

Value Investing Has Never Been More Relevant

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The following is an excerpt from a Jeereddi Partners letter dated January 25, 2017.

“Difficult to see. Always in motion is the future.” -Yoda

The political landscape exploded in 2016. The change was not predicted by most and feared by many. Regardless of one’s political leanings, the current torrent of change will have substantial long-term financial implications. We are perhaps at the beginning – not the end – of a significant geopolitical cycle. Investors across the world should prepare for a wild ride. Many won’t. We will.

History portends that investors react irrationally to strong change and fear. Value investors capitalize on such irrational behavior. Whether we like it or not, strong catalyzing and unpredictable change is coming down the pike – right now. It is going to hit the global economy and markets in unimaginable ways. The instability may last a long time. As a result, we believe that there is a compelling investment opportunity set developing for our particular strategy. It could be substantial and promising. We look forward to unearthing it as the landscape shifts underneath us.

Some large-scale, macroeconomic imbalances and risks – sovereign debt, aging demographics, massive unfunded entitlement programs, increasing inequality, declining productivity, undisciplined global fiscal and monetary policies, a surging US dollar, and rising nationalism – are here and growing every year. These risks will impact the long-term earning power of many businesses and industries. Fundamental investors must tread carefully. Highly leveraged investors and short-term, speculative investment platforms should be terrified. It is a potentially lethal investment landscape.

Value investing has never been more relevant. It offers us a tried-and-tested system – rich in heritage and logic – to navigate and profit from the potential upheaval and change. As you all know, true value investors assume the markets are unpredictable – in good times and in bad times. We are not disturbed when the environment changes. We are contrarian and confident in our Graham-and-Dodd investment processes. Such resilience and adaptability are part of our ethos. So, we are right at home in this environment.

We evaluate businesses undergoing “special situations” and consequences (or events that create meaningful discounts in a company’s valuation). There will be an abundant supply of such “special situations” given the current political and macroeconomic backdrop. Our investment system requires specific experience in evaluating these complex “special situations” (including financial distress events). This type of work is not for everyone. It is nuanced and hard. A firm must have a true, long-term mindset, and structure to execute this strategy correctly.

Human nature and the structure of the asset management industry (including incentive systems) make such a long-term orientation extremely rare. This paradigm creates structural inefficiencies and opportunities for disciplined, long-term investors. Just peruse the daily news cycle or published letters

of various investors to see evidence of market participants' short-term biases and fluctuating convictions. A majority of people in the news media and asset management industry believe they can assess and predict many things – the markets, the economy, politics, and even quarterly earnings. They cannot.

Our specific investment process is grounded in a long-term foundation that has three essential parts. The first is the understanding of the circumstances that cause other investors to shun a particular security. We must understand that “situation” and all its potential effects on the underlying business. The second task is the quiet contemplation and thorough assessment of a company's business model, industry dynamics, competitive position, future earning power, and likely operating scenarios. These processes require us to filter out distractions and opinions of others and focus on the fundamentals of the business, the nature of the apparent discount, the price, and the catalysts in place for unlocking of future value. Finally, we must manage the risk and reward of our entire group of investments as a whole portfolio. This specific portfolio-management process includes the sizing of our positions, determining various risk exposures, and hedging unwanted risk.

We apply this contrarian, three-part filter on a consistent basis – without recourse leverage – to optimize the value of our portfolio. Also, we are always questioning our initial entry price, key assumptions, and our overall value thesis for each investment. We maintain a conservative and fact-based orientation – adjusting the portfolio as we go along, security by security, to optimize profit potential and reduce risk. We systematically execute this process and grow our investment competency every year – regardless of the short-term results. We are that confident in the effectiveness of our process and the compelling, timeless nature of this type of value investing. In fact, our conviction grows when it fades in others.

The following is an excerpt from a Jeerreddi Partners letter dated October 24, 2017.

During the quarter, we initiated three positions in the retail sector – Tuesday Morning (or “Tuesday”), Michaels Inc. (or “Michaels”), and Ross Stores (or “Ross”). The recent distress in the retail industry provided a reasonable entry point for these investments. We have utilized appropriate hedges and left plenty of room to add to these positions given the recession risks endemic to the industry. We believe that in all three cases, investors fear a growing list of short-term issues (including Amazon's competitive disruption). As a result, investors are unable to recognize the discounted price and attractive call option embedded in each investment. In Tuesday Morning's case, we also saw an opportunity to catalyze the value potential ourselves.

Tuesday Morning (Nasdaq: TUES)



Tuesday Morning is a small off-price housewares retailer undergoing a turnaround. The stock is distressed and heavily shorted having fallen nearly 90% since December of 2014. We believe investors misunderstand the optionality and value potential of Tuesday Morning's business. Investors, exasperated by several years of operational missteps and the resulting abysmal share price performance, are too focused on the current negative operating metrics and the competitive retail environment.

The market is missing the significant opportunity within Tuesday Morning's business. We believe that many of the company's issues are solvable with proper management. Tuesday Morning has a loyal set of frequent shoppers. The off-price retail category is in fact growing and is resistant to online competition due to its hands-on treasure hunt dynamic. Tuesday Morning's same-store sales are increasing. We also believe that many investors are underestimating the math and significance of Tuesday Morning's excess real estate holdings and a batch of non-recurring charges (running through the accounting ledger).

There are several risks with Tuesday Morning's business including a housing or consumer recession, a group of suboptimal store locations, short-term operating losses, an older customer demographic, and a transitioning business model. We believe these risks, while significant, are priced in Tuesday Morning's shares given the disastrous share price performance (previous to our purchase) and the current malaise in the retail sector. Investors in offline retail stocks, hammered by sharp losses, are throwing away their calculators and running for cover. Tuesday Morning shareholders are no exception. We are thankful that our predilection to look for distress kept our exposure to traditional retail at de minimus levels going into the current disruption unleashed by Amazon and other online entrants in the space.

At our purchase price, Tuesday Morning trades at less than half its tangible book value and a 0.1x multiple to revenue (with competitors that trade at more than 1x revenue). Tuesday has excess real estate value and operates in a growing industry (off-price retail). Tuesday Morning has a decent balance sheet (at the moment). As mentioned, there are also extraordinary operating charges relating to its distribution center (which management has spoken about during its recent quarterly calls) that we believe will reverse in due course. Investors are not correctly evaluating these factors.

We have modeled many detailed operating cases for Tuesday Morning. There are several base-case scenarios with modest assumptions that create substantial shareholder value (multiples of the current stock price). With prudent management, we believe the company could mitigate some of the risks of

the business in the event of a recession or a significant operating setback. The resulting asymmetry of the investment is compelling.

We are taking a hands-on or activist approach to our Tuesday Morning investment. We see an opportunity to work with a management team and board of directors to build substantial shareholder value. As you would expect, we conducted in-depth, comprehensive due diligence including multistate store visits and numerous meetings with operators and executives in the industry to construct our thesis and vision.