THE UNIVERSITY OF AUCKLAND INVESTMENT CLUB

BULLETIN AUGUST 2015

UAIC BULLETIN
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EDITORIAL

UAIC Bulletin Issue One 2015

Welcome to the first issue of the "University of Auckland Investment Club Bulletin" for the 2015- 16 season. My name is Shyamal Maharaj, for six years I have studied Accounting, Economics and Finance and as your Editor my goal is to bring you exciting page turners and compelling articles. To do this we are taking a refreshing approach to become the Bulletin our readers deserve. With a team of four writers we are all committed to giving you the knowledge and insight into the reality of investing, value and finance.

Issue One focuses on understanding the basics of value investing principles and progressively applying value investing principles to the spectrum of investment alternatives available in the world today.

Anthony: An introduction to value investing tailored towards new members of the Club. The article explains what value investing is and the major principles behind the strategy.

Angus: A sceptical examination of the current popularity of the technology industry as an area of investment, drawing comparisons to the fabled dotcom bubble of 15 years ago.

Bruno: An investigation into the benefits of index funds and ETFs, and an analysis of their relative merits when compared to more traditional value investing methods.

Benjamin: Last semester a group of UAIC members were fortunate enough to participate in a phone call with Dr. George Athanassakos the chair of the Ben Graham Centre for Value Investing. Dr. Athanassakos spoke about the value investing course offered at the centre, lessons he has gleaned from investing greats including Irving Kahn and Walter Schloss and the qualities which help make a successful investor.

Logan: An analytical narrative on short-term gains compared with long-term returns. The advantage of looking toward the long-term effect of volatility smoothing as empirically evident in most equities over 5+ years.

We hope you enjoy the fantastic quality of contributions to come.

THE 2015-2016 BULLETIN TEAM

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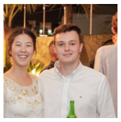

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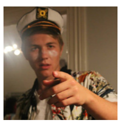

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The University of Auckland Investment Club is a student run association operating out of the University of Auckland Business School, in the Owen G. Glenn Building. Our main aim is to improve the practical financial education of our members while developing networks with other like-minded students and those within the finance industry.

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UAIC

University of Auckland Investment Club

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DR. GEORGE ATHANASSAKOS

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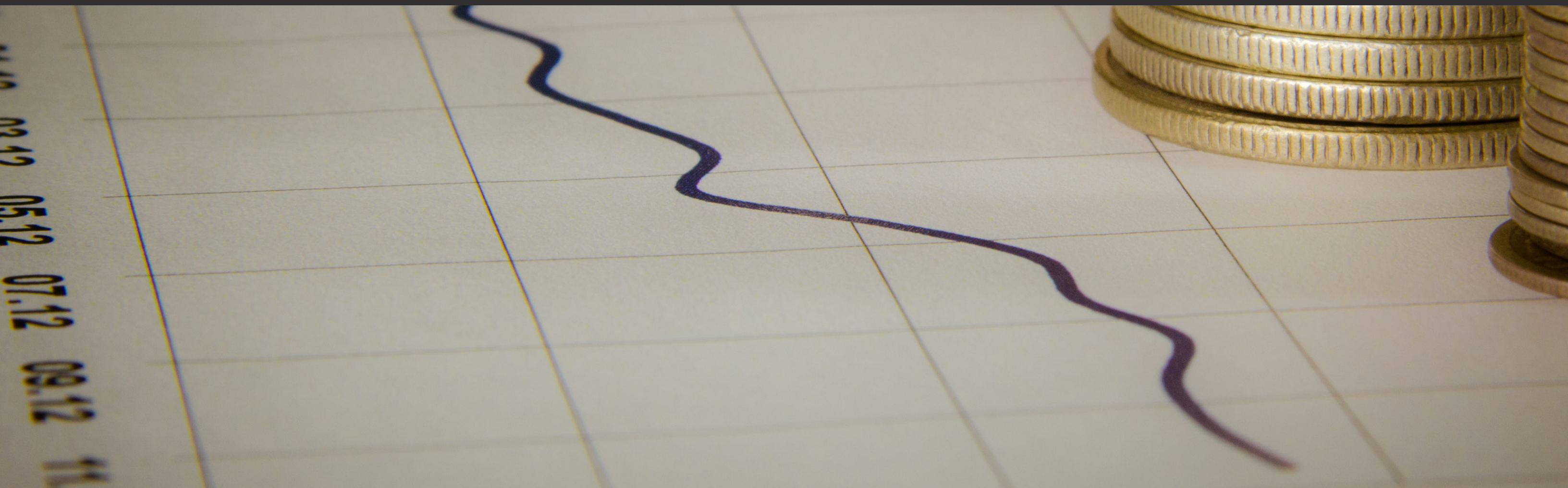
VALUE INVESTING 101

BY ANTHONY ELLIS

An introduction to value investing tailored towards new members of the Club. This article explains what value investing is and the major principles behind the strategy

> ***"Long ago, Ben Graham taught me that 'Price is what you pay; value is what you get.' Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down."***
>
> **- Warren Buffett**



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VALUE INVESTING IS THE STRATEGY OF ESTIMATING WHAT A STOCK IS WORTH AND BUYING IT FOR A LOT LESS... YOU ARE SELECTING SECURITIES WITH MARKET PRICES LOWER THAN THEIR INTRINSIC VALUE

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An investor's profile or "style" of investing is a concept shaped by many different things. Attitudes, risk and return preferences, education and personality, just to name a few. However, potentially the most influential characteristic of all is the investment strategy that one adopts.

