intensive use of real estate some of the larger education businesses are starting to benefit from interesting brand economies, as they expand across the country."

"Economics elsewhere in the supply chain are also good: Towns and municipalities tend to be eager to have colleges locate in their jurisdiction, because they bring many ancillary benefits to the locality. Teachers and instructors who often also practise professionally in the field they teach are also positively impacted by the opportunity to teach a subject that they master: Contact with the student body is a useful networking tool, and increases their industry recognition. Teaching may also give them significant lifestyle benefits." (Annual Report, 2004)

"After extensive research, we invested heavily in two U.S. education companies, EVCI and DeVry. Both proved to be extremely pro table investments. Thankfully, I sold them before the Obama Administration came to power and created a far less benign environment for the for-profit education sector in the U.S. In all, we made three times our money in Raffles. But we would have had a six-fold return had I not reinvested in the company. (Annual Letter, 2015)

Case study: Eurotunnel

Summary: In 2000, Aquamarine acquired a series of convertible debt instrument in Eurotunnel, a then less than decade old underground tunnel that links the UK to Continental Europe. Trains that run through the tunnel, carry cars, lorries and busses. Economics: Eurotunnel could charge customers a premium over ferries and customers would still save money. Incentives: Not only would customers save money, but also time. Evidence: Eurotunnels market share from 1997-1999 grew from : 14% to 35% in the HGV market and 39% to 55% in the car market. Black Swans: The emergence of low cost airlines, the consolidation of European freight transportation companies and the astounding ability of ferry companies to cut cots.

"One of Aquamarine Fund's more recently acquired positions is the debt instruments of Eurotunnel. This chart compares the time for freight to cross the channel using either Eurotunnel, the ferry service, or via container port. When one costs this out, it turns out that there are tremendous cost savings for freight transporters in using Eurotunnel."

"The bottom line? Eurotunnel can charge as much as GBP 25 more than its competitors, and they still save money. It is the sort of customer economics indicated in the slides above which are driving the Eurotunnel's volume and market share gains, and which will ultimately drive their economic success, and result in good returns for the shareholders of Aquamarine Fund." (Annual Report, 2000)

"I say on the whole, because… I believe that our investment in Eurotunnel was more likely than not, a mistake. My original thesis was that the business would develop a "virtuous circle." Fixed operating costs, and increasing volume were going to drive lower cost per unit, and lower prices. This, in turn would drive competing modes of transportation out of business and beget greater volumes, with continuous and improving operating and financial results. I believed that I could, with relative clarity, see my way to IRR's in the high 20's."

"But I mis-appraised various factors. One was the remarkable ability of the ferrys to cut their costs alongside Eurotunnel. Another factor is the low cost airline business, which barely existed at the time of the investment. It has since blossomed, and has taken significant amounts of traffic away from Eurostar/Eurotunnel. A third is a dramatic increase in the size and concentration of ownership of European freight transportation companies, reducing Eurotunnel's pricing power. What this means is that Eurotunnel is a decent business, not a great business. Given the recent swirl of negative publicity we are at a time of high pessimism, I would likely wait for a better opportunity before selling." (Annual Report, 2004)

Case study: Horsehead

Summary: In 2012 Aquamarine invested in Horsehead. Although it has a strong balance sheet and a viable business model, a technical default on a small line of credit led Horsehead to bankruptcy. Economics: Lowest cost recycler of zinc in the U.S. Incentives: Environmentally friendly, converting a byproduct of recycled steel to zinc. Black Swan: Investing in improving their technology left Horsehaed vulnerable to a technical default at a time when zinc prices fell and remained below their marginal cost of production for a significant time period.

"Our investment in Horsehead was made for all of the right reasons. The company has an excellent business model and first-rate technology, which originally involved taking a byproduct of recycled steel and using a smelter to produce marketable zinc. This cost-effective and environmentally-friendly process enabled Horsehead to become the largest and lowest-cost recycler of zinc in the U.S. We bought the stock in 2012 at an average price of about $10 per share and doubled our money by 2014."

