

The **MARKETS NOW**

The triumph of 'value'

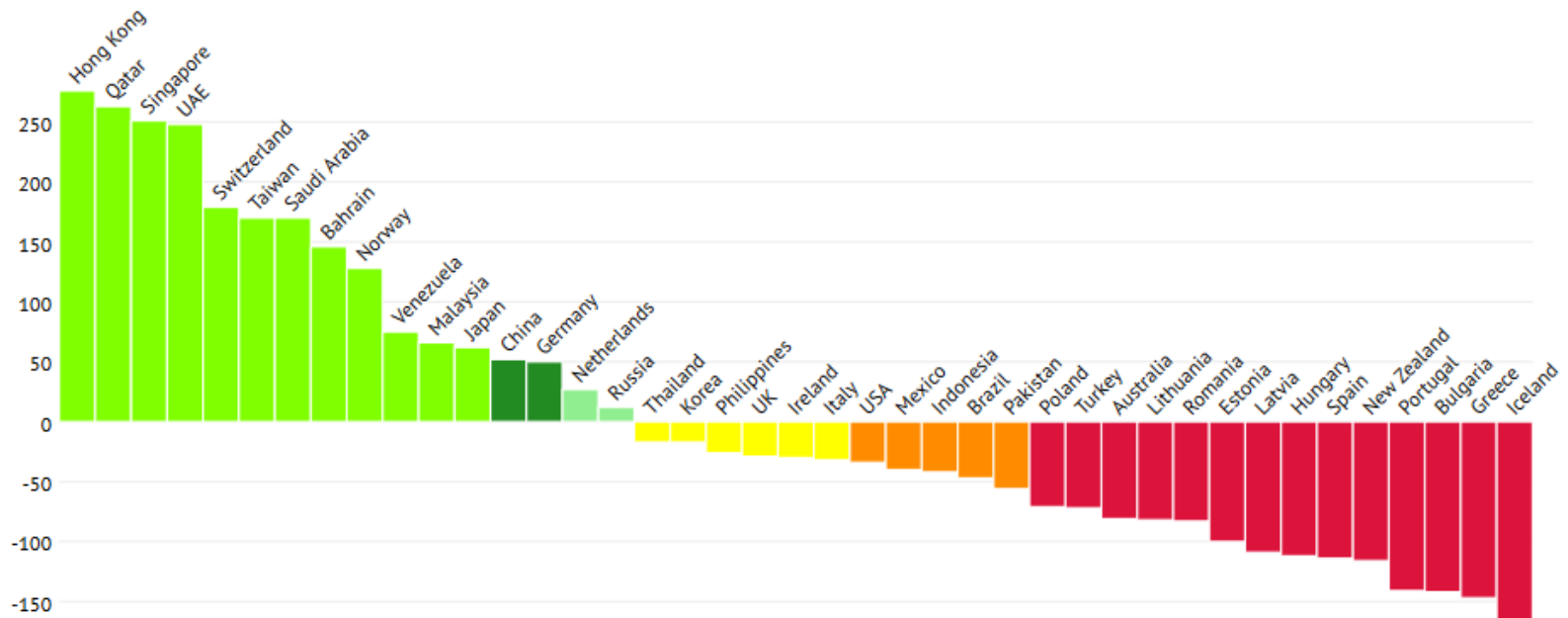
Tim Price, Director of Investment, PFP Group

Twitter: @timfprice

Problem #1

Most of the developed world is drowning in debt..

Net foreign assets of various countries as % of GDP



Source: IMF, Stratton Street Capital

Problem #1

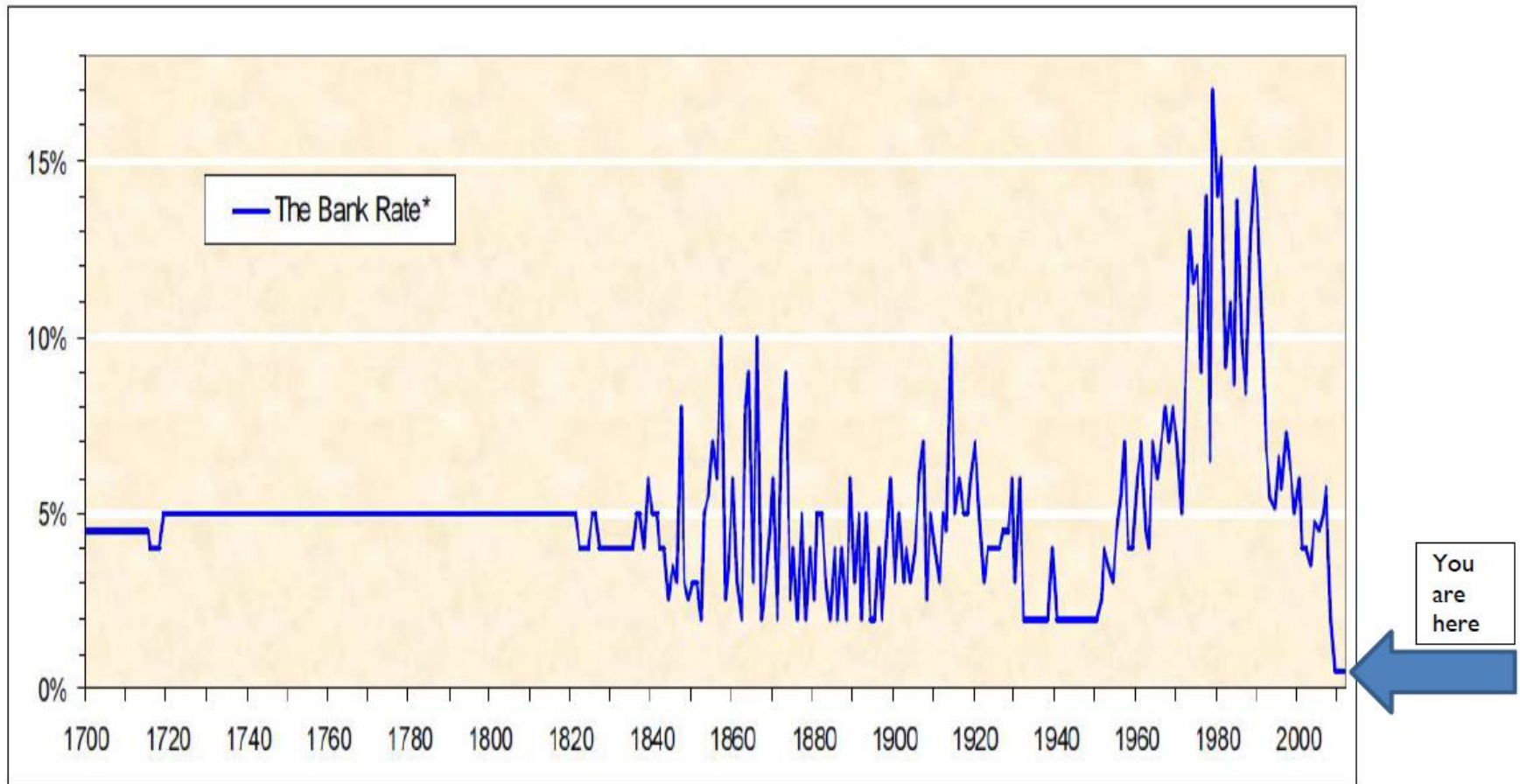
Most of the developed world is drowning in debt..