Many financial greats such as Warren Buffett, Charlie Munger and Benjamin Graham can directly attribute their success to an investment strategy known as 'value investing'. While many of the seasoned members of UAIC will need no introduction to value investing, those who are new and eager to get involved with the Club should first gain an understanding of this fundamental strategy. Value investing is deeply embedded in the Club's foundation. It is the approach many finance magnates live by, and it is proven that, when used effectively, the strategy is one that can, and often does, produce results.

| What is Value Investing? |

Put simply, value investing is the strategy of estimating what a stock is worth (its "intrinsic value") and buying it for a lot less. In other words you are selecting securities with market prices that are lower than their "intrinsic value". It is the antithesis of short-term trading that has consumed those participating in the stock markets. Value investing goes beyond merely treating a stock as a number on a screen or a piece of paper to trade; instead a stock is part ownership of a business. This mindset is something that market participants should aspire to. It requires boldness, trust in oneself and diligence.

Value investors use quantitative and qualitative analysis of a company's fundamentals in order to derive the per-share intrinsic value. There is no universal approach to derive this figure. Value investors use a variety of fundamental principles and methods to discover and purchase undervalued stocks. If you understand the principles outlined below, you are well on your way to understanding value investing.

| The Fundamental Principles of Value Investing |

Principle 1: Efficient Markets Do Not Exist

A value investor cannot subscribe to the efficient-market hypothesis (EMH). EMH theorizes that all stocks are fairly valued in the market, as the price already reflects all publicly available information. Value investing relies on the concept that securities can be over- or undervalued. Just because market consensus is that a stock is trading at the right price does not necessarily mean that it is correctly priced.

Principle 2: Be Thorough in Your Quantitative Analysis

You need to look at all available financial data when determining a company's true intrinsic value. You can apply numerous financial techniques to data to try to estimate the intrinsic value of a company, the most common of which are present value calculations, the price-to-earnings (P/E) ratio and the price-to-book (P/B) ratio. These methods are by no

means comprehensive and definitive, and should only be a part of a value investor's toolkit, but they do provide a good starting point.

- P/E Ratio – This ratio looks at the relationship between the stock price and the company's earnings. To calculate it, simply take the share price and divide it by the company's earnings per share. The P/E ratio is essentially telling you what the market is willing to pay for the company's earnings. A high P/E ratio will usually indicate that the stock is overpriced and thus you should be looking for a stock with a relatively low P/E as this indicates either the market has little confidence in it or it has been unnoticed (i.e. undervalued).
- P/B Ratio – This ratio compares the book value per share of a given company and its market price. There are two ways to calculate the P/B ratio. Firstly, the company's market capitalization can be divided by the company's total book value (Shareholders' Equity) given on its balance sheet; or by dividing the company's current share price by its book value per share (book value/number of outstanding shares)
- Present Value of the Stock - the sum of all discounted future cash flows. In English this means the free cash flow that the company will generate in the future, discounted back to today's dollars at an appropriate rate of interest.

Principle 3: Go Beyond Ratios & Quantitative Analysis

Value investing is not as simple as calculating a few ratios and numbers. One must also apply common sense, critical thinking, personal preferences, morals, and much more when determining a stock's intrinsic value. Look outside the stock market, undertake qualitative analysis, ask questions like who are the company's competitors? How viable are their products or services? Will those products or services be viable in the future? Is the management team efficient and effective?

> *"VALUE INVESTING IS NOT AS SIMPLE AS CALCULATING A FEW RATIOS AND NUMBERS. ONE MUST ALSO APPLY COMMON SENSE, CRITICAL THINKING, PERSONAL PREFERENCE, MORALS AND MUCH MORE"*

You should only buy companies that you understand or have thoroughly researched. Warren Buffett argues that when you do not understand what you are buying, you cannot possibly be able to predict its value. Similarly, Charlie Munger will only invest in businesses within his 'circle of competence'. If you have trouble answering the questions above, then perhaps you haven't done enough research, or perhaps you just don't know the company or industry well enough, and you should move on to another company.

Principle 4: Have a Margin of Safety

Every investor's method of calculating intrinsic value is different and highly subjective. A 'margin of safety' is the difference between the intrinsic value of a stock and its market price. For example, if you buy a stock for $7 that you believe to be worth $10 you are paying for 70% of its estimated inherent value; thus your margin of safety is 30%.

