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Issue XVI

Fall 2012

Joel Greenblatt — “Thought Process and Clarity are Key”



Joel Greenblatt

Joel Greenblatt is the Managing Partner of Gotham Capital, an investment firm he founded in 1985, and a Managing Principal of Gotham Asset Management. Mr. Greenblatt is the author of four investing-related books, including the New York Times bestseller *The Little Book that Beats the Market* and *You Can Be a Stock Market Genius*. Mr. Greenblatt is the former Chairman of Alliant Technologies, a Fortune 500 company and the current Chairman of Success Charter Network, a network of charter schools in New York City. He is an Adjunct Professor in Finance at Columbia Business School and a graduate of the Wharton MBA program.

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Loews Corporation — “Patience is part of our DNA”



Joe Rosenberg and Jim Tisch

Loews Corporation is one of the largest diversified holding companies in the United States. Since its founding in 1959, Loews has been rooted in the principles of value investing as a means of generating wealth for its shareholders. CEO Jim Tisch (one of three members of the company’s Office of the President along with his brother Andrew and cousin Jonathan) and Chief Investment Strategist Joe Rosenberg shared their thoughts and experiences with G&D.

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Royce & Associates — Legendary Small Cap Investors



Charlie Dreifus, Chuck Royce, Buzz Zaino, Whitney George

Royce & Associates, investment advisor to The Royce Funds, is one of the industry’s most experienced and highly respected small-cap investment managers. Founded in 1972, Royce & Associates has produced outstanding returns over its 40 year history by maintaining its value-oriented discipline regardless of market movements and trends. G&D sat down for a group interview with portfolio managers Chuck Royce, Charlie Dreifus, Whitney George, and Buzz Zaino.

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Columbia Business

Pictured: Bruce Greenwald at the Columbia Student Investment Management Conference in February 2012. The Heilbrunn Center sponsors the Applied Value Investing program, a rigorous academic curriculum for particularly committed students that is taught by some of the industry's best practitioners.



Pictured: Heilbrunn Center Director Louisa Serene Schneider at the CSIMA conference in February 2012. Louisa skillfully leads the Heilbrunn Center, cultivating strong relationships with some of the world's most experienced value investors and creating numerous learning opportunities for students interested in value investing. The classes sponsored by the Heilbrunn Center are among the most heavily demanded and highly rated classes at Columbia Business School.



Welcome to *Graham & Doddsville*

Welcome back to another year of Graham & Doddsville. We are delighted to bring to you the 16th edition of Columbia Business School's student-led investment newsletter, co-sponsored by the Heilbrunn Center for Graham & Dodd Investing and the Columbia Student Investment Management Association.

Now in its seventh year, Graham & Doddsville is still going strong. We would like to offer a special thank you to Anna Baghdasaryan and Joe Jaspan, last year's editors, for showing us the ropes and ensuring that the product presented to you last year, in three spectacular issues, was of the highest quality. We would also like to recognize Graham & Doddsville's founders, Joseph Esposito, Abigail Corcoran, and David Kessler. What you are reading today is a product of their initiative and inspiration.

Now on to our distinguished and diverse lineup of successful value investors as well as some of the interesting topics you will see them address in the following pages. **Joel Greenblatt**, now in his 17th year as

an adjunct member of the Columbia Business School faculty, describes his shift from special situations investing to a formula-based approach. He describes how the most glaring inefficiencies in the market today are caused by a widespread focus on very short-term performance which isn't likely to abate any time soon. Mr. Greenblatt notes that despite the market's run this year, he still believes it is cheap based upon the measures that he follows.

Jim Tisch and Joe Rosenberg from Loews Corporation detail some of the history behind a few of their best investments. Mr. Tisch expands on the importance permanent capital has had on his investment style and the inherent dangers in acquiring companies. Mr. Rosenberg, who recently celebrated his 50th year on Wall Street, recounts how he got started in the industry. He also shares with us his introduction to Larry Tisch many years ago and what brought him to Loews, his home since 1973.

We were also extremely fortu-

nate to be granted a group interview with **Chuck Royce, Whitney George, Charlie Dreifus, and Buzz Zaino** from Royce & Associates. This quartet of legendary small cap investors speaks candidly about the similarities and differences of their respective investment styles – from the importance of meeting with management to the safety of a clean balance sheet. They also detail how they believe small-cap investing has changed over time, and how it has impacted where they find ideas.

This issue also contains pictures from the 2012 "From Graham to Buffett and Beyond" Dinner, which takes place each May in Omaha, Nebraska. We thank our featured investors for sharing their time and insights with our readers. Please feel free to contact us if you have comments or ideas about the newsletter as we continue to refine this publication for future editions. We hope you enjoy reading this issue of Graham & Doddsville as much as we have enjoyed putting it together.

