

When It Comes to Value Investing, Are You A Fox or A Hedgehog?

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I have read three interesting books so far during my year-end break, namely:

- [*The Man Who Solved the Market: How Jim Simons Launched the Quant Revolution*](#), by Gregory Zuckerman;
- [*A Man for All Markets: From Las Vegas to Wall Street, How I Beat the Dealer and the Market*](#), by Edward O. Thorp; and
- [*A Mind at Play: How Claude Shannon Invented the Information Age*](#), by Jimmy Soni and Rob Goodman.

All three books contain useful insights and valuable mental models to add to one's cognitive toolbox. Key takeaways for me include:

- 1) the importance of always questioning the status quo;
- 2) taking a probabilistic approach towards decision-making;
- 3) utilising combinatory play/thinking to stimulate creativity; and
- 4) focusing on what works in practice, rather than just in theory.

Jim Simons, Edward O. Thorp, and Claude Shannon all developed an edge by applying mathematics and technology in a way that had never been done before. Their insatiable curiosity led to enormous success as they found practical application for their innovations. Importantly, they kept an open mind as they searched for order and predictability where others just saw chaos, noise and randomness.

Value investors, similarly, look for a signal (intrinsic value) in the noise (price and news) and attempt to make decisions that have a high probability of success, defined as generating above-average long-term investment returns. The basic principles of intelligent value investing are timeless, but the application thereof allows for improvement, refinement and innovation. Warren Buffett improved on the traditional Graham & Dodd approach (with the help of Phil Fisher and Charlie Munger) by recognising that the value of long-term compounders are generally underappreciated, even at significant premiums to book value. Joel Greenblatt showed that a diversified portfolio of growing companies with wide moats (as represented by high ROIC-WACC spreads) can generate very attractive investments returns, notwithstanding the mantra that portfolio concentration is a necessary ingredient of outperformance.

Contemporary value investors such as ourselves have also needed to evolve our thinking due to new market phenomena such as unprecedented low interest rates and the increasingly global operating environment of most companies, while staying true to value investing principles. We have had to keep an open mind and question old adages such as *"true value investors don't invest in technology stocks"*.

The value investing foxes have adapted to the changing environment in their search for discrepancies between price and value, finding new ways to identify mispriced securities that Mr Market has on offer (or is bidding for, in the case of those value investors who also engage in short-selling, anathema to many die-hard value investors), but hedgehogs have had a tougher time of late. Many value investors, who for a long time had pleasing investment track records, have seen their own cumulative

returns revert to (or drop below) the long-term return of the broader market lately. Is this a cyclical phenomenon or a secular change in the efficacy of traditional value investing, given abnormally low interest rates, how technology has changed the business environment, and our understanding of how companies sustain their competitive advantage?

Human nature doesn't change, but neither does the phenomenon of creative destruction – it is a permanent feature of capitalism. One's approach towards value creation (investing) should also allow for adaptation and creativity by borrowing concepts from other successful approaches that are congruent with the core premise of value investing.

Personally, I've found it useful (and profitable) to constantly challenge my own prior investment beliefs and to explore novel tools to assist in the application of value investing principles. Examples include the use of automation in financial statement line-item forecasting, implementing a statistical approach towards position sizing, using alternative data sources for additional insight and developing algorithms to assist in avoiding behavioural bias in decision-making. The interesting ideas shared by the MOI Global community have also contributed to an improvement in my own investment process (and that of Protea Capital Management), and I look forward to removing more of my own ignorance by participating in Best Ideas 2020 next month, both as an instructor and a viewer.

Preparing a presentation regarding one's investment thesis of a company, engaging in thoughtful exchanges with those who might disagree with an idea and learning about attractive investing opportunities identified by fellow intelligent investors, helps to improve one's own investment process. Reviewing past presentations is also useful. It reminds one of the value investing hedgehog's one big idea: *value investing works*, and it expands the value investing fox's collection of smaller ideas, ensuring that we continue to make value investing work in practice, and not just theory.