Why I'm Now More of a Buffett and Munger Type Investor

Written by Jae Jun follow me on Facebook Twitter June 22, 2015

I've changed.

How?

It's the same evolution that a lot of people have followed.

Originally I focused purely on Ben Graham's criteria and net nets. The beauty is that Graham's techniques are easy to understand and follow because there is a lot of quantitative factors.

Here's one example of a Graham checklist you can study and follow. Graham came out with this back in his early days while running the partnership with Jerome Newman.

Graham's 10 Point Checklist

1. An earnings-to-price yield at least twice the AAA bond rate
2. P/E ratio less than 40% of the highest P/E ratio the stock had over the past 5 years
3. Dividend yield of at least 2/3 the AAA bond yield
4. Stock price below 2/3 of tangible book value per share
5. Stock price below 2/3 of **Net Current Asset Value** (NCAV)
6. Total debt less than book value
7. Current ratio great than 2
8. Total debt less than 2 times Net Current Asset Value (NCAV)
9. Earnings growth of prior 10 years at least at a 7% annual compound rate
10. Stability of growth of earnings in that no more than 2 declines of 5% or more in year end earnings in the prior 10 years are permissible.

Why It's Important to Change for the Better

It's important to "adapt" your own version of this checklist because times have changed and this 10 point checklist may not work as well as it used to.

And like a lot of people that have adapted and changed away from a pure quantitative approach

towards buying quality assets, I have too.

Buffett is the most obvious example here because he followed Graham's investment style during his early partnership days until he met Charlie Munger.

Of course, Buffett's focus is now exclusively on buying quality businesses due to the size of Berkshire Hathaway, the compounding required to keep up growth and the special deals Buffett can strike up.

But what's the reason so many people morph from a Graham investor to more of a Buffett and Munger style of investing?

My changes were made based on the need to keep things simple, chase low hanging fruit and improve risk management.

Graham certainly did all these things, but when combining my temperament with Graham methods, I started digging myself into a hole without knowing it.

So I changed.

Keep Things Simple and Chase Low Hanging Fruit First

The truth is that simple ideas and investments are not sexy.

Some investments are so easy and obvious that people think it's a dumb idea.

Or, that low hanging fruit type investments have low upside so it's not worth the investment.

Being an early investor in Uber is much sexier than being an early investor to AT&T.

The Fitbit IPO is a clear indicator of how people want to be in on the next big thing.

You get bragging rights if you say you got into the Fitbit IPO. You get more recognition from friends. You can talk and speculate about what the company is going to do to jet you to your next million.

But I hold Amerco (UHAL). The parent company of U-Haul DIY moving trucks and storage.

The investment thesis is simple.

- Their DIY truck rental business has a huge moat which is close to a monopoly.
- They own a ton of real estate for its storage business.
- They are family owned with large insider ownership.
- The bad family fights are behind them.

- They do not focus on quarterly performance or what Wall Street expects them to do.
- Their financials aren't the easiest to understand because of the different parts and their focus on reinvesting for the long term.

I used to think that I had to find complex stocks.

That my goal was to find 1,000% potential returns. That would be awesome, but my focus was way off.

I was reaching for the golden shiny apple at the top of the tree when there were very good apples hanging in front of my nose.

I was simply ignoring them because it didn't seem complicated enough.

Well, here's a note I received the other day.

> *You should stop relying on your spreadsheet models and being so promotional with your website – it hinders your ability to analyze and think as an investor. I've followed you for quite a while, and you haven't grown much in the past few years. – Anonymous*

I don't know about you, but I'm perfectly content with having the skill to quickly know which stocks to pass on and which ones to dig into further. I'd rather know when something is overvalued or undervalued instead of just chasing a stock and falling in love with the story.

Take it from Seth Klarman;

> *Many investors are able to spot a bargain but have a harder time knowing when to sell. One reason is the difficulty of knowing precisely what an investment is worth. An investors buys with a range of value in mind at a price that provides a considerable margin of safety. As the market price appreciates, however, that safety margin decreases; the potential return diminishes, and the downside risk increases. Not knowing the exact value of the investment, it is understandable that an investor cannot be as confident in the sell decision as he or she was in the purchase decision. – Seth Klarman*

A 50 page complex stock analysis is not growth.

