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WHAT MAKES A SUCCESFUL VALUE INVESTOR?

AN INTRODUCTION

Investing is all about asking questions. For example, our Investment Process at Loh-Gronager Partners (LG Partners) centres around a dynamic ~250 question investment checklist that we must run through for each current and potential investment. 250 questions may sound excessive to some and too few to others, but what it forces us to do, is to look at all aspects of a business as objectively as possible and in a particular order that we find conducive to forming an unbiased investment decision.

When we boil it down though, all these 250 questions are essentially trying to help us to answer a single question which is: **What discount to its intrinsic value is this business currently priced at?** Or to put it another way: **How cheap do we think this business is relative to what the market is saying its worth?**

Despite this first-hand experience of how deceptively simple questions can have complex answers; it seemed only natural to us that our first publication on investing should focus on answering the question that is at the core of all investing:

What makes a successful value investor?

In this Multi-Part Series (clearly it was not so simple for us to answer!), published monthly, we are going to explore the most well-known as well as the most misunderstood aspects that go into answering this age-old question.

Firstly though, we need to start with some definitions:

Successful	Success in the Investment industry is straightforward to measure and that is the cash earnt. Your net worth is your score card (whether public or private) of the investment returns that you have generated over the course of your investing lifetime. Now that is not to say that 'Net Worth' is the only measure of success, but it is the simplest for our purposes.
Value or **Value Investing*** *Note I will use these terms interchangeably	We don't think anyone has put it more succinctly than the late Charlie Munger who said: *'All investing is value investing, whereby we seek to buy an asset for less than its intrinsic value...everything else is just speculation'.*
Investing	The allocation of Capital to the markets / businesses / opportunities where it can achieve the highest return relative to the risk of permanent capital loss.

From these definitions, we can conclude that all successful investors are value investors. To be successful they must have spent their careers uncovering under-priced securities, be they: stocks, bonds, derivatives or any other type of investment, they all succeeded by buying 'value'. Now I can already hear some of our readers disagreeing with our measurement of success as Net Worth and wondering why we do not instead use reported investment returns? The main issue of comparing investment returns is that they are almost never like for like. From a returns perspective the best definition of 'successful investing' would be as the renowned debt investor Howard Marks said:

'The highest incremental return for the lowest corresponding unit of risk'.

However, risk in and of itself is an incredibly subjective subject, with entire industries formed around its measurement as regards to returns (the Fund of Funds Industry for one) and countless ratios have been devised with fancy sounding names (Sharp, Sortino, R^2 to name a few, that don't have Greek letters) to attempt to measure it. At LG Partners we define risk as the probability of permanent capital loss. This makes sense, as the best way to protect ourselves from risk or a permanent loss of ours and our investors' capital is by only buying businesses for less than their intrinsic value. Which is what our investment process and investment checklist are designed to help us to assess.

The next part of the question to address is over what time period do we measure success? I don't think anyone would argue that one years' returns (as high as they might be) are enough to judge whether an investor is exceptional or not. However, at the opposite end of the scale is it right that we can only measure an investors' true success at the end of their careers i.e. in hindsight. As a method of investing that is working exceedingly well today and has for some time, may end with a loss that wipes out all the previous gains and some! At LG Partners we measure the success of our own investments on a 5-year rolling basis and ask that our investors measure our performance along the same time frame. So, for our purposes we are going to say that 5-years of investment returns are the minimum over which success should be measured.

Destination Analysis is one of my own favourite tools when it comes to problem solving in life and in investing. For those that are less familiar with the concept, destination analysis involves starting with the answer or destination and then working backwards to solve a problem or answer a question. So, in this case to answer the question: What makes a successful value investor? We could look at the track record of the world's most successful investor and then try and reverse engineer how they had achieved their success...enter Warren Buffett.

A little-known fact about Buffett (outside of the value investing community) is that he ran his own hedge fund in the form of the 'Buffett Partnerships' from 1957 to 1968, before his take-over of Berkshire Hathaway. The results for which can be seen in the table below:

Year	Overall Results From Dow (1)	Partnership Results (2)
1957	-8.4%	10.4%
1958	38.5%	40.9%
1959	20.0%	25.9%
1960	-6.2%	22.8%
1961	22.4%	45.9%
1962	-7.6%	13.9%
1963	20.6%	38.7%
1964	18.7%	27.8%
1965	14.2%	47.2%
1966	-15.6%	20.4%
1967	19.0%	35.9%
1968	7.7%	58.8%

During its 12 years of operation the Buffett Partnerships earned a 31.6% annual return (25.3% for limited partners or after fees), with no losing years. Compared to a return of 9.1% per year for the Dow (the most widely followed index of the period). To put this into perspective a $10,000 investment in the Buffett Partnership at inception would be worth $289,734 when it was closed, versus just $32,339 for an equivalent investment in the Dow Index!

