
A Defense of Value Investing

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*Every dog will have its day. Of late, it has been technology.
Tomorrow it will be something else.*

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Dear Cramer (and anyone else who vociferously agrees with his columns on value investing),

As you have indicated a predilection for getting "sick" at the mention of a non-momentum investment strategy, please don't operate heavy machinery or drive a motor vehicle shortly after reading the following.

For those readers who aren't burdened by such baggage, let me state simply that I am a value investment manager. I'm afflicted by a seemingly lifelong obsession that price is a factor in the success equation of investing. Pay a fair price for a great business, or a great price for a fair business, and you stand to do well over time. Grossly overpay for nearly anything, and you will suffer -- the tortoise vs. the hare, "margin of safety" and all that good stuff.

Preliminary Lipper numbers for 1999 show that the average large-cap value mutual fund was up something in the order of 5% and small-cap value was worse. That's a bit worse than the triple-digit return of the Nasdaq 100. And while this year has seen probably the widest discrepancy in decades between growth and value, it has been tough sledding for the past four years, which raises the following questions:

- What exactly is value anyway?
- Is a value manager who sticks to his or her guns like a suicidal moron subconsciously seeking alternative employment in the food and beverage industry?
- Is a person or institution with assets invested in a value style therefore also lacking in IQ points and, as JJC points out, in need of a 3-by-5 card on which is written, "Making money is good, losing money is bad"?
- Can every academic study that ended in 1995 or earlier concluding that value trounces growth with less risk be tossed in the trashcan?
- Is the professional investment management business so rigged now by consultants and mutual fund advisory businesses that it really is impossible to at least modify your stripes if the environment changes?

- Should a portfolio manager automatically sell every stock that is presently at a loss? Or should an investor automatically redeem every dollar from a portfolio manager who has just had a bad year?

I would like to answer most of the issues indirectly with the following diatribe.

Everyone has bad years, except, obviously, Bill Miller.

Every style has bad years.

Neither life nor investing are linear programs: As soon as someone uncovers a way to quantitatively predict the future, the method stops working. As in, where are the pooches of the Dow these days? And Garrett Van Wagoner was up how much this year, after being down how much the two years prior? Is he any smarter or dumber (we know he's richer) now than then? Should you have put money with him two years ago? Should he have abandoned his small-cap growth, pedal-to-the-metal style two years ago -- and bought Waste Management (WMI) instead? Should you have blown out of emerging market stock funds in 1998 after they were down 25% or so? If so, you would have missed the fact that they were uniformly up 60% or more in 1999.

If I'm not mistaken, Cramer himself had a rotten 1998. He has obviously picked himself up and reloaded, or he wouldn't be blasting well-known value managers. Should he have folded his tent and gone to work as a reporter for CBS Market Watch?

So, things change, often in a big way and invariably in ways that are difficult to predict. But you have to have the conviction to be there and be there in a large way when things do change.

They always do. There is nothing more deleterious to your net worth than constantly trading short-term losers for yesterday's winners. The recent success of blindly selling what hasn't worked over the past three months and buying what has worked *is* a recipe for disaster and a dream-come-true for the brokerage community even at \$6 per trade.

Now in all fairness to Cramer, in some cases it can be true that stubbornness is another form of stupidity, and simply clinging to a mechanistic formula of buying anything with a low price-to-earnings ratio or price-to-book ratio is not "sticking to your guns" as a value manager. It's a mechanistic formula that has a tendency to fail like any other mechanistic formula. If your only tool is a hammer, all stocks start looking like nails.

Value-oriented management as practiced here starts with two premises. For every cheap stock we see, we ask what is wrong (but not obvious) with this picture that makes this security appear to be very inexpensive. And how bad will it be if I'm wrong?

Correctly identified, a stock's intrinsic value is like a big fat lighthouse that I can point to when the short run goes against me. What the heck are investors in Value America (VUSA) holding on to?

Of course, one of the big curses that afflicts value managers is being early. Having a portfolio of ideas where a few mature every 12 to 24 months is a plausible investment scenario in any market, save that of the past few years. But four years of waiting can hurt.

Another curse of many value managers has been size, something that our brethren in growth should take notice of. When you run \$10 billion in a value discipline, you become that sector of the market. If the sector does poorly, you do poorly. But sticking to your knitting is not stupid, and it's not gutless to tell that to a consultant or an investor.

As for the manager Cramer quoted as confessing, "We rode these value stocks all the way down ... I wanted to tell these clients to invest elsewhere" -- that manager should be fired. He obviously does not believe in what he is doing and sounds exactly like the guy who will make the top in Microsoft (MSFT) by buying it to "save" his job.

There is a reason for diversification for most investors. It is folly to expect that you, as the resident genius, will pick the best-performing stocks and sector *every year* and simply put all your eggs in that basket at the beginning of each year. That's why it still makes sense for nearly anyone to have some growth, some value, some small and some international. It's your answer to the question, "What if you're wrong?"

While I like to think I would take this kind of nonsense head-on no matter how I was doing, it certainly helps to have had a pretty good year with performance in our three specialties: mid- to large-cap value, small-cap value and all-cap value nearly at or well above 20% (plug over, thank you). It is not impossible to generate

very healthy capital appreciation and at the same time avoid a lot of nonsense.

We stay focused so a handful of stocks can generate meaningful performance; we run a handful of different screens and valuation models so we do not get trapped with one hammer and no, we don't do IPOs or "closet indexing." And that's my response to the *TSC* subscriber who was kind enough to send me the following email after my top 10 column last week:

"I am a first-time visitor of your column and now I understand why I haven't read you before. Your top 10 picks make a sloth's movements seem like a cheetah. I think molasses is more fluid than your picks. Sure, if I was a multimillionaire I could manage to live with and accept a whopping 20%-25% a year, but I'm not and I would like to double my money within the next 100 years. Start getting on the bandwagon. In about seven to eight years when this bull market is over, I'll start looking at those world-changing insurance companies. Go Albertson's (ABS)."

That's one I'll save, for right about this time next year.