“America is deeply insolvent, and for that matter, so are most of continental Europe, the U.K. and Japan.”

- Paul Singer, Elliott Management.

Problem #2

Interest rates in their historical context



**/variously the Bank Rate, Minimum Lending Rate, Minimum Band 1 Dealing Rate, Repo Rate and Official Bank Rate.*

Source: The Bank of England, Church House

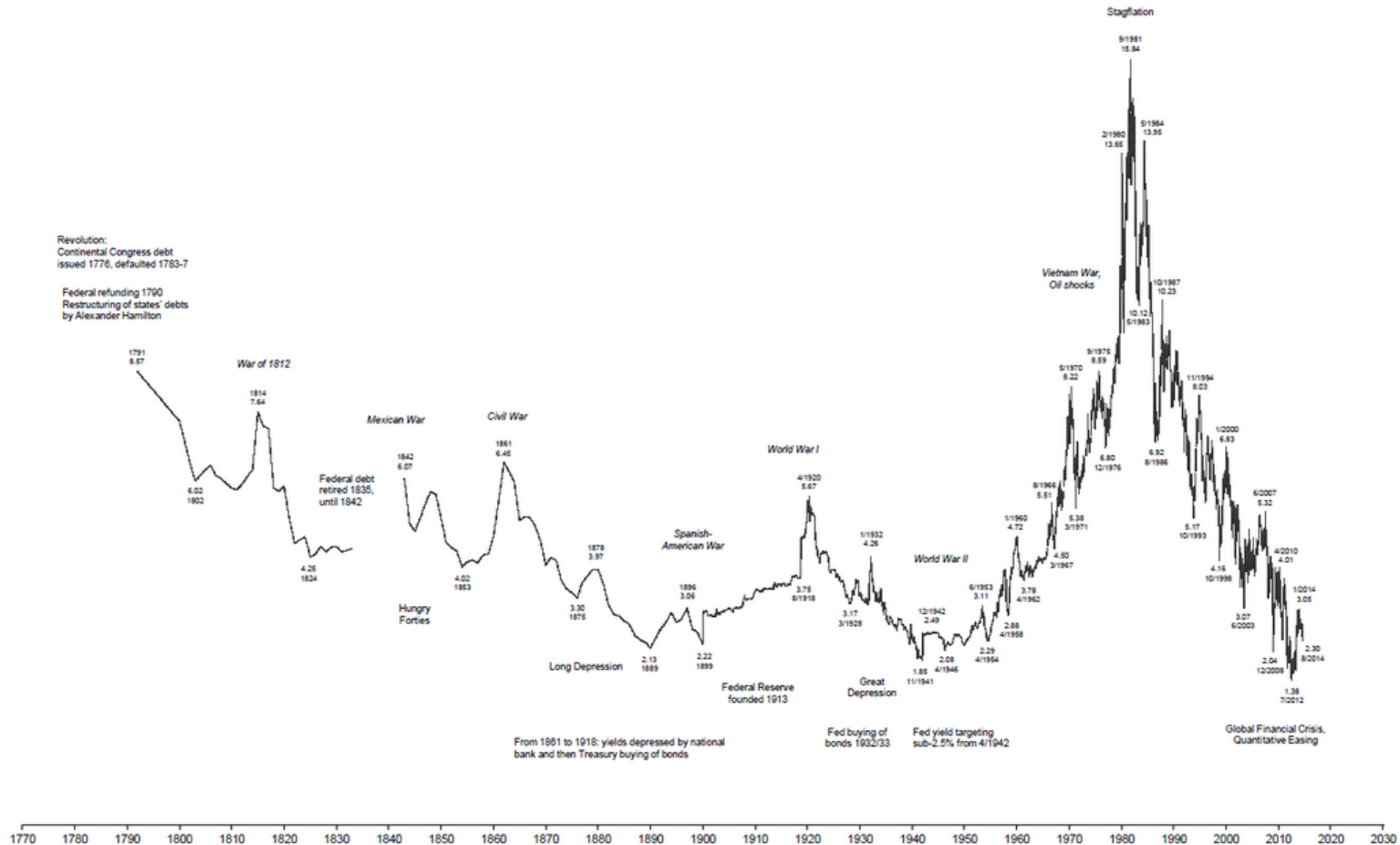
Yet bonds have never been more expensive..

