

Brass Rat Investments

Conversation with: Whitney Tilson, Stansberry's Investment Advisory

Interviewed by: Kishan Popat

On experience in the world of investments: One way to gain experience is to stumble around. However, a far better approach is to learn from somebody who has been investing for a while. Becoming a skilled investor is akin to becoming a proficient surgeon or fighter pilot, where practical experience under a seasoned mentor is crucial.

On the importance of giving back: Whitney mentioned that he often looks at his education in the world of investing as having learnt at the feet of vastly more experienced investors. He indicated the importance of giving back. Without learning from these experienced investors, his success in the investment world would have been far less likely.

On his books: We discussed his four books. (1) The Art of Value Investing: Essential Strategies for Market-Beating Returns, (2) More Mortgage Meltdown - 6 Ways to Profit in These Bad Times, (3) The Art of Playing Defense: How to Get Ahead by Not Falling Behind, (4) The Rise and Fall of Kase Capital – an upcoming book that Whitney is working on that discusses his own successes and failures as a hedge fund manager.

On traditional value investing: Whitney spoke of how a strategy of indiscriminately purchasing distressed, 'cigar-butt' stocks, has more often than not ended up being a poor investment process. Often, stocks that looked cheap were actually expensive in the longer run, as the fundamentals of the underlying businesses continued to deteriorate.

On buying high quality stocks and exiting too early: Whitney spoke at length about purchasing shares of some of the world's best businesses at depressed prices. Having seen share prices subsequently rally somewhat, he sold out as opposed to focusing on the longer-term outlook of these wonderful businesses. He spoke of buying Apple at \$0.35, Home Depot at \$10, and McDonalds at \$10.

In hindsight, a high-quality business that is growing can compound its per-share value much faster than an investor trying to flip in-and-out of 'cigar butts'. In his opinion, on average, 75% of the return from a stock investment in a high-quality growth company could be attributed to the actual growth of that company. 25% of returns could be attributed in buying the company cheap. In other words, it is more important to focus on what business you are buying rather than the price you are buying the stock.

On overpaying for a stock: We spoke at length about the fact that even for some of the highest quality growth companies on Earth, there was such a thing as paying too much. Cisco, which in 1999 was trading at 150x earnings, has still not seen its share price recover to its 2000 high, despite all of the growth seen in subsequent years.

On overconfidence: Whitney mentioned how early in his investing life, he outperformed the index for 11 out of 12 years, inclusive of the period leading up to the dot-com bubble.

That success bred overconfidence and led to notable mistakes in decision making in subsequent years.

On understanding your own variant perception: it is highly unlikely that when you find a 'cheap' stock, it is cheap because people have missed it. The odds are pretty good that the market is in fact correct in pricing the stock cheaply and that the fundamentals of that business may be poor. Thus, he emphasized the need to confidently articulate why your assessment is correct, whereas the broader market, with its sophisticated tools and savvy investors are wrong. It can take many years, under a good mentor, with a lot of experience under your belt to get variant perception right.

On having the conviction to say 'I was wrong': It is critical, as an investor, to be able to say that you are wrong. Not being able to accept that you are wrong has often led many an investor astray.

On growth investors: He indicated four critical areas of oversight that investors focusing on this approach should consider (1) Overestimating future growth – how competition eventually forces mean reversion (2) Not paying too high a price e.g. Cisco (3) The importance of not falling in love with companies you have invested in and seeing them neutrally (4) Failing to notice when a company ceases to be a great company

On the importance of thorough investigative research on your investment ideas: Whitney spoke of his short on Lumber Liquidators – finding a company that was selling its products into North America whilst cutting substantial corners. He spoke of the process of studying a company in detail, before subsequently going short.

Similarly, he touched on his research on McDonalds. By speaking to several franchisees during a period when the company was falling out of favor with investors, Whitney was able to discover that things were actually improving at the company. Subsequently, after that analysis, he decided to invest. Similarly, he spoke of his analysis of CJ's and Hardee's thick burgers – by calling multiple stores all around the country, he was able to notice that demand on these new burgers was phenomenal – and subsequently invested based off of that research.

On intrinsic value: Whitney elaborated on how many market participants buy assets hoping to sell them at a higher price later on. He advised us to (1) not to watch TV channels such as CNBC (2) take platforms such as Twitter and Value Investors Club with a pinch of salt (3) how platforms such as Seeking Alpha may occasionally have quality idea generation but that for the most part it was the same speculators sharing their opinions. The emphasis was on the need for a deeper understanding of an asset's true intrinsic value.

He emphasized the need to read extensively and to focus on speaking with smart industry experts to compound understanding of businesses and industries: He touched on the need to work consistently towards improving one's own understanding across industries, and how focusing on speaking to experts in a specific industry can

often be a good way to expand one's own 'circle of competence'. Depth of knowledge however is most critical to any investment decision.

On options: Whitney suggested that the inexperienced investor should largely stay out of options. The only exception he noted may involve long dated options, where the likelihood of favorable outcomes is greater.

It is irrelevant where a stock price has been in the past or how it has performed since you bought it: each day, we have to ask ourselves the question – 'is this stock priced fairly, over-priced, or under-priced'. Whether it has gone up 50%, down 50%, or anything outside of these ranges, the question each day remains the same. (Your emotions on the price and its movements do not matter).

On value investing being 'dead': Whitney spoke of how the old 'cigar butt' approach is currently out of favor and how price discovery in smaller stocks was less efficient today than it has been in a number of years. Yet, it is important to know that despite this, over time, the price of the stock will reflect the fundamentals of the business.

On the two most important decisions as a young adult: Whitney focused extensively on the two most important decisions young adults will make. (1) Whom they will marry, and (2) what profession one should choose. He emphasized the importance of 'inverting' when it comes to making decisions such as these.

We also briefly touched on how, when it comes to divorces, often it is not that people have married the wrong spouse. More likely, people have not paid the necessary attention to what their spouse really needs over 5, 10, 15 years – and that things get worse over time. Listening and paying attention consistently is critical.