This concept is important because should your estimation of intrinsic value not be correct, the margin of error acts as a safety net, limiting potential losses. For example, if it turns out that the correct value of the stock was $8.00 your margin of safety has covered your error, and still provides a $1 return.

You need to adopt a margin of safety that you are comfortable with and is reasonable. Benjamin Graham's fundamental rule was that an undervalued stock should be priced at least a third below its intrinsic value . While some may argue this may not be a valid benchmark today, the important point to note is that you need to find a position whereby you can effectively hedge any uncertainty and error on your behalf.

Principle 5: You Are Buying a Business

Don't forget you are actually buying part ownership of a company. Do not treat the stocks as mere numbers on a screen. Charlie Munger invests in businesses with no intention of selling; he thinks of buying from an ownership point of view. Ask yourself, would I really want to own this?

Principle 6: Have Patience & Learn From Your Mistakes

Value Investing is about patience. A value investor is in for the long term. You cannot expect to buy a stock and sell it a week later for double the price. Value investors will spend a lot of time waiting for the right opportunities to buy and sell. Should you fail, learn from your mistakes, and use those mistakes to further refine your investment strategy: the more you learn, the wiser your future investments will be.

| Where to From Here? |

The most readable books about stock market investing for new investors are One Up on Wall Street and Beating The Street, by Peter Lynch. These books describe various types of stock, including value stocks, and will give you things to watch out for.

If value investing appeals to you intuitively, next check out Benjamin Graham's books, which are cited by Warren Buffett as the greatest books about investing ever written. Benjamin Graham is considered as the 'father' of value investing. His books Security Analysis and The Intelligent Investor are commonly regarded as the foundation of value investing.

Also check out the investor resources on the UAIC website. There are a variety of value investing related articles that warrant a read. UAIC Website

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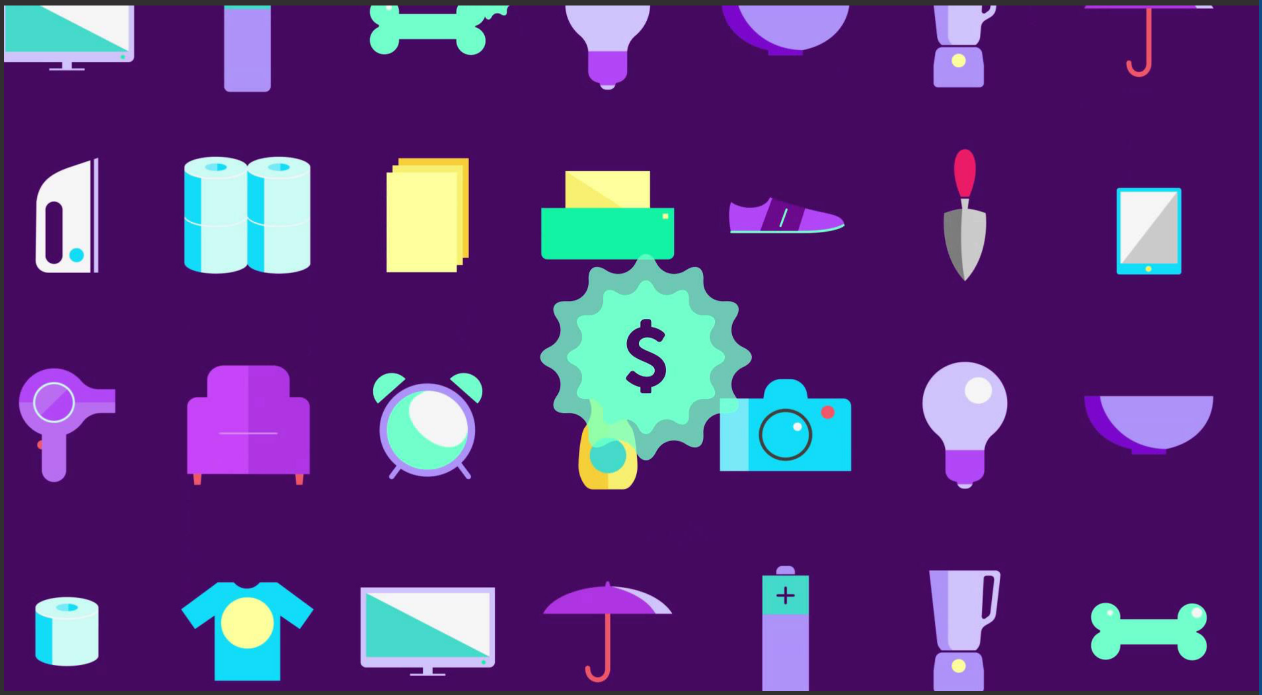
TECH-ULATION

BY ANGUS PRYDE



A sceptical examination of the current popularity of the technology industry as an area of investment, drawing comparisons to the fabled dotcom bubble of 15 years ago.