Interest Rates

Yield on 10-year U.S. Treasuries, 1791 to date

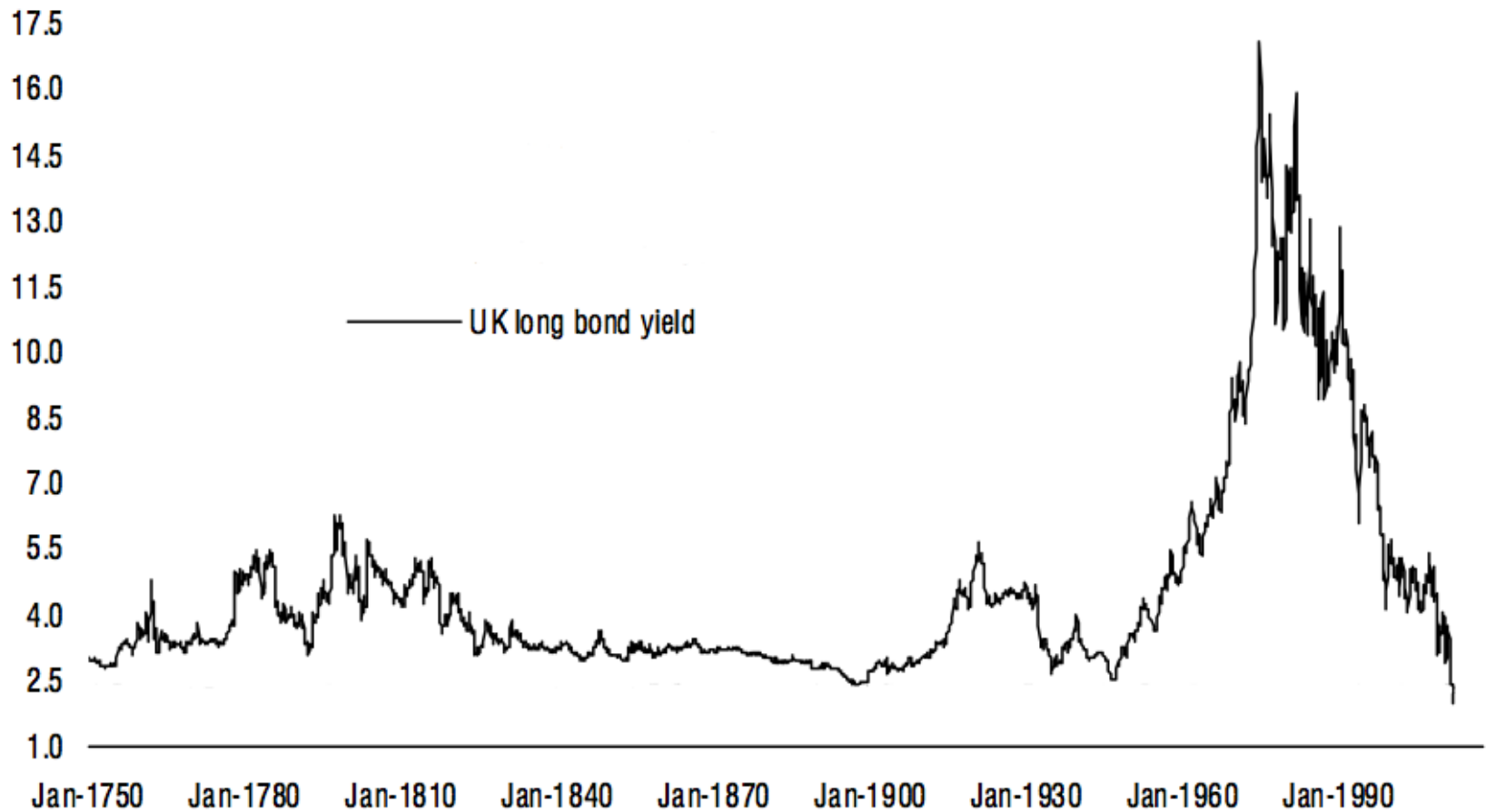
Monthly bars

Linear scale



Yet bonds have never been more expensive..