"Ironically, Horsehead's troubles began with the decision to replace its smelter-based technology with a superior electrolytic process. When run at capacity, this new process will be lower cost and cleaner. But the company's new plant in North Carolina experienced costly delays and has not yet run at capacity. To tide it over, Horsehead raised capital through debt and equity financing. These setbacks would normally have been no more than a temporary frustration. But the price of zinc collapsed in 2015, producing the perfect storm. Strangely, Horsehead's bankruptcy didn't result from running out of cash. Rather, there was a technical default on a small line of credit from Macquarie Bank; Macquarie froze Horsehead's bank accounts, which triggered the bankruptcy — shortly before zinc prices nearly rebounded. I believe Horsehead didn't need to be thrown into bankruptcy, given that its last audited balance sheet showed assets in excess of $1 billion, equity in excess of $400 million, and over $30 million in cash."

"When I write these post mortems each year, I try both to explain our investment approach and also to draw practical lessons from any mistakes I've made. In the case of Horsehead, this isn't easy, either emotionally or intellectually. At some level, the company's dramatic shift from success story to bankruptcy was a black swan event. There's some element of sheer bad luck here that is, unfortunately, a part of investing."

"I would never have predicted that zinc prices would plunge below the marginal cost of production and remain there for so long, given that global zinc supplies were tight and that demand was steady. And I would never have predicted that Horsehead would have such trouble getting its plant up and running, given that there are four similar plants in other parts of the world."

"In retrospect, I made one serious mistake with Horsehead that I'm determined not to repeat. I saw its debt rising a year ago and failed to recognize how vulnerable this could make the company in extreme circumstances. Knowing the vicious nature of leverage, I should have been more sensitive to this increased risk. To avoid repeating this error, I'm in the process of creating an "in- ight" investment checklist, which includes these two questions: has the company we own taken on new debt, and have its leverage ratios changed significantly? If a company hits one of these tripwires, it may not be necessary to sell, but I need to monitor these growing risks carefully on a daily or weekly basis. We've typically done best by operating as patient, buy-and-hold investors. But in a dynamic situation like this, I have to be open to the possibility of getting out quickly." (Annual Report, 2015)

Looking ahead

Even if interest rates increase in the future, acting like gravity to asset prices, this effect might be offset by inflation: "I believe the best option is to remain invested in stocks, even though the valuations don't represent the sort of bargains we've found in the past. The truth is, none of us knows how this era of low interest rates will end. Sooner or later, rates have to go up, which implies a decline in asset prices. But if that rise is accompanied by sufficient inflation, then stocks won't necessarily decline. Even if interest rates rise substantially, it's possible that inflation — or merely the expectation of inflation — could result in a very strong bull market." (Annual Report, 2016)

Guy is a global value investor: "With developed markets not particularly cheap, I also believe that many of our best opportunities in the next few years may lie in developing countries like India and Brazil." (Annual Report, 2014)

He draws on a considerable international track record: "Overall, our investments in emerging economies have been overwhelmingly positive, despite the occasional setback. For example, we made a 671% gain on Crisil, 423% on Alaska Milk, 400% on Estacio, 398% on Rafes, and 225% on Cresud. These winners more than outweighed our 50% loss on EFG Hermes and our 77% loss on Jordan Phosphate." (Annual Report, 2017)

Guy continues to learn, re-engineering the way he analyses businesses: "I think something I've learned over the past ten years is this idea of businesses that allow for attractive reinvestment opportunities. I think Nestle is the kind of business that throws that up. I think it's a business that is close to Warren Buffet's description of an inevitable and so it's just an incredibly comfortable thing to hold in the portfolio, even if the valuation is not as low as some other things. It’s something that you can just hang out with for a very long time and know that you’ll do well. That certainty of knowing that you’ll do well, it’s just a matter of time, is a wonderful thing.” (MOI, 2014)

Warren Buffett has described investing as connecting the dots. ”Another fascinating insight came from a brief email interaction with Alain de Botton, the writer and philosopher, who is one of the founders of The School of Life. He clarified for me the distinction between businesses that fulfil a basic human need and businesses that stimulate a desire which they subsequently meet. Luxury goods, tobacco and gambling are good examples of the latter type of business. This idea set me thinking about the businesses that Berkshire owns. What struck me is that almost all of them fall into the “Meeting Basic Human Needs” category. And even those companies that may belong in the “Creating Desire” category – such as Netjets or Borsheims — have the advantage of being the low-cost producer in that niche.” (Annual Report, 2014)

United States of America

“Warren Buffett gives this idea that anybody betting against the United States for the last 200 years is a really dumb idea and will continue to be a really dumb idea for the next 200 years is not just a folksy Midwesterner showing love for his country. It shows a very, very keen analysis of different countries in the world, the investment environment in different countries in the world and the clear understanding that the United States is the most desirable place and an extraordinary set of circumstances have come together to create the United States.”