On March 10th 2000, the NASDAQ hits an all-time high of 5,132.52. Pop - a year later it trades at 1,923.38. The famed dotcom bubble and the subsequent market correction saw people rapidly grow their wealth and then lose it quicker. Crazy valuations of businesses that couldn't hope to turn a profit were rife in the market, the inadequacies of their business models rationalised by the exciting potential of the internet. Fast forward 15 years, and the situation is in some respects reminiscent. Technology companies are trading at hard to justify valuations, with investors banking big time on future growth and the potential for earnings. Speculation, or rather tech-ulation, is prevalent yet again.

Some insist that this is not an indication of another bubble – and given the lack of outright foolishness, such as the $US300 million market cap for Pets.com despite it making a loss on every sale, there is a lot to be said for this. Enter Jet.com (Jet).

Jet is the new online retailer that just launched with aspirations of challenging Amazon. How does it plan on doing this? Simple – offer lower prices. A bold strategy, particularly given Amazon's established infrastructure, strong existing relationships with merchants and economies of scale. Jet believes it has the innovative business model needed to succeed, and so too do the private investors that bank rolled the business to the tune of $225 million before it even launched. This is significantly more than the $111 million raised by Pets.com at the height of the dotcom bubble. Foolishness? Perhaps so.

The value proposition of Jet is a good one. You pay $50 a year for an annual membership and from that you have access to millions of products at unbeatable prices. A pricing innovation that helps Jet to offer consumers unprecedented value is its basket system. When a consumer adds items to their basket, Jet is able to identify the marginal costs to its supply chain and dynamically reprice the basket. Items that combine well given their geographic proximity will result in a smaller incremental increase to price compared to items that need to be sourced from different locations. Sounds pretty good from a consumer's perspective. It's from a business perspective that Jet appears to be on shaky ground.

Jet's pricing scheme is such that it makes profit solely from the $50 membership fee, with all profit made on selling the product being put back into the price so that it continues to relentlessly undercut competitors. The scale needed for such a model to be profitable is enormous - $20 billion in reve-

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TECHNOLOGY COMPANIES ARE TRADING AT HARD TO JUSTIFY VALUATIONS, WITH INVESTORS BANKING BIG TIME ON FUTURE GROWTH AND THE POTENTIAL FOR EARNINGS. SPECULATION, OR RATHER TECH-ULATION, IS PREVALENT YET AGAIN.

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nue according to Founder and CEO Marc Lore. Jet reckons it can get to this scale in 5 years, which is ambitious to say the least. Big numbers often get thrown around so it's useful to put things into context. Amazon has been in business for 28 years and has conquered the online retail space throughout the world; generating $US22 billion in revenue in its most recent quarter. This means Jet needs to become a quarter of the size of Amazon in just 5 years to become economically viable, a required acquisition of $US15 million paying customers. Until then, its cash burn baby burn.

A key issue for Jet's expansion is how it sources its products. Given its infancy, Jet does not stock all of the products it sells in either its direct warehouses or its direct merchant partners. In an effort to still deliver on its value proposition and to "bridge the gap" until it reaches scale, Jet.com is buying the goods it doesn't stock from other retailers and making a loss on the sale. These sales where Jet acts effectively delivers a concierge service currently make up a third of all Jet's current sales. In illustration of this, the Wall Street Journal bought 12 products at a price of $US275.55 but at a cost to Jet of $518.46. The losses Jet makes on sales such as these are expected to accumulate to $300 million in 5 years.

Huge expected losses need to be funded by someone and there appears to be no shortage of private investors willing to provide the necessary capital, with Jet potentially reaching a $US3 billion valuation by the end of the year. This is despite its business model being unproven and the unanswered question of whether its value proposition will be able to wrestle millions of customers away from Amazon. It's a good story though, one that many investors are believers in. CEO Marc Lore said "the amount of capital we need is a fraction of the value we'll create when we get there". But there is a big "if" surrounding whether they will ever get there, a degree of speculation that points towards the existence of another tech bubble.

Despite the parallels to the dotcom boom, the distinct difference in today's situation is that the crazy valuations are of private companies rather than public stocks. It has given rise to the birth of the "unicorn" – a label given to a tech business that has risen to a $US1 billion valuation or higher through private funding. According to Fortune.com there are just over a hundred of these mythical beasts. Some, such as Tinder, are only just beginning to implement revenue models. If there is a failure of these tech companies to become profitable and build attractive margins, eventually the capital will dry up and the businesses will be forced to shut their doors.

Some may choose to list publically, opening themselves up to market scrutiny. How does a value investor navigate this? By only paying for businesses with a sustainable competitive advantage and the ability to actually earn a profit. Given the constantly evolving nature of the tech industry these competitive advantages are few and far between, but that doesn't mean they don't exist. Just ask Google.