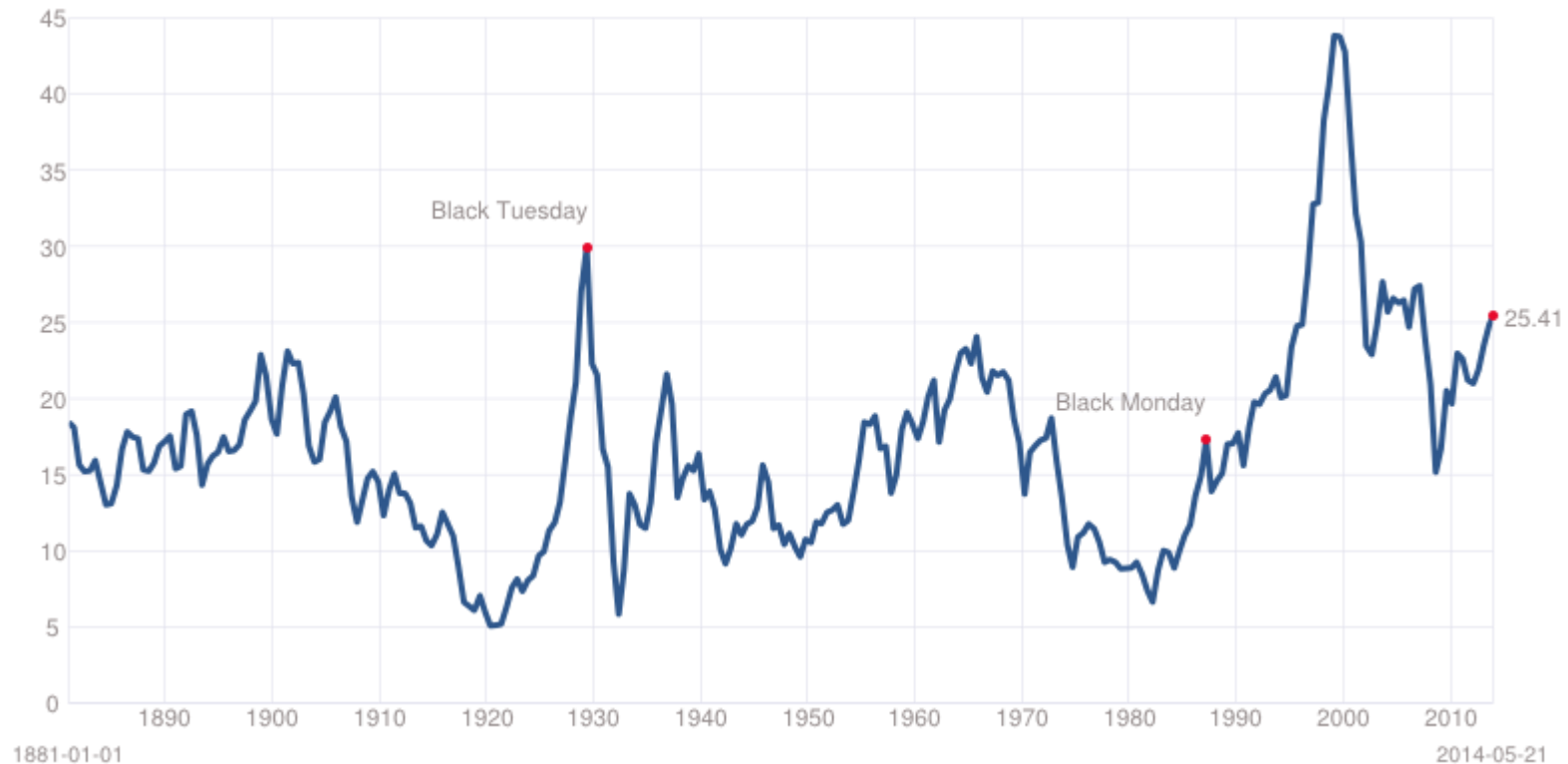
UK long bond yield, 1750 to 2014



Source: Thomson Reuters, Credit Suisse

And stock markets aren't necessarily cheap..

Shiller p/e for the S&P 500 index, 1881 to 2014



Source: Robert Shiller.

Mean Shiller p/e: 16.5

The pragmatic response ?

The pragmatic response ?

- Ignore indices

MSCI Asia ex-Japan top 10	Country	Comment
Samsung Electronics	S.Korea	Low margin exporter
TSMC	Taiwan	Low margin exporter
China Mobile	China	Low margin telecoms
China Construction Bank	China	State run Chinese bank
ICBC	China	State run Chinese bank
AIA	Singapore	
CNOOC	China	Large inefficient China oil/gas
Ten Cents	China	Expensive internet business
Hyundai	S.Korea	Low margin exporter
Bank of China	China	State run Chinese bank

The pragmatic response ?

- Ignore indices

MSCI Asia ex Japan Index

Top 10 Constituents

	Country
SAMSUNG ELECTRONICS CO	KR
TAIWAN SEMICONDUCTOR MFG	TW
TENCENT HOLDINGS LIM(CN)	CN
AIA GROUP	HK
CHINA MOBILE	CN
CHINA CONSTRUCTION BK H	CN
ICBC H	CN
HON HAI PRECISION IND CO	TW
BANK OF CHINA H	CN
HYUNDAI MOTOR CO	KR
Total	

MSCI Asia Pacific Index

Top 10 Constituents

	Country
TOYOTA MOTOR CORP	JP
SAMSUNG ELECTRONICS CO	KR
COMMONWEALTH BANK	AU
BHP BILLITON LTD	AU
TAIWAN SEMICONDUCTOR MFG	TW
WESTPAC BANKING	AU
ANZ BANKING GROUP	AU
TENCENT HOLDINGS LIM(CN)	CN
MITSUBISHI UFJ FIN GRP	JP
NATIONAL AUSTRALIA BANK	AU
Total	

Asian Equity Fund

Issuers and active weights*

Top 10 issuers	%
Samsung Electronics Co Ltd	6.3
Industrial & Commercial Bank of China Ltd	4.2
Hutchison Whampoa Ltd	3.6
Taiwan Semiconductor Manufacturing Co Ltd	3.5
NetEase Inc	2.8
Hyundai Motor Co	2.7
ICICI Bank Ltd	2.7
Bank Negara Indonesia Persero Tbk PT	2.6
PetroChina Co Ltd	2.4
AIA Group Ltd	2.3

Asia Pacific Fund

Holdings

1. Taiwan Semiconductor Manufacturing
2. Samsung Electronics
3. Jardine Strategic Holdings
4. Hyundai Motor
5. Fortune Real Estate Investment Trust
6. AIA Group
7. China Petroleum & Chemical
8. Hankook Tire
9. Techtronic Industries
10. Swire Properties

Asia Pacific Fund

Top 10 Holdings (%)

	Fund
Samsung Electronics	5.6
Taiwan Semiconductor Manu	3.7
Commonwealth Bank Of Australia	3.0
Sk Hynix Inc	2.7
China Construction Bank	2.6
Industrial & Commercial Bank Of China	2.5
Westpac Banking Corp.	2.1
Mediatek Inc.	1.9
Hyundai Motor Co. Ltd.	1.8
Macquarie Group Ltd	1.8

Asia Pacific Fund

Top 10 holdings

	(%)
Taiwan Semiconductor Manufacturing	3.3
Samsung Electronics	3.0
DBS Group	2.8
BHP Billiton	2.7
Amcor	2.6
Cheung Kong	2.6
Ezion	2.5
PetroChina	2.5
Commonwealth Bank of Australia	2.3
Kasikornbank	2.2

The pragmatic response ?