Next, we move on to Buffett's track record as the steward of Berkshire Hathway from 1965 to 2022, the results for which can be seen in the table below:

Berkshire's Performance vs. the S&P 500

Year	Annual Percentage Change: in Per-Share Market Value of Berkshire	Annual Percentage Change: in S&P 500 with Dividends Included
1965	49.5	10.0
1966	(3.4)	(11.7)
1967	13.3	30.9
1968	77.8	11.0
1969	19.4	(8.4)
1970	(4.6)	3.9
1971	80.5	14.6
1972	8.1	18.9
1973	(2.5)	(14.8)
1974	(48.7)	(26.4)
1975	2.5	37.2
1976	129.3	23.6
1977	46.8	(7.4)
1978	14.5	6.4
1979	102.5	18.2
1980	32.8	32.3
1981	31.8	(5.0)
1982	38.4	21.4
1983	69.0	22.4
1984	(2.7)	6.1
1985	93.7	31.6
1986	14.2	18.6
1987	4.6	5.1
1988	59.3	16.6
1989	84.6	31.7
1990	(23.1)	(3.1)
1991	35.6	30.5
1992	29.8	7.6
1993	38.9	10.1
1994	25.0	1.3
1995	57.4	37.6
1996	6.2	23.0
1997	34.9	33.4
1998	52.2	28.6
1999	(19.9)	21.0
2000	26.6	(9.1)
2001	6.5	(11.9)
2002	(3.8)	(22.1)
2003	15.8	28.7
2004	4.3	10.9
2005	0.8	4.9
2006	24.1	15.8
2007	28.7	5.5
2008	(31.8)	(37.0)
2009	2.7	26.5
2010	21.4	15.1
2011	(4.7)	2.1
2012	16.8	16.0
2013	32.7	32.4
2014	27.0	13.7
2015	(12.5)	1.4
2016	23.4	12.0
2017	21.9	21.8
2018	2.8	(4.4)
2019	11.0	31.5
2020	2.4	18.4
2021	29.6	28.7
2022	4.0	(18.1)
Compounded Annual Gain – 1965-2022	19.8%	9.9%
Overall Gain – 1964-2022	3,787,464%	24,708%

Note: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

Berkshire has compounded its share price by almost 20% per year, double the return of the S&P 500 Index at 9.9%. To put this into perspective a $10,000 investment in Berkshire Hathaway shares in 1965 would be worth $355,218,395 today versus $2,387,076 for an investment in the S&P 500. For any original Buffett Partnership investor that invested $10,000 at inception and rolled it into Berkshire they would have roughly $2.6 billion today!

This raises the question as to why no subsequent investor has even come close to replicating or beating Buffett's 67-year track record? Through his annual investor letters (which if you have not read them already, I suggest you stop reading my thoughts and get straight on the Berkshire Hathaway website and start!) Buffett himself suggests that it comes down to three reasons:

Group Think	Too many managers take the easy route of 'following the crowd' and through their investment policies and actions, all the funds start to look the same and therefore get roughly the same results.
Playing it Safe	Being a contrarian investor is seen as a 'risk' to most investment managers, who are more interested in their job security and a steady pay check. The idea of buying out of favour assets even at attractive prices involves too much 'career risk'.
Illogical Diversification or to use a Munger aphorism **'Deworsification'**	'Diversification is a protection against ignorance, [It] makes very little sense for those who know what they're doing.' In short, good ideas and therefore big winners in the investment space are rare and the ability to 'back-up the truck' when you find one is the only sure way to outperform.

Investing Buffett says can be summed up with the old market adage that it is 'simple, but not easy' (a term that applies equally well to the question we are trying to answer). The secret to Buffett's success as we see it is that he only invests in things that he understands (circle of competence), he thinks like the owner of a business rather than just a shareholder, he has the right temperament, he is comfortable being lonely or a contrarian in his views, he is focussed, he is passionate, he is intellectually honest as well as curious, he is patient when it comes to his investment process but at the same time decisive when it comes to the investment decision and finally he does all of the above while acting with humility. All of which we are going to explore along with the thoughts on the subject from many other exceptional investors in the publications to come, starting next month.

I trust you have enjoyed our journey together so far however, if our paths diverge from here, then as the investing legend, Charlie Munger says, 'In the investment business, all knowledge is cumulative' and in this spirit, we wish you continued success on your journey!

Yours sincerely

Ardal Loh-Gronager
Managing Partner
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