“Just strategically, the United States is extraordinary if you look at the stand of the continent, the wealth of the continent and then you look at the wealth of the continent in terms of the diversity of mineral resources, the diversity of agricultural resources, the diversity of proximity to Asia on the one side and Europe on the other, then you look at the immigrant groups that came in there and the incredible diversity of people you have there and on top of that, the founding fathers of the United States were clearly super smart people who did some extraordinary intelligent things with how they wrote the constitution. I also think there is an element of dumb luck. They got so much of it right and it’s created this extraordinary thing that in 200 years of its founding, the super powers emerged and it continues.” (MOI, 2018)

Checklists

Self-improvement is a necessity for the serious investor: ”The stock market has an uncanny way of finding us out, of exposing weaknesses as diverse as arrogance, jealousy, fear, anger, self-doubt, greed, dishonesty, and the need for social approval. To achieve sustainable success, we need to confront our vulnerabilities, whatever they may be. Otherwise, we are building our success on a fragile structure that is ultimately liable to fall down. But the real reward of this inner transformation is not just enduring investment success. It’s the gift of becoming the best person we can be. That, surely, is the ultimate prize.”

Once one is aware of one’s mistakes, a checklist reduces the chance of repeating that mistake in the future: ”Ultimately, good investing is an inward journey. What I need to do is look inside myself and say, “What have I done, what is it about me that takes me into these businesses with no collateral values and how do I figure out a question that I can ask myself that will prevent me from doing that going forwards?” That’s part of the effective construction of a checklist and is the reason why it’s different in every case for each individual.” (MOI, 2018)

Social psychologists have found that people have a tendency to over-estimate themselves. Aristotle believed excellence not be an act but a habit. A checklist can help foster the right habits and protect us from our capacity to skip elements: ”If you go shopping, your wife gives you your list of items and you go down them. I would argue that this is something very different. It’s not about remembering anything. I don’t know if you, John, or any people watching this have had the experience. I’ve had the experience of reading a text and then I suddenly realized that I’d skipped a whole paragraph and there was something in the paragraph that I skipped that was important and I need to go back and reread it so that I get the full meaning. We’ve all had the experience of reading a book and then rereading it and learning all sorts of new things that we didn’t read the first time. It just seems like our minds have the capacity to jump things and we all do it.

When it comes to all sorts of elements in life, it’s probably fine, but when we’re deciding to commit a huge amount of capital to something and we don’t want to lose money, we want to try and prevent our minds from doing that. The checklist is not a failsafe mechanism, but it’s like Granny’s rule – we eat our dessert after we’ve had the main course. It’s a way of trying to interrupt that natural skipping that the mind does” (MOI, 2018)

“The example I have given in talks is an airplane that is crashing. There is no question that checklists have been extremely helpful in reducing airplane accident rates. What it does is it brings the brain back to the place where one can make rational decisions.” (MOI, 2009)

However, different people are more or less vulnerable to different kinds of biases. In order to be as useful as possible, each person must create their own checklist: ”This kind of self awareness is vital since you can only design a checklist to address your weaknesses if you know what those weaknesses happen to be.”