- Ignore indices
- Concentrate on value

“Investors do not make mistakes, or bad mistakes, in buying good stocks at fair prices. They make their serious mistakes by buying poor stocks, particularly the ones that are pushed for various reasons. ***And sometimes – in fact very frequently – they make mistakes by buying good stocks in the upper reaches of bull markets.***”

- Benjamin Graham.

The pragmatic response ?

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Why owning popular global brands can be dangerous

Fortune Magazine's 'Ten Stocks To Last The Decade' (14 Aug 2000)

August 14, 2000

1. Nokia (\$54)
2. Nortel Networks (\$77)
3. Enron (\$73)
4. Oracle (\$74)
5. Broadcom (\$237)
6. Viacom (\$69)
7. Univision (\$113)
8. Charles Schwab (\$36)
9. Morgan Stanley (\$89)
10. Genentech (\$150)

The pragmatic response ?

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Why owning popular global brands can be dangerous

Fortune Magazine's 'Ten Stocks To Last The Decade' (14 Aug 2000)

<u>August 14, 2000</u>	<u>Closing Prices December 19, 2012</u>
1. Nokia (\$54)	1. Nokia (\$4.22)
2. Nortel Networks (\$77)	2. Nortel Networks (\$0)
3. Enron (\$73)	3. Enron (\$0)
4. Oracle (\$74)	4. Oracle (\$34.22)
5. Broadcom (\$237)	5. Broadcom (\$33.28)
6. Viacom (\$69)	6. Viacom (\$54.17)
7. Univision (\$113)	7. Univision (\$0)
8. Charles Schwab (\$36)	8. Charles Schwab (\$14.61)
9. Morgan Stanley (\$89)	9. Morgan Stanley (\$14.20)
10. Genentech (\$150)	10. Genentech (\$95 T/O)

Portfolio lost 74.3% with three bankruptcies and one bail-out.

The pragmatic response ?

- Ignore indices
- Concentrate on value
 - Don't buy rubbish
 - Don't overpay for the good stuff

The top ten holdings of a popular global equity fund

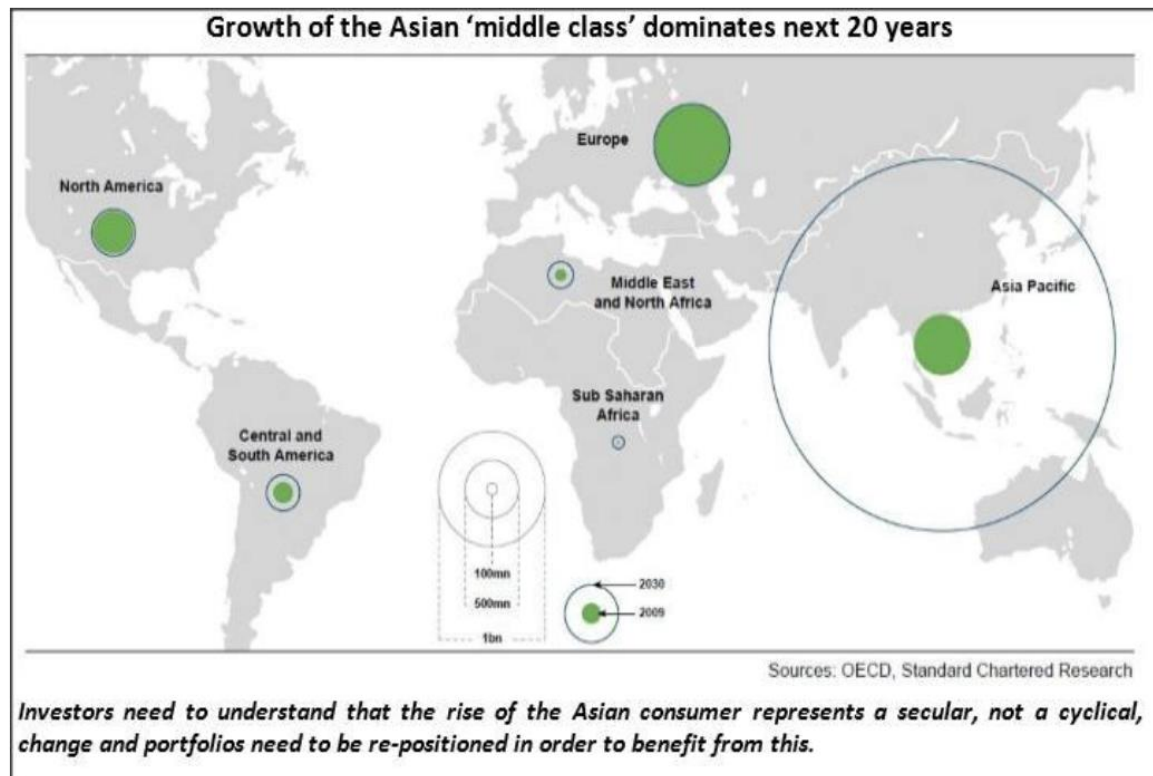
Stock	Price / book	Price / earnings
Microsoft	4.3	16.8
Reckitt Benckiser	6.2	20.2
Dr Pepper Snapple	5.6	18.4
Unilever	6.7	20.6
Stryker	3.4	17.2
Imperial Tobacco	5.5	13.3
Kone	10.8	20.5
Pepsico	6	20.4
Becton Dickinson	4	18.1
Intercontinental Hotels	N/A	25.1

The pragmatic response ?

- Ignore indices
- Concentrate on value
- Don't overlook Asia

The pragmatic response ?