- *G&Dsville Editors*



Alex Porter and Jon Friedland of Porter Orlin with the first and second place finishers at the Moon Lee Prize Competition which was held in January 2012 at Columbia Business School



Panelist of Judges at the Pershing Square Value Investing and Philanthropy Challenge which was held in April 2012 at the Center for Jewish History

2012 “From Graham to Buffett and Beyond” Dinner, Omaha



Panel: Prof. Greenwald, Mario Gabelli, David Winters, Tom Russo



Greenwald making a point



Russo explaining Nestle



Winters answering a question



Russo posing with audience



Gabelli with Columbia students and Louisa Schneider



Gabelli in a light moment

Joel Greenblatt

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G&D: Professor Greenblatt, what was your introduction to investing and who were some investors who directly or indirectly influenced you early in your career?



Joel Greenblatt

JG: I went to Wharton, and, as they still do today, they taught the efficient market theory. This didn't resonate with me all that well. Then, I think when I was a junior, I read an article in *Forbes* about Ben Graham. The article outlined how he had this formula to beat the market, provided an explanation of his thought process, and described "Mr. Market" a little bit. I read that article and a light bulb went off – I thought: "boy, this finally makes some sense to me."

I started reading everything I could by Benjamin Graham. I also read a book called *Psychology and the Stock Market* by David Dreman. He was one of the first people to focus on behavioral finance and was really ahead of his time. I started reading about Buffett and his letters. All that stuff resonated very well with me. I would say that I'm self-taught in that sense. I learned the basics, I understood how to tear apart balance sheets, income statements, and cash flow statements from school and from growing up in a business family, but my understanding of the stock market really came from my own independent reading.

"... when I was a junior, I read an article in *Forbes* about Ben Graham. The article outlined how he had this formula to beat the market, provided an explanation of his thought process, and described "Mr. Market" a little bit. I read that article and a light bulb went off – I thought: "boy, this finally makes some sense to me.'"

G&D: You spent some time with Richard Pzena, who happened to be the first interviewee for *Graham & Doddsville*, while at Wharton. Do you have any stories or anecdotes that you could share from your time together at Wharton?

JG: Sure. We were in the same program and were also the same year at Wharton. We were in an undergrad/grad program where you earned your MBA and undergraduate degrees in five years. We were in that same cohort. I became friendly with Rich in our last

year as undergraduates. When we first joined that program in our senior undergraduate year, I had told him about some of the reading I had done regarding Graham's belief that formulas could be used to determine profitable investments. We decided to do a master's thesis with another good friend of mine analyzing Graham's approach. At the time, we didn't have access to a database of stock market information. Standard and Poor's used to put out a Stock Guide with some balance sheet and income statement information on about 5,000 companies monthly. The school library had about 10 years' worth of these guides.

Not having access to a database, we actually went to the library. We wanted to go back and test Graham's formulas, so to speak. So we went to the library and manually went through the S&P stock guides. We started with the A's and B's, which covered about 750 companies, and analyzed eight or nine years' worth of financial data. It was very time intensive. Rich was also very good with computers. We had a DEC10 computer that was about six times the size of this room. Rich knew how to take the data that we had all compiled and, with the little punch cards, get the data into the computer. So we were able to test some simple Graham formulas. That work ended up actually get-

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ting published in the Journal of Portfolio Management.

G&D: How long did you spend on that?

JG: That was many hours; I really couldn't tell you. I guess my time was cheaper back then!

G&D: What inspired you to write *You Can Be a Stock Market Genius*?

JG: The motivation for me was the recognition that I had really learned about the business from reading. I thought it was pretty cool that these investors had been willing to share with readers what they knew and had learned during their careers. I'm not a very good listener, so I like to learn by reading. When I was in school, there were two things that seemed like interesting pursuits if I ever became successful: one was to write and one was to teach.

We ran outside capital at Gotham Capital for ten years and then returned the outside capital in '94, though we continued to run our own money. We had been quite successful during that time and so I thought that if I put together a group of war stories as examples and described the principles that I had used to make money, it would be very instructive for people. I wanted to write it in a friendly, accessible way so that individual investors could profit from it as I had. I started writing

the book in '95 or '96. I also started teaching at Columbia in '96. I hadn't taught MBAs yet. So when I was writing the book, I didn't realize that I was really writing it at an MBA level. I had assumed that because I had been doing it so long, individuals knew a lot more than they actually do.

So I ended up writing a book that most hedge fund managers have read, but one which was perhaps at a little higher level than I had intended. I wrote it accessibly, so I had fun writing it, but I think it was at more of an MBA level, not just a regular investor level. I think that was a mistake that I made because I was looking to educate a much more needy bunch than MBAs and hedge fund managers. That was really one of the things that drove me to continue writing until I could accomplish my original goal. I am very proud of that book, but I just think it's written at such a level that you have to be fairly sophisticated in financial analysis, at least, to fully profit from its advice.