INSIDER

INDEX FUNDS VS VALUE INVESTING

BY BRUNO LANE

An investigation into the benefits of index funds and ETFs, and an analysis of their relative merits when compared to more traditional value investing methods.

In recent years, index funds and exchange-traded funds (ETFs) have experienced an enormous increase in prominence as investments of choice for many regular investors. This is partially illustrated by the fact that, in the period 2009-2014 in the US, $US1 trillion was invested in index funds, whereas $US363 billion found its way into actively managed mutual funds. Mainstream investing wisdom would seem to say that this phenomenon is here to stay. Even Warren Buffett and Charlie Munger, two of the world's foremost paragons of value investing, have stated that index funds are an attractive alternative for investors who don't have the skill or the inclination to pick individual stocks, and likely to perform better (after fees) than many hedge funds and mutual funds with high fees. The question that this article will ultimately consider, therefore, is to what extent these opinions hold true.

| What are index funds & ETFs? |

In contrast to mutual funds (commonly known as unit trusts or managed funds in New Zealand), which are actively managed by a portfolio manager, index funds and ETFs are run on a passive basis. As the name suggests, index funds seek to replicate an index, rather than beat it. This largely entails the investment in stocks that make up a particular index, in proportion to their relative market capitalisations (total market values) in the index. Conceptually, there is very little material difference between index funds and ETFs. The main difference is that, like all mutual funds, index funds are priced once daily, at the end of the trading day, based on the market value of the underlying securities, whereas ETFs are traded all day on an exchange, with the price being set by buyers and sellers (which means that they are easier to buy and sell rapidly). ETFs tend to closely track the performance of the index they are designed to replicate. Institutional investors can deposit baskets of the constituent stocks to create new ETF units, and vice versa. This arbitrage activity generally keeps ETF trading prices in line with underlying net asset value. In other words, index funds and ETFs are distinct instruments designed with the same conceptual underpinning.

Index funds and ETFs tend to track a particular index such as S&P 500. However, they can also provide a representative spread of stocks of a particular level of market capitalisation, from a certain industry, or even of a particular characteristic (e.g., high dividend yields). This range of options can be viewed in the variety of ETFs offered by Smartshares, which is, at present, the only provider of ETFs in New Zealand. These include ETFs which represent the top 50 stocks traded on the NZ stock exchange (NZX), the top 20 stocks on the Australian Stock Exchange (ASX), and the top 500 stocks on US stock exchanges (S&P 500). Other examples of more specialised ETFs provided by Smartshares are the NZ Mid Cap ETF, the Australian Property ETF, and the NZ Dividend ETF.

| What are the benefits of index funds & ETFs?|

Index funds and ETFs pose an intellectual headache for many investors. This is because most investors tend naturally to use the concept of 'beating the market' as a benchmark

for success. Technically index funds tend to operate on par with the market. The probability of an actively managed fund out-performing the market is relatively low. Consequently, this approach is inherently flawed. This is illustrated by the fact that in the 20-year period ending in 2013, the S&P 500 Index averaged a 9.22% return, whereas the average equity fund investor averaged a return of only 5.02 %. How could this be the case, especially for investors who have reposed confidence in proven professionals?

The first reason for this is the fees charged by mutual fund managers, which tend to be around 1% (compared with 0.2% or less for index funds). Just as importantly, mutual fund investors tend to have a higher propensity to move their money between funds than investors in index funds, and studies have proven that investors who switch funds tend to do so at the wrong time, buying high and selling low. This can be explained, in part, by the fact that the performance of a mutual fund is tied to that of the fund manager. This means that a period of bad performance by a fund, could lead to many investors questioning the managers competence and in extreme situations abandoning the fund for a better alternative. Switching between ETFs can result in transaction costs, and often, a loss will be incurred by liquidating one's position. Often this transition results in paying a premium for funds that have higher-performing returns and are comprised of stocks trading at inflated NAVs.

This means that, when push comes to shove, any investor who is achieving a return equivalent to that of the market, is in fact receiving above average returns compared to that of those not invested in ETFs. To demonstrate this, using the S&P 500 example from above, over a 10-year period somebody that has invested in an index fund ended up being 48% better off than the average mutual fund investor. It turns out that 'dumb' money (as Buffett puts it) is actually 'smart' money when deployed in this manner.