- Ignore indices
- Concentrate on value
- Don't overlook Asia



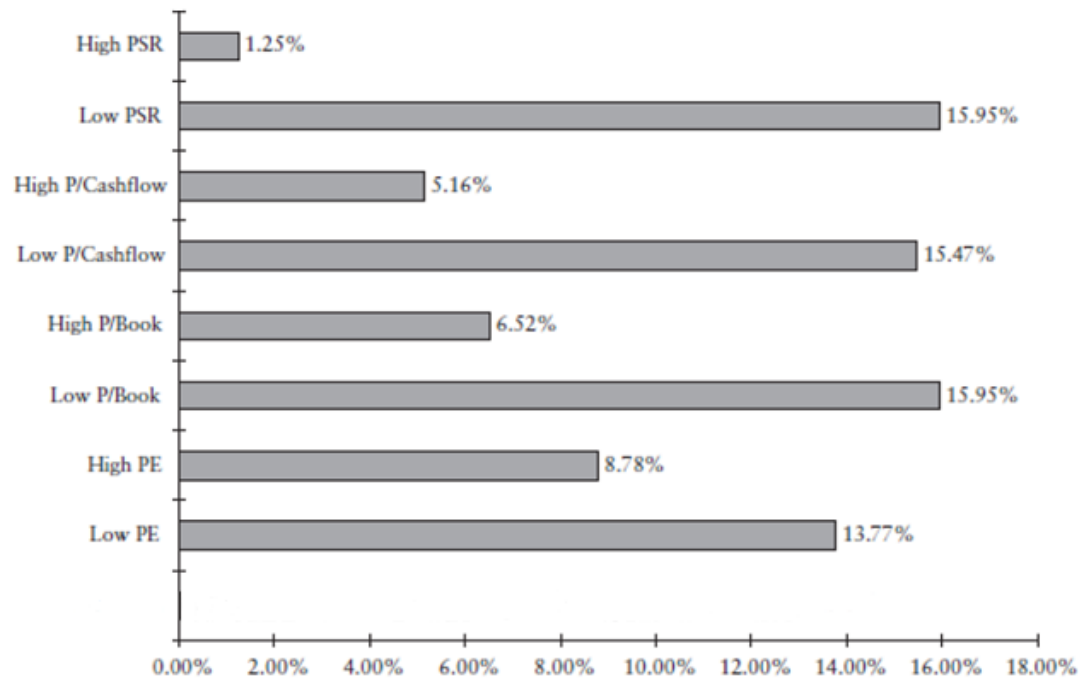
Feeding the Orang-utans in Omaha Zoo



Source: Omaha Zoo

Some metrics naturally lend themselves to value investing

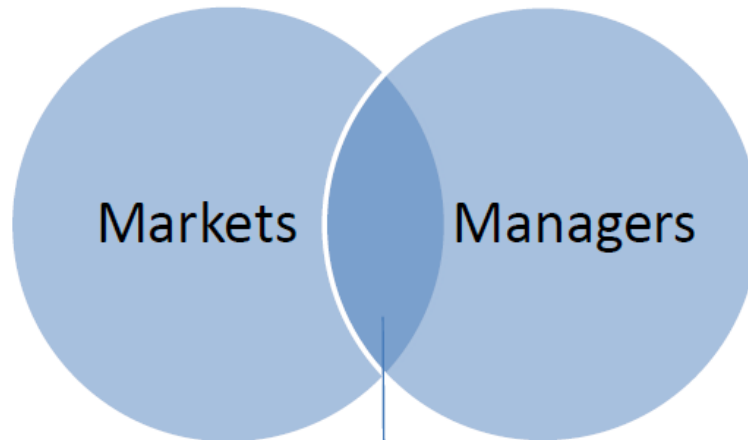
Compound average annual rates of return across various strategies for the 52 years ending in December 2003



(Source: What Works on Wall Street by James P. O'Shaughnessy, Third Edition, McGraw-Hill 2005)

Invest with real value specialists

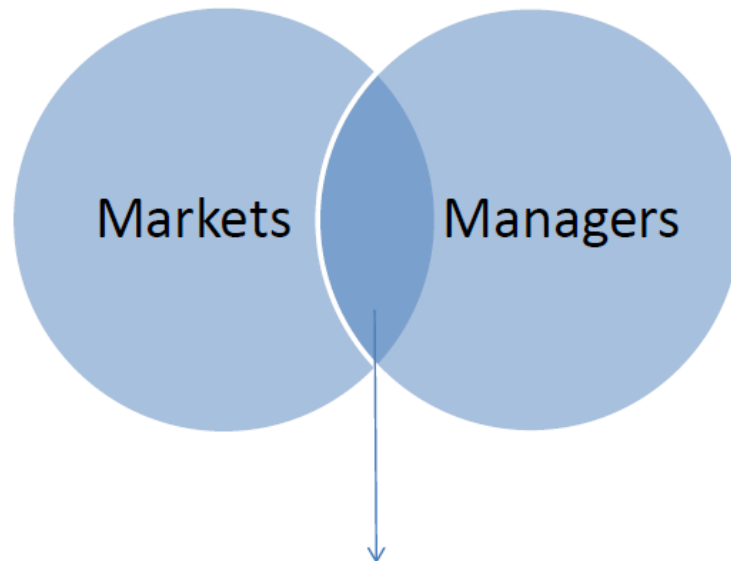
What we require of the stocks we seek:



- Businesses in understandable economic sectors not prone to dramatic change, ideally with 'wide moats'
- Typically low price / book; low price / earnings; low price / sales ratios
- Shares trading at a meaningful discount to assessed intrinsic value, with a 'margin of safety'
- Unconstrained, index-blind bottom-up value