Increased activity is not growth.

Growth as an investor is knowing what to buy and when to buy.

Growth is being able to pounce on a deal when it's obvious.

Growth is knowing how you react in certain situations preventing yourself from falling victim to it each time.

Growth is being able to sit still and wait for an elephant to shoot instead of trying to shoot every rabbit.

And all this comes from keeping things simple instead of trying to do too much.

Graham did the same thing. Being such a savvy businessman and investor, Graham knew that he didn't have to complicate things. He cut out the fat in investing and used discipline and simple ideas to generate his returns.

Keeping Things Simple from a Baseball Perspective

I'm a Seattle baseball fan which is painful.

The team has been the definition of mediocrity for the past decade, but one of baseball's best hitters is Seattle's very own Edgar Martinez.

In case you're not a baseball fan, know that baseball is a game of failure.

Most professional players can't hit the ball more than 70% of the time.

If you can hit the ball at least 3 out of 10 times throughout your career, you are considered elite.

Edgar Martinez falls into this category.

But what makes him so special?

Two current hall of fame pitchers, Pedro Martinez and Randy Johnson, as well as future hall of famer Mariano Rivera have gone on the record saying that they thought Edgar Martinez was the best and toughest batter they've faced.

Was it his homerun power?

No.

He had 309 and is no. 125 on the all time list.

Was it his speed?

No.

He was slow due to an injury.

It was simply because he was so disciplined, knew himself and limited mistakes that made him so difficult to get out.

In recent interviews by Edgar, his approach was to keep things simple even when the stakes were high.

Instead of trying to hit the game winning home run, his method was to stick to the basics, not get out and to keep the ball in play.

Does that sound familiar?

- Edgar Martinez was happy with low hanging fruit by maintaining focus on the bigger picture – keeping the game alive in key situations even with a single.
- Edgar Martinez focused on protecting the downside and letting the upside take care of itself.
- Edgar Martinez didn't go all out on one pitch that could blow up his team's chance of winning.
- Edgar Martinez style of play wasn't sexy and why he hasn't been inducted into the hall of fame.

Edgar Martinez is the baseball version of the investor I want to be.

That means controlling the things that I can.

Things like

- understanding how the stock fits within my overall investment objective
- calculating a valuation range to know when to act or not
- defining an entry price and exit strategy
- making better decisions with portfolio allocation

The Need to Always Improve Your Risk Management

Risk can be viewed differently between people, but when you boil it down, people don't want to lose money.

As Howard Marks puts it,

> *I don't think most investors fear volatility. In fact, I've never heard anyone say,*

> *"The prospective return isn't high enough to warrant bearing all that volatility."*
> ***What they fear is the possibility of permanent loss.***

I too fear permanent loss of capital.

> *The key to investing is knowing how to survive. That means at times playing conservatively, cutting losses when necessary and keeping a large portion of one's portfolio out of play. – George Soros*

As I took up being a Graham first investor, one bad trait that I found myself creating was the focus on upside.

Graham never emphasized the upside so this was purely a bad side effect created by myself.

While focusing on the upside, I've made plenty of bad mistakes that come along with it.

- Trying to do too much all the time
- Over allocating on positions that I should have made much smaller
- Consuming too much information without putting the time to process it
- Fear of missing out on something
- Trying to pick up pennies in front of a bulldozer
- and the list goes on

But one day, it finally sunk in.

I finally knew and experienced what it meant to limit the downside.

> *Protect the downside. Worry about the margin of safety. – Peter Cundill*

And another gem from Klarman.

> *Interestingly, we have beaten the market quite handsomely over this time frame, although beating the market has never been our objective. Rather, we have consistently tried not to lose money and, in doing so, have not only protected on the downside but also outperformed on the upside. – Seth Klarman*

For me, that meant becoming a more Buffett and Munger investor.

Slowing down my agendas and giving myself more time to think and process the information on hand.

Look for strong moats.

Look for good management.

Look for businesses that I can hold for a long time without losing sleep over.

I've changed for the better.

Have you?