Curtis Jensen

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Curtis Jensen is a Portfolio Manager at Robotti & Company. Curtis spoke with the editors of the Ben Graham Centre's Newsletter about his experience being a value investor.

Could you share with us your journey to becoming a value investor? How did you initially develop and act upon your interest in the industry?

Oddly enough, I think I was a value investor before I knew what the term meant. I had a work colleague back in the 1980s, his name was Andy, and one day I said to him, what do you do with your money? I had started to think about saving a little bit of money. He said, there're these guys named Michael Price and Mario Gabelli and basically what they do is, they try to buy stuff for less than what it's worth. Well, that sounds good to me! I bought some of their mutual funds at that point. Roll forward 10 years, I'm at Yale Business School, I meet this Professor Marty Whitman and it was serendipity.

> "I think I was a value investor before I knew what the term meant"

I thought about doing a joint degree with the forestry school, go into environmental studies and do something good for the world. But that changed during the second semester of my second year. I was trying to maximize the value of my education, so I decided to take an extra class. A friend steered me toward Marty and I ended up in his class. What he was teaching really resonated with me. I discovered that I loved doing research and it showed in my work product. He brought me in for an interview and I stayed for 20 years - so it was serendipity, luck and passion! I didn't set out on this path, in other words.

You began in small cap, became a CIO, and now invest with Robotti – could you summarize and contrast your learnings as an investor from each experience?

I began working with Marty at Third Avenue. At the time we had one fund and we were having a good experience with our small caps within that portfolio. So, we had clients asking, why don't you just start a small cap strategy that's specific to small caps? We did that, launched it and Marty and I were co-managing it to begin with. I think small caps are super interesting. There's a lot of inefficiency and neglect. It's a wonderful place to go hunting for new ideas. The other thing about small cap investing is that you really have two ways to win. One is public market appreciation. But in the case where the public markets aren't recognizing the value, a lot of times you can get the private markets to come in and realize value for you. Not true if you own Amazon or Microsoft or Apple, there's not going to be a takeover you are solely dependent on public markets. But with a lot of small and mid-cap names, over the course of time, you do tend to get a lot of takeovers. While small caps are a fertile hunting ground, I also didn't like being pigeonholed in a sector fund where valuations can be cyclical. I went to management in 2005, 2006 when small caps were really peaking and I said that I was out of capacity, I had no ideas, things are overvalued and I wanted to close the fund. They said, no way, we're keeping it open. What followed was a difficult period. So, they forced me to stretch my discipline a little bit at some point and I vowed that, if I were to do this in another phase, I would want it to be unconstrained. That was the downside of having a focused area like that.

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Later on, as CIO of the firm, I was pulled in a lot of different directions. I had to wear a lot of different hats. I was in charge of many processes and people, managing around 25-30 research analysts at one point and had to do the performance reviews, which were a prickly exercise. I was also the public face of the firm in terms of marketing and it took me away from my true love, which was investing. So I was bound and determined at some point to do my own thing and have an unconstrained and flexible mandate, and really focus on investing.

Throughout your career, were there any investors you looked to emulate or saw as role models?

I've come across a lot of characters. I have to first mention Marty with whom I spent 20 years. He wasn't a natural teacher I would say, a lot of it was absorbing and watching what he did. One of the things I learned and admired most about him was that he was probably the most fiercely independent thinker I've ever met in my life, to the point where he could almost be considered antisocial. He was not an easy personality, but I really admired that and I believe that's what it takes - you really have to be willing to stand out there on your own.

Then, of course, there are people like Warren Buffett, with principles and ideas about human behavior and executive behavior and all of those things… and people like Jean-Marie Eveillard, who is no longer managing client money… but very principled people. There are a multitude of smaller, off the run, names that have piqued my interest. In the last year, I came across a firm called Edelweiss Holdings, who are headquartered in Switzerland, essentially a very private company but you read their principles and it really resonates with me. Lastly, it's also about some of the companies I've been invested in and their leadership. I'm thinking about people like John Elkann at Exor for example, who have turned out to be wonderful capital allocators. And so, those are the kinds of people I look at as role models.

I chose to work with Bob Robotti because of his integrity, patience and passion for investing – three key qualities.

We've heard Stanley Druckenmiller famously talk about how the market environment, when you first start your career, impacts your thinking permanently – how do you think your first few years in the industry have impacted how you view markets today?