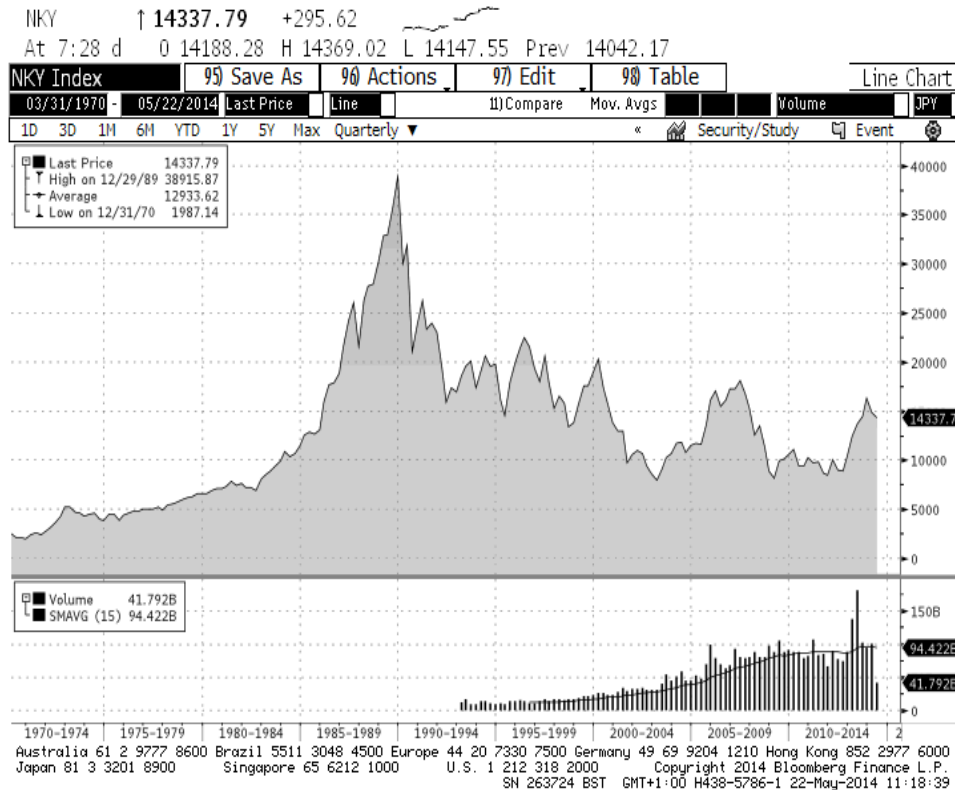
Invest with real value specialists

What we require of the funds we seek:



- High quality, honest, motivated owner-managers
- An explicit commitment to value investing on the continuum between Ben Graham and Warren Buffett
- Boutique funds, not capacity-constrained leviathans

There is real value in Japan



- 25 years in the wilderness
- 57% of Topix companies are covered by 2 or fewer analysts
- The BoJ has pledged to double the Japanese monetary base (so hedge your yen exposure)

Compelling returns from Ben Graham 'Net-Net' investing

Net-Net stocks in the US between 1970 and 1983

Mean return for the index: 11.5% per annum

Mean return for Ben Graham 'Net-Nets': **29.4% per annum**

(Source: Professor Henry Oppenheimer: 'Ben Graham's Net Current Asset Values: A Performance Update')

Net-Net stocks globally between 1985 and 2007

Mean return for the index: 17% per annum

Mean return for Ben Graham 'Net-Nets': **35% per annum**

(Source: James Montier: 'Graham's Net-Nets: Outdated or Outstanding ?')

Invest with real value specialists

Fund statistics for a dedicated Japan value fund

Comparisons – domestic and global markets					
	Net Cash (% of Market Cap)	Avg P/E ex Net Cash (x)	EPS growth 2013/14 (%)	Median Price/ Book (x)	Div Yield (%)
Fund	62	4.9	38.2	1.0	1.9
Topix 500	-11	19.7	14.3	1.2	1.8
Topix Small	9	14.7	6.5	0.9	1.7
S&P 500	-18	21.1	15.2	3.1	1.9
US Small Cap - Russell 2000	-14	17.8	6.1	2.1	0.2
Stoxx 600	-21	20.7	11.7	2.3	2.4
Asia ex Japan 500 largest	-22	21.1	13.6	2.5	2.4
MSCI Emerging Markets	-33	19.5	9.8	1.7	2.9

Invest with real value specialists

Company statistics for a North American holding company operating in financial services and insurance

Corporate Performance													
<i>(in US\$ millions, except as otherwise indicated)⁽¹⁾</i>													
	Book value per share	Closing share price ⁽²⁾	Revenue	Net earnings	Total assets	Investments	Net debt	Common shareholders' equity	Shares outstanding	Earnings per share			
<i>As at and for the years ended December 31⁽²⁾</i>													
1985	1.52	3.25 ⁽³⁾	12	(1)	30	24	-	8	5.0	(1.35)			
1986	4.25	12.75	39	5	93	69	4	30	7.0	0.98			
1987	6.30	12.37	87	12	140	94	5	46	7.3	1.72			
1988	8.26	15.00	112	12	201	112	27	60	7.3	1.63			
1989	10.50	18.75	109	14	210	113	22	77	7.3	1.87			
1990	14.84	11.00	167	18	462	289	83	82	5.5	2.42			
1991	18.38	21.25	217	20	447	295	58	101	5.5	3.34			
1992	18.55	25.00	237	8	465	312	69	113	6.1	1.44			
1993	26.39	61.25	267	26	907	641	119	211	8.0	4.19			
1994	31.06	67.00	465	28	1,549	1,106	166	280	9.0	3.41			
1995	38.89	98.00	837	64	2,105	1,222	176	346	8.9	7.15			
1996	63.31	290.00	1,082	111	4,216	2,520	282	665	10.5	11.26			
1997	86.28	320.00	1,508	152	7,149	4,054	370	961	11.1	14.12			
1998	112.49	540.00	2,469	280	13,640	7,868	830	1,365	12.1	23.60			
1999	155.55	245.50	3,906	43	22,229	12,290	1,249	2,089	13.4	3.20			
2000	148.14	228.50	4,157	76	21,668	10,400	1,252	1,941	13.1	5.04			
2001	117.03	164.00	3,953	(407)	22,184	10,229	1,194	1,680	14.4	(31.93)			
2002	125.25	121.11	5,105	253	22,173	10,597	1,603	1,760	14.1	17.49			
2003	163.70	226.11	5,731	289	24,877	12,491	1,961	2,265	13.8	19.51			
2004	162.76	202.24	5,830	53	26,271	13,461	1,966	2,606	16.0	3.11			
2005	137.50	168.00	5,901	(447)	27,542	14,869	1,984	2,448	17.8	(27.75)			
2006	150.16	231.67	6,804	228	26,577	16,820	1,614	2,662	17.7	11.92			
2007	230.01	287.00	7,510	1,096	27,942	19,001	1,207	4,064	17.7	58.38			
2008	278.28	390.00	7,826	1,474	27,305	19,950	413	4,866	17.5	79.53			
2009	369.80	410.00	6,636	857	28,452	21,273	1,071	7,392	20.0	43.75			
2010	376.33	408.99	5,967	336	31,448	23,300	1,255	7,698	20.5	14.82			
2011	364.55	437.01	7,475	45	33,407	24,323	2,056	7,428	20.4	(0.31)			
2012	378.10	358.55	8,023	527	36,945	26,094	1,921	7,655	20.2	22.68			
2013	339.00	424.11	5,945	(573)	35,959	24,862	1,753	7,187	21.2	(31.15)			
<table border="1"> <tr> <td>Compound annual growth</td> <td>21.3%</td> <td>19.0%</td> </tr> </table>											Compound annual growth	21.3%	19.0%
Compound annual growth	21.3%	19.0%											