“Obviously, in terms of building checklists, there is no question that the place to go is past mistakes. Not only one’s own past mistakes, but also to look at other investors’ past mistakes and see what those mistakes were. It seems to me, and it is a process that I am still going through, that the more specific the checklist item is the better.” (MOI, 2009)

“Aquamarine Fund is, and should be about delivering investment returns, not about feeling good. The checklist item that these investments violated is one that asks, “does making this investment result in some non-monetary, or psychic gain which interferes with my ability to think clearly about the investment return?” (MOI, 2009)

Outperformance

Guy prefers to think in terms of doubles, as he believes this fosters long-term thinking in comparison to annual performance. ”Rather than think of annualized percentage returns, I like to think in terms of doubles. I achieve a double when I manage to deliver a net 100% return on the whole portfolio. Thinking of doubles is a better way to frame the challenge, because it enables me to think of the investing process as something that happens over a number of years, rather than what happened last month, last quarter, or last year.” (Annual Report, 2006)

“Over the last year, I received a number of questions asking why I compare my performance to the S&P in these reports rather than the MSCI World Index which covers a more global basket of stocks. The short answer is that I do not want to “index shop”, or even go anywhere near that slippery slope.” (Annual Report, 2012)

He views his shareholders as partners, who’s understanding of the business help support a long-term focus: ”You, my existing shareholders, have been on a significant learning curve with me. You have a much greater understanding of what I am doing than most investment professionals and therefore are much less likely to be startled by a sudden decline, or by a period of lackluster performance. As I have said before, your presence on the shareholder register helps to provide me with an environment in which I can operate more rationally and I have little interest in diluting that.” (Annual Report, 2014)

Guy remains modest: ”This is not the result of brilliance on my part… it is the result of a consistent application of the value investing philosophy – that of evaluating the intrinsic value of a business, and seeing if I can buy at a discount to that value.” (Annual Report, 2002)

He aggressively pursues the chance to learn from others: ”Those investment vehicles that outperformed Aquamarine Fund over the same period, I believe, fall into two categories: They have been either lucky, or smart. As far as the smart managers are concerned, I work very hard to learn from, and reverse engineer what they are doing. This work includes a lot of reading, visiting various conferences, and even bidding on charity lunches with Warren Buffett (to my great fortune, the wisdom of Mohnish Pabrai came as a free extra). By the same token, when it comes to those who were perhaps luckier than smart, I seek to make sure that I do not get envious by being grateful for my own progress in investing our money, along with the not-insubstantial rewards that have come with this.” (Annual Report, 2010)

Lunch with Warren Buffett

In 2008, Guy and Mohnish Pabrai successfully placed a winning bid of $650,100 for a lunch with Warren Buffett. The proceeds of the bid went to the Glide Foundation. The Glide Foundation is “a radically inclusive” community, centered around a united Methodist church in San Francisco’s impoverished Tenderloin district. Through the provision of health services, over 800,000 meals to those in need and other initiatives, Glide aims “to alleviate suffering and break the cycles of poverty and marginalization.”

On June 25, 2008, Guy & Lory Spier along with Mohnish Pabrai, his spouse Harina and their two daughters Monsson and Momachi, joined Warren for lunch at the Smith Wollensky steakhouse in Manhattan. Guy was awestruck by Warren’s brainpower: “In the past, having come top of my class at Oxford, I'd somehow convinced myself that I had the mental capacity to compete with him, and I had hoped that I might one day learn to perform equally well. Seeing him in person that day, I was left with no doubt at all that I could never hope to match him."

He found the experience helped set him on his own path: "This could have been dispiriting, but I found it weirdly liberating. For me, the lesson was clear. Instead of trying to compete with Buffett, I should focus on the real opportunity, which is to become the best version of Guy Spier that I can be."

Guy's way in business

"My friend William Green, who mentioned something that Howard Marks had said to him about what constitutes a successful life. Howard made the point that he didn't just care about his accomplishments in life but about how he achieved them. I wholeheartedly agree. I want to be successful, but I care very much about how I do it. I'd rather not get there than get there the wrong way." (Annual Report, 2017)

Warren Buffett has often said that there is plenty of money to be made in the center of the court. "The late Donald Keough, author of a book entitled The Ten Commandments for Business Failure and a former director at Berkshire Hathaway, taught me the importance of "playing center court." The idea is never to take the risk of venturing into grey areas. Today, more than ever, playing center court is both a smart business approach and the right thing to do in ethical terms." (Annual Report, 2014)

"Charlie Munger points out that it's always easier to be truthful because you don't have to remember your lies. […] The key instruction that I have repeated numerous times to Aquamarine's staff is that if they ever receive a call from the SEC, FINMA or other regulators, they should feel free to invite them into our office and give honest answers to their questions without having first to check in with me or our legal counsel." (Annual Report, 2014)