I really got going in the mid-nineties when there was always some sort of crisis going on. One of the interview questions Marty asked me, this was in 1994, was about the Mexican peso crisis. I had no idea other than what I had read in the newspaper, I believe they were calling it the tequila crisis. But Marty was asking me these big macro questions. In 1997/1998, we had the Asian Financial Crisis and the Russian ruble had imploded and there were all these macro eruptions going on. The big thing in the late 90s, when I was getting going was, of course, the tech/telecom boom. One of our mottos was, "buying what's popular when it's popular is a recipe for disaster". There was this idea that capital was cheap and abundant, it really led to a lot of dumb deals and a lot of bad investments. I watched that environment as it ebbed and flowed and I do see parallels to today's environment in some ways.

This is especially true when you think about companies, back in the late 90s, who don't exist today. But, there were elements of reality in some of those companies. For example, there was a company called Webvan. A friend of mine left a 20 year career at Procter & Gamble to go work for Webvan. It was this idea about delivering groceries to people's homes. Of course, that didn't go 20 years ago, but today it exists, right? CMGI was another name that was basically Google before Google existed. It was this portfolio of internet investments, they had a search engine and a Web portal. In other words, back in the late 90s, there were crazy valuations, but elements of reality and utility underlying many of these businesses.

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There was also a sub segment of businesses that were, what I call, cocktail napkin businesses with no revenue or employees, just ideas that somehow got funding. Of course, when the funding dried up, they disappeared. There were fiber optic networks, massive building of fiber, to the point where there was a surplus of fiber optic supply, if you can imagine that, and capital available to do it. And sure enough, people took advantage of that. So, I think that whole idea of capital flows and the abundance of cheap capital, and all of those things were probably the biggest imprint early on in my career.

At MOI Global in 2020, you listed five ways to find ideas – industry structural change, corporate action, industry food chain analysis, peer network, and internal library. Where have your best ideas come from, and how do you see this approach evolving in the future?

I can't pinpoint any one of those areas to my best ideas. I think, oddly, my best ideas have always been the simplest ones. You hear these stories about Warren Buffett, he has a 20 minute phone call with the CEO and he makes a decision to buy a $10 billion company. It seems impossible, but some of my best investments were the simplest sort of setup, It's almost embarrassing. And I would say that in almost all cases, my best investments involved an element of luck. There's no question that luck plays a role in many outcomes in life generally and in investing.

Thinking back to the beginning of the pandemic, in March and April of 2020, it was pretty easy to tell that there was a panic going on. I ended up buying Morgan Stanley and there were two things going on there. One being that they had announced the acquisition of E-Trade. So the stock had already gotten knocked down, then, the pandemic hit. It was a capital markets sensitive company, so the stock really got creamed. I looked at it and said, well, it's trading at 70 percent of book value, it has a mid-teens sort of ROE, it just bought E-Trade, so it's likely that the earning power of the business is not only going to be more stable, but it's going to be higher.

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There are a lot of good things about the E-Trade acquisition. The company was over capitalized, so it checked the balance sheet box. I then went in and talked to the people I knew at Morgan Stanley, I said, "What do you think? How are you thinking about the world?", and it was almost like I made the decision very, very quickly. I called my largest investor and I explained to him that I don't have a 20 page analysis of why I bought Morgan Stanley. In the investment management world, it's sort of expected that you're the smart person. There's this tendency to try to make things more complicated to give the appearance that you're smarter than your client and you really want to sound brilliant. So sure, you can write a detailed 20 page analysis, but as I said, my best ideas have been the simplest ones. And when they get more and more complex, the longer it takes to explain it, I think the more likely you are to get in trouble.

With your third R being the realization of value, you have referenced an intentional bias towards companies with a founder, a

significant shareholder, a group of shareholders, a family involved, or where management has evidenced an evident owner-operator mentality. Could you explain how you came to focus on this aspect of investing?

I think there was some influence going back to Third Avenue, but over time, I have just gravitated to this idea that, and I believe there's academic literature supporting this, that there is a tendency for these kinds of firms to outperform. And when I say these kinds of firms, firms that have a family involved or an entrepreneur or a controlling shareholder. I think what it brings is a focus on the long term health of the business and they invest accordingly. They're not thinking about quarterly results, they're thinking about multi-generational wealth creation, and what that also means is that they tend to finance themselves more conservatively.

Marty had this expression that said he was willing to sacrifice an element of ROE for an element of safety and I think I'm in that camp. I'm not trying to maximize my returns as much as I am focused on resilience, durability and those qualities that go with family control or that type of set up where there is a large shareholder who is focused on the long term needs of the business. One of the things I really focus on is being able to sleep at night and that type of a setup is very comforting for me.

