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Our core investment philosophy is based on Buffett and Munger's famous four filters:

1. An understandable business that's within our circle of competency.
2. The business possesses sustainable long term competitive advantages.
3. A competent and honest management team.
4. A reasonable price.

We think like chess and taekwondo, there are different levels of value investing due to different levels of understanding of Buffett and Munger's framework, different levels of research, different levels of thinking, and different levels of organizational structures.

Of all the value investors, Warren Buffett, Charlie Munger and Li Lu are the ones we admire the most because we think they represent the highest level of value investing. Why?

- They have deep understanding of the most important concepts in investing such as circle of competency.
- They know the edge of their competency.
- Their research is deep and thorough.
- They are learning machines.
- They are deep and better thinkers.
- They have intentionally structured their life and businesses in ways to reinforce the positive feedback loop.

What prevents most investors to follow their lead to highest level of investing then? Charlie Munger characterizes Berkshire's value investing approach as "simple but not easy." In a typical Mungerism way, he added, "anyone who finds it easy is stupid."

In theory, a value investment is an investment in which the purchase price is lower than the intrinsic value, which is defined as the net present value of future cash flows - the often quoted "paying fifty cents for a dollar." This theoretical simplicity is so intuitive that it may sound beguiling easy.

In practice though, many would find that the measurement of "a dollar" frequently deviates from the theoretic value, due to, well, practical reasons.

First of all, to project future cash flows out for many years is no cinch - try that on even the generally-considered-predictable companies such as General Mills. It requires building a solid circle of competency within an industry, which as Li Lu has preached many times, can take years. There are two major limitations to build a core circle of competency. First, few industries and companies are predictable. The situation is exacerbated by the growth of internet industry, which exposes even traditional businesses to more frequent and dramatic changes. Secondly, it can take years to build a core circle of competency, even for professional investors. The delayed gratification is real and significant.

Building a circle of competency is even more impractical when there's a mismatch between the investment horizon of the GP and that of the LP - just imagine a long term focused money manager telling his short-term focused investors "hey guys, we're going to really take our time to build a circle of competency and by the way, we'll miss the hottest areas because of that. " The structural disadvantage is real.

Secondly, evolutionally speaking, our brain naturally seeks shortcuts (system 1). Given the amount of work that's needed to project business fundamentals for 5-10 years (even without considering choosing appropriate discount rate), a low price to earnings multiple or a low price to book multiple is much easily available and quantifiable. Therefore, it's perfectly understandable that value Investors who have adopted the Ben Graham's net asset value approach or liquidation value approach often use low valuation multiples as proxies of value.

Historically, Graham's approach has worked as it provides a slight statistical advantage over the index. However, significant limitations exist. For instance, assets values nowadays are much more opaque than the good old days and it's rarely practical to liquidate a public company. We also find it frivolous to conclude that company A is cheap because it has a P/E ratio of less than 10- what if earnings don't grow in the next 10 years? What if earnings decline 50% in the next 10 years?

Thirdly, as Richard Feynman witted: "In physics, we can never be sure that we are right. But we'll be sure as hell when we are wrong." In investing it's no different. Investing is all about projecting and future but so many factors, some random to a large extent, all affect the future outcomes. Therefore, even if we work really hard and make investment decisions based on sound logics, we could still be wrong. But we've all got the overconfidence bias and commitment and consistence bias in us. It's almost against human nature to admit that we not infallible. Making things worse, many investment managers have clients who can't tolerate fallibility. If they admit they've made a big mistake, they will be "bounced."

Munger is absolutely right - Berkshire's approach is damn hard.

If so, how can one advance to higher levels of value investing over time?

The obvious prerequisites would include Intellectual honesty, intellectual independence and learning from mistakes. This would require us to create an environment that cultivates and facilitates intellectual honesty, intellectual independence and learning from mistakes.

Another critical aspect is the intended sources of investment returns one aspires to pursue.

As we all know, the total return from holding a company's equity securities comes from three sources: fundamental growth, valuation change, and dividends. It's imperative for us to think about which component of the return is the most desirable, which is inextricably wound up in our time horizon for holding an asset.

Let's say we have an IRR target of XY% a year. How we plan to achieve the XY% is an enormously important question. We can aim for getting most of the XY% from the fundamental growth of the business we invest in over a long period of time. Or we can aim

for getting most of the XY% from valuation changes over and over again. Or we can get the 20% from a mix of both.

The reason why we think it's critical to contemplate the sources of investment returns in the first place is because it dictates our research process.

Many value investors look for statistically cheap and mispriced securities with a reversion to the mean mentality. This way they will most likely get most of their returns from valuation change. And the faster the valuation change, the better. Therefore, a short holding period is actually desirable.

The investors who look for cheap stocks probably don't need to think about what the economics of the business will be like in 10 years because it doesn't help much. They'll be incentivized to think about what a "reasonable" multiple is for a company's stock? Why investors hate the company? At what multiple should they exit the security? What the fundamentals of the company will look like in the next 1-3 years? They might spend a few days, or a few weeks to come up with some sort of conclusions with regards to those questions by reading annual reports, analyst reports, transcripts and etc. They'll buy the stock when the multiple is low and sell when the multiple is high. Lather, rinse, repeat.

But if the goal is to achieve most of the XY% return from fundamental growth of the business over a long period of time, naturally it would make sense to have an owner's mindset and one can't help but want to learn everything about the company.

One would be curious about the history of the company, the management team, how the company gets to where it is now. How has the company done over the past few cycles? How has the company suffered in the past? What are the most important factors for the company to be successful in the long run? What has the company done that's so different from the competitors? Have they been gaining share or losing share? Why? One would want to talk to the customers, the distributors, the suppliers and understand how they view the company and the management team. It's a lot more thinking and digging. One will be less inclined to think about when to sell the company before purchasing because one would want to suffer with the company and management team in tough times and enjoy the good times together. It's a long-term partnership.