> *"IN THE PERIOD 2009-2014 IN THE US, US$1TRILLION WAS INVESTED IN INDEX FUNDS, WHEREAS US$363BILLION FOUND ITS WAY INTO ACTIVELY MANAGED MUTUAL FUNDS. MAINSTREAM INVESTING WISDOM WOULD SEEM TO SAY THAT THIS PHENOMENON IS HERE TO STAY."*

Aside from performance, there are a number of other benefits to index funds, including:

- They provide investors, who may not be savvy to the workings of business and the intricacies of evaluating stocks, with a stress-free result that has a proven and reliable track record.
- Investors that are interested in investing in foreign markets, but do not have sufficient contextual knowledge to analyse individual stocks can use index funds and ETFs as a way of benefiting from booming market conditions abroad without gambling on any given stock.
- They provide an option for investors who wish to broadly diversify their portfolio, but do not have much money to invest. Whereas it will not be viable for somebody with $10,000 to invest in 20 different stocks due to individual transaction expenses, investing any amount of money in an index fund or ETF will only result in one set of costs arising.
- For inexperienced investors, they can serve as a launch pad to future active investment decisions. The very act of investing into an index fund or ETF could prove to be a valuable educational experience for a beginner, and the ongoing investment position is likely to encourage active following of the market.

| Why invest in individual stocks at all? |

Despite the considerable benefits of investing in index funds and ETFs, there are still a host of reasons why investors should consider investing in individual stocks.

First and foremost, it is not impossible to out-perform the market. Most novice investors tend to aspire to replicate investment strategies used by the like of Buffett. As Buffett said in his 1993 Berkshire Hathaway Shareholder Letter *"if you are a know-something investor, able to understand business economics and to find five to ten sensibly-priced companies that possess important long-term competitive advantages, conventional diversification makes no sense for you".*

Simply put, for those who are prepared to invest the time into the careful application of value investment principles, can often produce a favourable result, which may not be obtained by a "know-nothing investor" risking their money in an index fund.

The individual can enjoy significant advantages over their professional counterpart(s). Whereas fund managers face huge pressures to ensure that their funds are always performing favourably (meaning they must at times take drastic steps to mitigate short term losses), individual investors can adopt a relaxed approach when it comes to the short-term, and instead rely on the intrinsic value of the business that expects to yield long-term results. Individual investors may also be able to earn superior returns by taking advantage of the knowledge and insight into an industry that they understand well. Using this insight they can buy into fast-growing companies that are often overlooked by institutional investors.

There is no denying that index funds and ETFs restrict the option to invest in lesser established stocks based on their market capitalization. Indices are inherently weighted towards established stocks that have limited scope for large gains in the foreseeable future. On the other hand, value investors are better equipped to apply their skills in order to identify stocks that they believe the market has undervalued with a greater potential for undergoing a major increase in share price at some stage in the future.

The simple reality is, the best way to learn to invest is through active participation (just as the best way to learn a language is through total immersion). As discussed, there is an educational aspect to index funds and ETFs, that serve as an effective intermediate level investment for a novice investor. Only by experiencing a full spectrum of triumphs, and more importantly failures, will investors be able to improve their investment ability by a meaningful margin.

An ideal application of Buffett's philosophy would be to invest in index funds as opposed to mutual funds that may expose novice investors to utility minimizing trade-off between risk and return. All things considered there is a learning curve when it comes to any form of investing, including value investing. Therefore, an index fund/ETF is a good place to start from a value investing perspective. If you have a genuine passion for value investing, a willingness to learn from mistakes and a good temperament the outcome should yield sustainable, preferable and substantial results.

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SHORT TERM GAINS VS LONG TERM RETURNS

BY LOGAN VAN RYNBACH

An analytical narrative on short-term gains compared with long-term returns. The advantage of looking toward the long-term effect of volatility

As humans, we naturally think short term. In a capitalist society, the idea of becoming rich quickly and providing your life with material options to make you happy is a very appealing one and so that's why people turn to equities. They are often seen as the riskiest type of investment, as they are the most volatile in terms of returns, but have the most potential upside. One reason for the volatility is because people speculate on company press releases and rumours in an emotional way. This often creates share price volatility on what might not necessarily be a big issue for a company. Companies must be dynamic because they exist in an ever-changing business environment, and so to stay competitive, they must adapt to changing market and industry conditions.

able economic events. For example, a public-listed company loses a major contract and the share price falls significantly, but the company was at full production capacity before and had to turn away business as a result. Now with the additional capacity, they can take on more business, possibly smaller contracts at a higher price due to the buyer have less buying power than the previous customer. This in turn increases revenue. Management's ability to turn negative situations into opportunities is what sets a good management team apart from the rest. In the rash of negative news speculation, some investors look to sell their shares to mitigate any losses, and this additional supply causes the share price to drop. Contrastingly, some investors buy when a company's outlook is optimistic. This, however, translates to the dreaded buy-high, sell-low mentality. The only money to be made here is by the investment banks and the stock exchange operator.

Taking advantage of negative speculation is the best way to buy into a quality company. Buy low, sell high is ultimately what makes financial gains. However there are many reasons why a long term, value investing, buy low and hold strategy is the best way to generate returns. Here are 7 reasons why long term investing is better than short-term investing/trading.

