Dr. George Athanassakos

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Dr. George Athanassakos was interviewed by
Rob Carrick of the Globe and Mail
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RC: Can you explain how value investing is like bargain hunting in the stock market … buying $1 for 50 cents?

GA: Value investing is a particular style of investing developed by Ben Graham at Columbia University in the 30's, where by value investors try to find and buy stocks on sale. And as you mentioned, the typical lay person's definition is that value investors wish to buy stocks that are worth $1 for 50 cents. The big question is how they go about finding stocks that are on sale. They follow three steps in doing this. In the first step they screen stocks based on a number of metrics such as P/E, P/BV etc and in doing this they are looking for potentially undervalued stocks. Stocks with low P/E or P/BV are stocks for which the markets are very pessimistic about growth opportunities in the future. That is why the price is very low compared to the level of earnings or book value of equity. Value investors feel that stocks with such over pessimism could be potentially undervalued, as people do to not normally like these stocks. But like I said, these are possibly undervalued, this is because a company can have a low P/E because it is really a bad company and it deserves to have a low price and it is not actually undervalued. This is where the second step, that of valuation, comes in. Once we narrow down our sample to include only those stocks that are potentially undervalued stocks, then we are spending time to value them in depth and find what their true values are and compare them to the market price. At this step, we determine which the good stocks are and which are the bad stocks from the group of potentially undervalued stocks. Finally, the last step involves making investment decisions using the concept of margin of safety. We will not buy a stock unless its price is 30-50% below its true value. That is, now we are buying the stocks that the market values for 50 cents, when they are actually worth $1.

RC: What are the benefits of investing in stocks no one seems to like?

GA: Stocks that no one seems to like are stocks that are more likely to be undervalued as investors both individuals and institutional herd. If they do not like a stock they all get out at the same time, same as when they like a stock they all get aboard at the same time. Such behavior tends to bid stocks down and many times excessively. In the long run, markets get things right most of the time but in the short run they make tremendous mistakes. We want to look for these stocks and see which ones the herd has pushed way below their true value. Similarly, we like to invest in smaller stocks and less followed stocks as they tend to be under the radar, not discovered yet and may be truly undervalued. This of course will be determined by our second and third steps referred to above. Valuation is the most challenging step. In the courses and seminars I give, I spend 90% of the time explaining the valuation process we follow as value investors. I want to stress, however, that you do not want to invest in all stocks that people do not like. Again stocks that people do not like may pass the first step of indentifying potentially undervalued stocks but they may not be on sale. But we need to value them to make an investment decision, given a margin of safety. I believe there is a big confusion out there about what value investing is all about. Value investors do not blindly invest in unloved, low P/E stocks. It is more than that. The problem has emanated from academics who, not knowing what stocks value investors actually buy, they look only at the first step of screening for potentially undervalued stocks. Academics know that the low P/E stocks are the group of stocks from which value investors find stocks to invest in and so they call them value stocks. And the high P/E stocks are the group of stocks which value investors tend to avoid, and so academics call them growth stocks. What academics then actually examine are not value stocks, but potentially value stocks.

RC: What are the long term results of value investing compared to the broader stock market and to growth investing?

GA: There are many academic studies looking at the value (low P/E) vs. growth (high P/E) stock returns of the first step around the globe. I have also carried out studies both in US and Canada and in Australia on the performance of potentially undervalued vs. potentially overvalued stocks. And we all agree that in this naïve first step value beats growth. The magnitude depends on the market and particular period studied, but the numbers depending on the period and markets vary between 6% and 14%. In addition to that I have also looked at performance during recessions and bear markets and also in these bad periods value beats growth. Others have looked at performance during good and bad earnings announcements and still value (low P/E) beats growth (high P/E). I have recently carried out the first study to look at all steps that value investors follow to find stocks to invest in from 1985-2007. Here too, I find that value beats growth in the first step. More importantly, stocks actually chosen to invest in following the second and third steps of stock valuation and selection had absolute returns of 15.3% in 1985-1998 and 47.7% in 1999-2007. This is well above the market portfolio and a growth strategy. A growth strategy for example would have produced a return of 11.8% in the first period and 17.9% in the second period. The market return was about 10-11% in both periods.

RC: What in your opinion has made the returns from value funds so poor the past two years?

GA: Value (low P/E) stocks did not perform as well the last 2 years, but neither did growth (high P/E) stocks and the markets. It is important to understand that value does not beat growth every year; it is on average the value beats growth. For example in 1 out of 3 years growth beats value. But we were very spoiled with the performance of value stocks especially over the 1999-2007 periods that the last 2 year performance surprised us. One reason, I believe, for value stocks doing poorly the last couple of years (to March 2009, as they have done extremely well since the March bottom to date) is related to the fact that value stocks tend to be smaller and less liquid stocks and these are the stocks that were really hurt by the liquidity and credit crisis of the last couple of years. When you have smaller, less liquid stock and people panic and want out one has to sacrifice price a lot to get out and so the results. I would like to point out, however, that the truly undervalued stocks passing my 2nd and 3rd steps referred to earlier outperformed. In the extension of my study to include the last two years, preliminary results show that we could hardly find any undervalued stocks and the only one we found undervalued, while it also fell (by 10%), its decline was much lower than those of the market and the growth stocks.

RC: How much patience do investors need if they want to own value funds and stocks?

GA: Markets go up and down over time around the true intrinsic value of stocks. Prices eventually gravitate towards intrinsic value in the long run. We do not know exactly how long it takes for the market price to converge to intrinsic value. Value investors tend to be patient investors and their time horizon is 3-5 years. They say if the markets do not realize the value in this period, then either we have made mistake or markets may never realize the value. So they sell even at a loss in this case.

RC: What is the outlook for value as the markets and the economy improve… is it time to buy?

GA: From my study entitled "Do value investors add value" and I referred to it earlier, value stocks, especially the truly undervalued stocks, while they did well both in 1985-1999 and in 1999-2007, they did extremely well in 1999-2007. One reason is that over the latter period there was much more volatility, and volatility is value investor's best friend. If we assume that there will be volatile markets in the near future then it is natural to expect that value stocks will do extremely well, on average. Over the last 6 months some of the best performers were value stocks. In April, I had students look at a number of value (low P/E) stocks such as Linamar, Dorel, Churchill, Glentel and so on,. Which were also found to be truly undervalued; all of these stocks have appreciated by 100%+ over the last few months.

RC: Who are the true smart value investors in the US and Canada?

GA: First of all let's ask what makes of a good value investor - it is discipline, patience, strength of character, control of emotions, humility, and a keen understanding of human psychology and institutional biases. Value investors who possess such characteristics in the US are, Warren Buffett, who is the most visible, but also others who prefer to keep low profile, such as Walter Schloss, Irving Kahn, Seth Klarman, Masson Hawkings, Martin Whitman, Charles Brandes and others. In Canada, we also have had a number of great value investors, like Peter Cundill, Prem Watsa, Richard Rooney, Bob Tattersall, and the next generation of Francis Chou, Irving Michael and up and coming younger ones that no many have heard of yet, such as Jeff Stacey of Staceymuirhead of Waterloo. Your readers can visit my web site bengrahaminvesting.ca (under Burgundy Resource Centre) to see the speeches to my value investing classes at Ivey over the years of all those value investors who in my opinion possess these characteristics and see for themselves the character and the personality of these investors.