Could you summarize and highlight your approach to identify, evaluate, and address unsystematic risk throughout your investment process?

I think it's important to always put an adjective in front of the word risk. There is no generic risk. If you're talking about a business, such as an airline, it could be commodity risk, it could be labor risk or it could be terrorism risk. There's a whole slew of risks that need to be identified when you're thinking about an airline. The risk management process starts on the front end with security selection, so it includes looking at the characteristics of the business, the balance sheet and whether the balance sheet is appropriate for that type of business.

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Of course it includes valuation, and that's building in more protection for yourself, looking at management's track record and what their incentives are - all of those things go into the assessment of the risk of an individual security. I've often said that I'm seeking out idiosyncratic risk. I think that's what stock selection is about to some degree. I don't really try and hedge it, but in a portfolio context, I do consider cross correlations and how two businesses might relate. For example, if you owned an airline stock and a hotel stock before the pandemic, you might think these are two different businesses, but essentially they're going to be subject to the same forces when travel dries up. Or in my case, I own two companies that currently have P&C reinsurance businesses embedded inside of them. Do they have any of the same exposures?

In 2006 and 2007, right before the housing bubble burst, our research team was finding all kinds of cheap stocks - housing related, building materials and furniture companies. It would have been easy to convince ourselves that all of these things were individually really interesting, but if you aggregated them together in a portfolio, potentially, you've done a lot of damage when the housing bubble burst. So, there was that individual security risk so-called selection piece, and then take a step back and say, what's happening in the portfolio more broadly?

We found your quote "I invest from the bottom up but worry from the top down" especially interesting. We interpreted that as choosing fundamentally strong businesses without excessively considering macro and hedging them within the portfolio afterwards. Could you walk us through how that plays out when you're allocating your portfolio?

It's a little bit informed by my experience in the global financial crisis where we, as a team, were 100 percent focused on company fundamentals and ignored a lot of the macro noise. We even had conversations with people who were aware of the dangers in structured finance elements of the housing crisis, in the subprime crisis and we sort of ignored it. From that point on, I think I learned a lesson to pay attention to the macro environment. If you were sailing a ship, 90 percent of your energy is focused on what's happening on the boat itself. But occasionally it pays to look up at the horizon and pay attention to the weather and the sea. So I think there is a balance today.

I think we are in an unusual environment, both in terms of broad market valuations, as well as, you've had massively interventionist central banks stimulating the global economy for 10 years. I don't know if the chickens are coming home to roost, but I think a lot of central bankers are realizing they're in uncharted waters.

I've always held a bit of cash in my portfolio. I like the idea of having dry powder for when the market gets dislocated or I find an opportunity. I've even started a little bit of a gold bucket within my portfolio - I look at that as part insurance and part investment. Other than that, I don't have any other macro hedges or anything like that.

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How do you approach sizing positions when your past interviews have highlighted this as a significant bucket where investors lose money?

I think sizing is a challenge and another place where I have evolved. It's really hard to know which is your best position. I used to think it was my cheapest stock, but sometimes the cheap stock will take years and years to work out, so all of a sudden it's not such a great investment and your investors are wondering why you're on this thing that doesn't go anywhere. In an ideal world, I would own 10 to 12 stocks, they'd all be equally weighted and I'd have the same conviction level about each of them, but that's not reality. If my max position size is a starting point, generally around 10 percent cost or market, and I look at it both ways and I haven't come across ideas where I'm comfortable going above 10 percent… I automatically re underwrite when something hits 10 percent. I'm essentially a one man band, so I don't see myself having more than 15 to 20 stocks, although I have a little bit more than that right now. I realize I have limited bandwidth and there's an element of return on energy that I consider when I'm making an investment, as well, so, I generally will size things around 5 to 10 percent. The waiting has to do with all of the fundamentals, plus, my own sense of conviction and knowledge of the business. So, for example, one of my top holdings, I feel like I know it extremely well, but don't know other things as well and that's partly reflected in the position size. I've also been bitten by positions that I think are small and they end up declining a lot and doing a lot of damage to performance.

Once you have entered a certain position, how often do you revisit the thesis and reevaluate whether it still holds true?