1. Brokerage Costs diminish returns

Brokerage costs in New Zealand are relatively expensive compared to the rest of the world, due to the small size of the market and limited competition. One company owns, maintains and regulates all of the securities exchanges in New Zealand. The total capitalisation of the New Zealand equities market is small in comparison to other countries, so fixed costs need to be shared across fewer trades. Also, there is lesser competition among brokers than in overseas markets such as Australia, so prices charged to customers tend to be higher. Heck, in the US, there is an app called 'Robinhood' which allows you to buy and sell shares for free. The only cost is compulsory SEC fees, which are ultra-low (1.8c per $1000 of principal and 0.12c per share) which the SEC levies on all sell transactions to offset the regulatory costs. With relatively high brokerage fees in New Zealand, a relatively large amount of capital (ideally > $3000) is required to be invested in order to make trading financially viable and increase the chances of breaking even and making a profit. The lowest brokerage fee currently in New Zealand is approximately $30 per trade, so if $3000 were invested into company A, the share price would have to rise 2% to break even on a buy and sell trade. Brokerage applies each time a part or full holding is sold or bought, and so by regularly trading, the fees add up and eat into your overall returns.

> *"TAKING ADVANTAGE OF NEGATIVE SPECULATION IS THE BEST WAY TO BUY INTO A QUALITY COMPANY. BUY-LOW, SELL HIGH IS ULTIMATELY WHAT MAKES FINANCIAL GAINS. HOWEVER THERE ARE MANY REASONS WHY A LONG TERM, VALUE INVESTING, BUY LOW AND HOLD STRATEGY IS THE BEST WAY TO GENERATE RETURNS"*

2. Compounding dividend growth

Over time, as companies' profits grow, companies may have an increase in free cash flow that they may decide to return to shareholders. Companies often try to beat their previous dividends as a sign of positive trading. As dividends increase, the percentage return on your initial investment that you receive back from the company each year will increase. Some companies offer reinvestment plans whereby you receive your dividend in shares. This means you will receive dividends on your dividends and so on. Short term traders are purely focused on capital gains and may or may not receive dividends within the time they hold a stock. This compounding dividend growth is an important long-term benefit to remember that is often forgotten about.

3. Timing the market

It is impossible to time the market. Buying at the very lowest point of a share price and selling at a record high is impossible. Like I mentioned above, if a 2% rise in share price is required to break even for a short-term investor, every percentage point below fair or relative value counts. For a long-term investor, the price-value relationship is less vital, and if the company is high quality, they may pay a premium to fair value initially and end up doing well over time.

4. Ability to do your homework before investing

Taking a long term strategy gives you more time to get a full understanding about the company and its operations in order to make an informed decision whether to invest; therefore, you are less likely to make an irrational decision and be sorry later.

5. Historical analysis of world equities

Whilst equities are the most volatile of all investments, over the long term at the macro level, they are skewed to increase. The business cycle every 6-9 years is a great way to enter the market whilst the world is in turmoil. It allows investors to purchase quality companies on their wish lists at relatively cheap prices due to the large number of short-term investors trying to sell out and mitigate their losses. People have lost vast amounts of money by selling up at prices well below what they purchased the shares for, but current stock market levels are well above the highest point in 2007, when the S&P 500 index reached 1,576.09 points on October 11. This year, on the 20st of May, the S&P 500 touched 2,134.72 points. This means that as of then, the S&P 500 was 35% above the 2007 peak. Over many decades, fluctuations in the business cycle are insignificant and so the risk that the share price of a quality company will decline below the level paid is very small.

6. Averages, the highs & lows of the market

Long term investing averages the return of the highs through boom years and lows of economic troughs, which over the long run works out to be a higher return on initial investment than if the business cycles were traded continuously.

In conclusion, long-term buy and hold strategies help to lessen the risk profile of your portfolio, and are an easy and passive way to generating returns on your life savings.

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INTERVIEW

DR. GEORGE ATHANASSAKOS

BY BENJAMIN WEDD

Dr. Athanassakos talks to us about his value investing course offered at the Benjamin Graham Centre for Value Investing, lessons he has gleaned from investing greats including Irving Kahn and Walter Schloss and the qualities which help make a successful investor.

On May 23, 2015, a group of UAIC members were fortunate enough to participate in a call with Dr. George Athanassakos, a Professor of Finance and value investing scholar. Dr. Athanassakos holds the Ben Graham Chair in Value Investing at the Richard Ivey School of Business, a position funded by Canadian value investor Prem Watsa, and has designed, the Ben Graham Centre for Value Investing. Some questions and their answers are below.

Q: What are the greatest lessons you have learnt from investing legends Irving Kahn and Walter Schloss?

Irving Kahn was the kindest person. He was very civil, very innocent and very trusting - he meant no harm to anybody. He was also curious; 107 years old and he still wanted to know the good Canadian companies to buy! His loyalty to Ben Graham was striking given that more than 60 years had elapsed since he was his student. Kahn's last wish was to take some of Graham's less well known books (he penned titles on the exchange rate and commodities amongst others) and modernise them like people have done with Security Analysis or The Intelligent Investor.