- Compound annual growth of 21.3% in book value per share – **over nearly 30 years**
- Business currently trades on a price / book of 1.26x
- Price / earnings ratio of 8

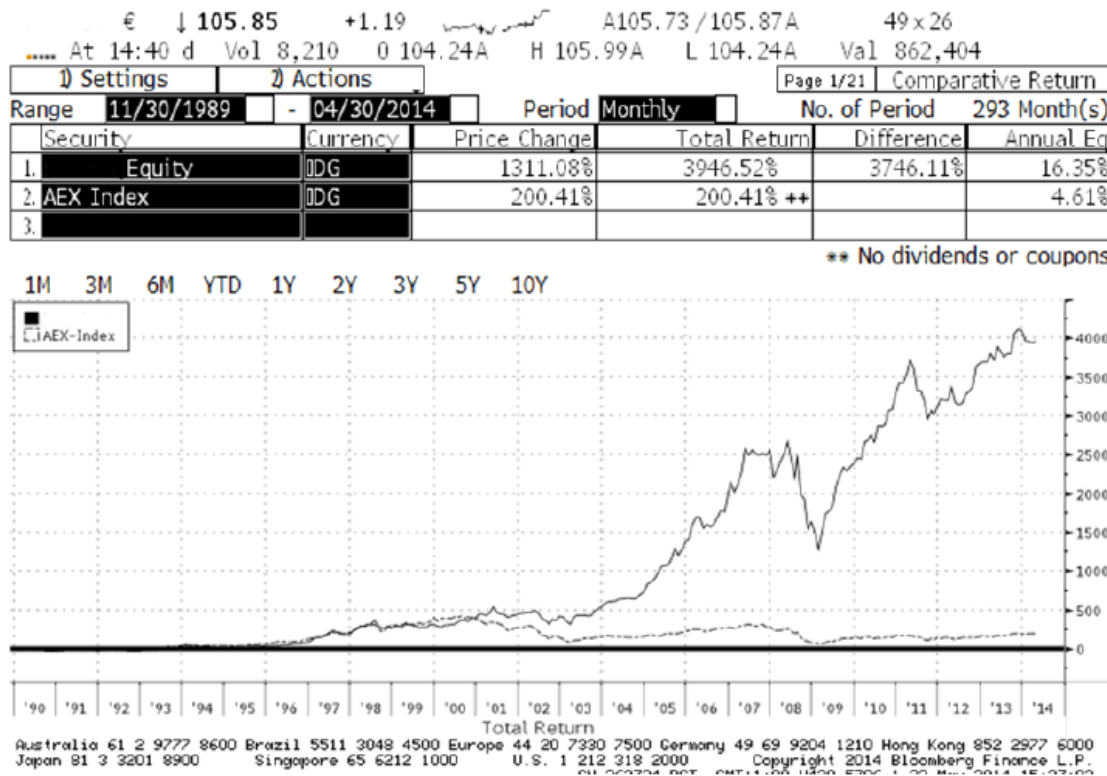
(1) All share references are to common shares; Closing share price is in Canadian dollars; per share amounts are in US dollars; Shares outstanding are in millions.

(2) IFRS basis for 2010 to 2013; Canadian GAAP basis for 2009 and prior. Under Canadian GAAP, investments were generally carried at cost or amortized cost in 2006 and prior.

(3) When current management took over in September 1985.

Invest with real value specialists

Share price performance for a Dutch holding company with diversified business interests (vs AEX Index)



- Annualised share price growth of over 16% - over **25 years**
- Price / earnings ratio of 14
- Dividend yield of 4%

And finally..

“..I can only tell you that the secret has been out for 50 years, ever since Ben Graham and David Dodd wrote ‘Security Analysis’ [and ever since Ben Graham followed up with ‘The Intelligent Investor], yet I have seen no trend toward value investing in the 35 years that I’ve practised it. There seems to be some perverse human characteristic that likes to make easy things difficult..

“There will continue to be wide discrepancies between price and value in the marketplace, and those who read their Graham and Dodd will continue to prosper.”

- Warren Buffett in the Appendix to ‘The Intelligent Investor’.

Questions ?

Disclaimer:

Trust no-one.