I go into things with this permanent hold mindset, but I realize that strange things happen and sometimes, the reason for owning a company changes and then the facts on the ground change. I think I'm entitled to change my opinion about it and change the position, whether it means resizing it or eliminating it altogether. There's a convention in the U.S. which is different than overseas - a lot of European companies report twice a year, but in the U.S., the convention is to report quarterly. So I'm always checking in on quarterly results. I try not to hyperventilate whether they're good or bad and really try to keep a long term focus on the business. If there's a corporate action, in other words, if there's a major acquisition or merger, divestiture or something of that nature, that usually commands my attention. I'm checking in periodically. I'm always doing work in the background on either a company or in the subject company's universe, whether it's a competitor, a supplier or a company that's related to the company that I own. That is ongoing. I also have some rules around if there's a large stock move. I automatically re underwrite something when it hits a three year vintage in the portfolio. My experience has been that a lot of value in my investments has been realized by year three and if it hasn't come within the first three years, I have to question why.

So I automatically do a re-underwriting as objectively as possible at three years, no matter what. And then, if the stock is down 20 percent from my cost, I also automatically re underwrite it. I don't necessarily sell it right away, in fact, I made the mistake of selling things without really doing a hard underwriting, and so, I don't have too many hard and fast rules but those are a few in terms of position sizes. I think fiddling with position sizes is usually a bad idea. It brings cost in the portfolio in terms of transacting and usually, I found if I want to sell a little bit, I should just sell the whole thing because my first sell is almost always my best. I do trim as a means of keeping positions within that five to 10 percent of what I consider a core holding. For example, if something runs up, I've had stocks go straight up for no apparent reason and I've trimmed it based on what I think is irrational market moves, but that's pretty rare.

Could you share with us how you now try to discern between management teams that just say all the right things, and management teams that you trust to do all the right things?

I've been fooled by management. There are two things that happen; One is, if you own a company long enough and you get to know the management team, there's a risk of losing objectivity - I've had CEOs sending me Christmas cards and it's like, OK, I'm losing sight of things here; In other times, management teams are just really good at selling. I've had bad results when I've trusted management too much, so I tend to prefer to look for what I call the footprints in the sand, which is management's actions. What have they actually done in the past? How have they allocated capital? You can look in the public record in the filings and see. Look at their acquisitions. How have they financed those acquisitions? What kind of incentives are in place inside the organization? I would encourage you to, if you're talking to people inside of a business, find out what the culture is like and what kind of incentives and what behaviors are driving the organization. You can look at a proxy statement and see what are management's incentives, how much stock do they own and how are they incentivized.

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Everyone says it's so important to meet with management. I think it's much more important, there's an awful lot in the public record you can look at to see what they've actually done. When their actions and their talk actually are aligned, you can feel pretty comfortable. I've tended to not like, there are a lot of CEOs who are very promotional. A lot of times, it's evidenced by a more levered balance sheet. They tend to be these swashbuckling characters, and even highly pedigreed executives, there's a whole list of people who have extremely impressive backgrounds but who have evidenced extremely bad behavior and poor results. So I put a much greater weight on what managements have actually done and their actions. As I put it, the footprints in the sand as opposed to what they say.

> “ Businesses don't go in a straight line… change often takes longer than Wall Street might assume ”

In the past, you were a business owner – how do you think this operational experience has impacted your investment

strategy over 20 years later? Has it shaped the way you evaluate management?

I was involved in a small food manufacturing and distributor, and it really was a great business education. It was many forces at work. First, we were a small vendor to large customers. All our suppliers were bigger than us and our product had a lot of substitutes. And so, we weren't really that important to our customers. The upshot of all of that is that we'd get squeezed and really learned what the term cash flow means. That issue became very real for us. We had a small payroll, but we still had to pay people, our suppliers and there were many, many times when my partner and I had to forgo a paycheck to do so. I think that idea of what actually is cash flow is pretty eye opening.

The second piece would be that businesses don't go in a straight line. It's not a linear type of thing. There are human beings involved, and change often takes longer than Wall Street might assume. I think Wall Street, a lot of times, has this idea that business is going to be a smooth line and the stock is supposed to go up in a straight line. The reality is totally different. Ask any CFO or I.T. person about their SAP implementation in a large company and they'll moan and groan and two years later, you can ask them the same question and they'll still be talking about it. So these things that we think take a couple of quarters, no, it takes time. It's hard to change business and make it move. And that's wonderful too for stock pickers because, sometimes, the stock prices move around so much more than intrinsic value. Wall Street has a certain set of expectations and you can use that to your advantage. So, it's those two key ideas - appreciating the value of cash flow and what it really means, and the idea that business development takes time and is not linear.