I had dinner with Walter Schloss. He was also very civil and had those key characteristics of humility and discipline - traits you don't see in many young people. Nowdays, people have a successful year and think they know all the answers. Schloss only lost money two years out of 50 and outperformed by an average of 5% after fees, yet he was still very down to earth. He walked with me around New York at 94 and showed me where he grew up and where he lived.

Schloss grew up in a very difficult environment. His family immigrated from Germany and his grandfather went bankrupt, which had a big effect on the way he treated his investments. Most value investors tend to have 10, maybe 20, stocks in their portfolio but Schloss was one of few who had a very diversified portfolio. He held over 100 stocks and I think part of the reason for this was the bankruptcy history and his fear of risk.

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Both investors had little in the way of egos and were willing to talk to anyone, whether that be an academic or a student or whoever. These investors lived very balanced lives without caring about the ups and downs of the market, which is why I think they had long lives.

Q: How do young people emulate those kinds of qualities and put them into practice every day?

It isn't easy. Some of these qualities you are born with, others you can learn - through your family, through your friends. If you grow up in an environment of risk takers and crazy people then you will become a crazy person! I asked the same question of Francis Chou, a brilliant but shy and low profile investor, how he became so good at understanding managers and controlling his emotions. He replied that as a child he grew up in a big family of Chinese descent in India and, as the eldest, he was sent by his father to the markets. There he would negotiate and buy goods from the merchants which taught him to be disciplined, patient and to control his emotions.

Q: Having met both Warren Buffett and Prem Watsa, do you subscribe more to Buffett or Watsa's view of investing?

To both of them (laughs). Prem Watsa can be thought of as an early Buffett and Buffett is now "late Buffett." When Buffett started he was young with less capital so he could afford to buy small cap, illiquid undervalued stocks with low PE's which is what Prem Watsa does today. As Berkshire became bigger, Buffett needed larger investments to 'move the needle' which precluded the small cap stocks. This is part of the reason why his performance has not been as good as it was in the beginning.

I think it is easier to make money investing the Prem Watsa way, finding small undervalued companies, than the way Warren Buffett does it today, because Prem Watsa has the flexibility to buy smaller capitalization stocks, which are often more under-valued than large capitalization stocks, due to less attention from analysts and institutional investors. The Buffett way is more difficult; you need intuition, experience and an understanding of what makes a competitive advantage sustainable. It's important to realise that value investing is not monochromatic; it has evolved. We started with the Ben Graham way, moved to the Philip Fisher approach, and now the way that Buffett does it.

Q: Why don't more companies try to emulate the Berkshire investment model?

I asked the same question of Warren Buffett. You either get value investing or you don't; there is no middle ground. What

makes someone successful as an investor is the temperament rather than the techniques they employ. To be a successful value investor you need to have the right personality and character but much of the time human nature gets in the way. Another reason is institutional bias. The way that many institutions work and the incentives they use prevent organisations from being value investors or adopting a model such as Berkshire's.

Q: You run the Value Investing course at Ivey. What is the difference between your course and a conventional finance course?

The key difference is that we start from the notion that the market is not efficient whereas most other finance courses assume that markets are efficient. Basically we are stock pickers and you cannot pick stocks if markets are efficient. That's the starting point.

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My course is unique in that it is an integrative course which brings together Finance, Accounting, Strategy, Economics and Psychology so all the pieces students learn throughout the year fall into place.

The class covers three core parts of the Value Investing process: 1) how to identify possibly undervalued stocks; 2) how to value them; and 3) how to use the "margin of safety" concept to make an investment decision by buying only truly undervalued stocks. I spend a lot of time on the valuation step which is different than a conventional DCF approach. Essentially we don't use terminal values because we don't trust them. We don't believe in growth either both of which are integral part of a DCF approach to valuation.

I spent a year talking to value investors, developing the programme by distilling what these investors say and do into academic concepts, elevating the trade subject we call value investing into a more rigorous academic topic. Value investors tend to explain concepts in a qualitative manner so part of the challenge was to quantify and verbalise what practitioners were telling me qualitatively. I think I did a pretty good job since my course is the highest rated in the University.

The Investment Club would like to thank Dr. Athanassakos for taking the time to answer our questions.

| Ben Graham Centre for Value Investing |

The Ben Graham Centre for Value Investing was formally founded in 2006 by current chair Dr. Athanassakos. The centre seeks to educate students in the investment paradigm derived from the investment ideas taught by Benjamin Graham and David Dodd at Colombia Business School in the late 1920's. The vision of the centre is three pronged: to develop future business leaders using the teachings of value investing greats, build up academic material based around value investing and spreading the word about value investing amongst academics and investment practitioners.

| Prem Watsa |

Prem Watsa is a Canadian based investor who sought to mimic Warren Buffett's investment approach after purchasing insurance companies and using their float to provide capital for investments. He is originally from Hyderabad in India and gained an MBA through the University of Western Ontario before setting up his investment vehicle Fairfax Financial Holdings in 1985.

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