Guy prefers to stay away from investments that do not align well with his moral framework: "Nothing comes to my mind right now, but it fails a checklist item, I mean this is just an example I brought up, but I did not invest in OPAP, the Greek lottery company that ended up doing extremely well because the product is not for the greater good. Sometimes the focus on that, to fail a checklist item, is this for the greater good, is this a net benefit to society that this company exists? Perhaps not, therefore, I don't want to make the investment." (MOI, 2018)

He prefers to avoid short selling: "First, and least important of the three, has been my unwillingness to play both sides of the market by "going short," or by finding a natural hedge for certain long positions. In general, selling short bad, fraudulent or overvalued businesses is much less pleasant, and is fraught with much more risk than going long good businesses at decent prices. I have shied away from it, in some cases leaving returns on the table." (Annual Report, 2003)

Guy's way in life

William Green, a close friend of Guy's and an early investor in Aquamarine, who edited *The Education of a Value Investor*, recalls a scene in Guy's kitchen in Zurich when Will had visited in order to view an initial manuscript. Guy: "I don't care if anybody reads this book, I don't care if it damages my reputation, I don't care what happens, I just want to give an honest account of my life." (MOI, 2018) William was taken back by this as he comments that is so rare to be authentic in the investing world rather than try to market constantly market one's self to the public. It is this authenticity that William and other close friends have come to value in Guy.

Guy believes that spending time with the right people is instrumental to leading a good life. It is not just that "people are the ultimate teachers" or that as Guy repeats from Buffett: "Hang out with people who are better than you, and you cannot help but improve." People define the quality of one's life. For this reason, he takes the time to write thank you notes to the people he has met and who left an impression on him: "I always take care to write "thank yous" to great people I've met along the way — all the way from the taxi driver and bell-boy to CEOs and Chairmen of major corporations." (MOI, 2012)

Whilst this has encouraged reciprocity in others and benefitted his business, this isn't the real driver: "The real returns, though, come in the form of a sense of interconnection: The very act of reaching out rewires my brain to embrace more of humanity into my in-group. I cannot predict how many friendships, partnerships and opportunities will arise from my daily correspondence, but the journey most certainly has been its own reward." (MOI, 2012)

However, some relationships can be toxic, and the key is to determining those people who are truly worth it: "In any case, the key lesson from Warren was to invest time and energy in the handful of people you're sure about and leave the rest of the alone. On this basis, I decided that I needed to become more efficient at eliminating people from my network if I wasn't sure about them.

Mohnish showed me a better way. Your life is just too short to deal with people who aren't straightforward and forthcoming about who they are. The best strategy is simply to leave the mysterious obfuscators alone. The goal is not to figure them out, but to keep the distance. Warren and Mohnish, who are both down-to-earth and entirely lacking pretence, are only interested in dealing with people who are an open book. They distance themselves from all the others, leaving them in the "not sure" category, which is the human equivalent to the "too hard" box on Warren's desk."

Guy subscribes to Kant's arguments on how people should be treated in the *Groundwork of the Metaphysics of Morals* (1785). Kant posited, if we accept that humans has their own free will, then that will ought to set its own end. We therefore should not aim to set the ends for other humans but accept them as ends in and of themselves. "The key, in my experience, is to value people as an end in themselves, not as a means to our own ends. […] Thanks in large part to Mohnish and Warren, I began to realise that I ought to focus more on what others need from me instead of constantly trying to get them to fulfil my own needs."

It follows that if one’s own happiness may not be achieved through using others instrumentally. If one is not an island and at least to some extent dependent on others for one’s happiness, then one needs them to be happy too. This perspective on life is shared by Bill Gates, who on the 15nth of May 2017 tweeted his advice on life in fourteen principles: ”Like Warren Buffett, I measure my happiness by whether people close to me are happy and love me, and by the difference I make for others.”

Guy makes an effort to give back to the community. He speaks frequently at different events, is an active member of the Entrepreneurs Organizarion, the Toastmasters and the Young President’s Organisation. Likewise, he always takes care to respond with kindness to people who reach out to him. He founded VALUEx as a community where members “can all have a positive influence on one another.”

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