How do you think about the current high-inflation environment in the context of value investing and in making portfolio management decisions?

I certainly don't have a forecast about where inflation is going to be. We have an internal debate about whether it's going to be moving up, or moving down from here. I tend to look at it at the micro level within the individual companies. Trying to get a sense of inflationary impacts on the cost side of the business, whether it's labor or materials. If you told me that inflation was going to be three and a half percent next year, I don't know how it would impact my investments and I would continue with the same thinking. I tend to focus on the micro specific to the business, inflation – it could be supply chain, labor or input costs - seems to be an issue at just about every company that I come across these days.

We've seen a lot of irrationality in markets over the past few quarters – as a long-term value investor, how do you shut out the noise to maintain your core focus while also considering potentially capitalizing on some of the opportunity that irrationality gives way for?

You've hit on a great topic and that is focus. It's not just the irrationality of the markets, it's my own irrationality too. I could have 10 things on my desk and I don't know which one is the priority I try to give myself a little bit of a roadmap each day. Not necessarily a to-do list, but at least a few things that I know I want to try and attend to, to keep me away from those distractions. The list is never perfect nor does it all get done, whatever, but it helps me to organize my mind a little bit and keep me away from the distractions.

I think the best way to not be worried about the market, is to prepare. What I'm referring to is having your inventory of ideas worked on and have enough conviction so that, when markets present you with an opportunity, you can execute on it with confidence and not sit there second guessing yourself.

As an increasingly large pool of capital is expected to move into the "responsible and sustainable investing" space, how do you think about ESG factors as they tie into both risk and opportunity in the changing market landscape?

It's really interesting. Essentially, ESG is another overlay for institutions and it's another filter that will probably eliminate and drive capital away from a slew of industries. It's showing up right now in things like oil and gas and coal, those are the obvious ones. I think as institutions come under more scrutiny and the boards and trustees of these places start looking at the managers, the managers are going to have to start looking even at finer filters. It could be things like tobacco, gambling or certain kinds of pharmaceuticals. There was an opportunity there because I think this is the flip side of what I was talking about with the tech telecom bubble and when there was so much capital coming into those startups. Today you have what I refer to as capital flight, which is money leaving certain industries, oil and gas and coal and carbon-based businesses, even some peripheral companies that are in the chemicals business, for example.

So I think it certainly presents an opportunity, depending on if you're constrained within your own mandate and how you have to tie those things in. We could have a whole afternoon talking about oil and gas. In my own investing, I use what I refer to as the corporate hexagon, which considers the chief constituents that I see in a business, including the employees, suppliers, customers and shareholders, also government regulators and the communities that the companies are operating in. It's not a hard and fast rule for me, but I try and have some perspective that includes all of that. So, I end up staying away from certain kinds of businesses and part of that is because I think there is some evidence that companies that are doing good, also tend to do well financially.

During a 2019 interview about the tug of war between so-called "value" investing and "growth" investing, you said that "value and growth are tied at the hip; there is no value without growth." Since that interview two years ago, has the landscape shifted and do you see a shift away from growth equities in the future?

I think there's two pieces here. One is, with an individual security analysis, I try to straddle both value and growth. I call it rational investing. This idea that there's an overlap between value elements, which I look at as risk averse margin of safety elements, and growth, which is, you've got to be cognizant of underlying growth in the business. If you think about this as a Venn diagram, there's an overlap of those two circles. Where they overlap is what I'm trying to do, which I call rational. The second part is, will there be a big shift from growth strategies to value strategies? It's hard for me to predict. I came into Robotti in 2016 and I was convinced that the pendulum had swung way too far in favor of growth. That was more than five years ago and I've been wrong since then, but it feels like the pendulum is starting to swing back in favor of valuation-conscious strategies, now that capital is no longer free as it has been for 10 plus years. As a "rational value investor", I want to believe that the convergence of economic value and market prices are starting to align and therefore capital will go toward those kinds of strategies. Time will tell.

Is there any advice you could leave us with that's really helped you along your journey, that you think would be really helpful for young investors?

Keep an open mind. Don't be too dogmatic. That doesn't mean don't be an independent thinker, just try to read an awful lot. Talk to people and do as much learning as you can, I think one of the wonderful things about my journey in this career is that the learning has been nonstop. I feel really blessed for that. I don't think there's any endpoint to learning. And so, I try to stay humble and curious and I think those things will keep me open to learning.