G&D: Given the proliferation of hedge funds since the *Stock Market Genius*'s release, are the opportunities in some of those same types of special situations similarly available today?

JG: I think they are. I think there are always opportunities. What happens to people who become very good at special situation investing

is that they make a lot of money, and then they get a little too big to invest in some of the smaller situations that are out there. In the book I wrote that some of these opportunities are less liquid or smaller, so a lot of people aren't looking at them as a result. I think in the book I said something to the effect of: "don't worry about getting too big for these strategies until you get to about \$250 million. When you get there, give me a ring." I would bump that number up to over \$1 billion today. You can't run \$10 billion and get ridiculous rates of return, most likely. A few people can, but they have a large staff, or they have concentrated positions.

There are still many strategies in that book that could make you a lot of money. I think that these opportunities are out there. Since I wrote *Stock Market Genius*, we had an internet bubble where people were pricing things stupidly, and then we had 2008, where stocks halved and a few years later they doubled. So to say assets were accurately priced all along, or that there were no opportunities, or that the market doesn't get very emotional and throw you opportunities, is kind of silly in my mind. That doesn't make it easy to tune out all of the noise that's out there, but there are still ample opportunities that one can find.

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My definition of value investing is figuring out what something is worth and paying a lot less for it. I make a guarantee the first day of class every year that if you're good at valuing companies, the market will agree with you. I just don't guarantee when. It could be a couple weeks or it could be two or three years. And the corollary is simply that, in the vast majority of cases, two or three years is enough time for the market to recognize the value that you see, if you've done good valuation work. When you put together a group of companies, that process can often happen a lot faster, on average. One argument I make in another one of my books (which few have read), called *The Big Secret for the Small Investor*, is that the world has become much more institutionalized over the years, even more than it was when I wrote *You Can Be a Stock Market Genius*, and that is a real advantage for longer-term investors. For institutional investors, you can track all money flows by one simple metric – which managers did well last year and which did poorly. Managers who did well last year attract all the money and managers who did poorly lose the money.

If you're an active manager, you may have a long-term horizon but your clients probably don't. So, most managers feel that they need to make money over the short term. Therefore,

professionals systematically avoid companies that are perhaps not going to do as well in the short term. In some ways, there's actually more opportunity in those areas now than ever before due to the greater institutionalization of the market.

True, there are some areas that are more followed. For instance, I wrote about spin-offs in *Stock Market Genius*. Of course a lot of people follow spin-offs, yet if you look at the studies, they still seem to outperform the market after they're spun off. Certainly a lot of the smaller situations are the situations where there is a huge dichotomy in size or popularity between the parent company and the spin-off. These opportunities are still there, partly because some are too small for most firms to take advantage of. Other opportunities are the result of volatile emotions in the market. Given the institutionalization of the investor base, the fact that markets are emotional, and the fact that there are still lots of nooks and crannies out there that even successful hedge funds can't pursue, I'm not concerned about the size of the existing opportunity set.

G&D: Do you see anything that could lengthen institutional investors' time horizons, thereby reducing the "time arbitrage" from which many value investors profit?

JG: No, not really. The reason is that there is an

agency problem where the people who are allocating the capital are not making the investment decisions. I was talking to a gentleman at one of the top endowments, and he said, "I would like to tell you that we have a long-term horizon, because we should. But I've been here 11 years, we've had three chief investment officers, and none of them left after a period of positive performance." Jeremy Grantham spoke at a Graham and Dodd Breakfast several years ago and one of his lines that I thought was funny, and probably very, very accurate, was: "for the best institutional investors, their time horizon is 3.000000 years." That is the horizon for the best. For many institutional investors, it's even shorter. So I think that's about all you can hope for as an investment manager.

I think the reason for this is that your investors – your clients – generally just don't know what the investment manager's logic was for each investment. What they can view is performance. It's pretty clear that for mutual funds, for instance, the performance of a given fund over the last 1, 3, 5, and 10 years has very little correlation with the future performance for the next 1, 3, 5, and 10 years. So institutional investors are left with predicting who's going to do well in the future, which they attempt to do by looking at the manager's proc-

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"I make a guarantee the first day of class every year that if you're good at valuing companies, the market will agree with you. I just don't guarantee when. It could be a couple weeks or it could be two or three years."

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ess. For most clients, the manager's process is not transparent and the rationale behind investment decisions is not clear. Clients tend to make decisions over much shorter time horizons than are necessary to judge skill and judgment and other things of that nature. So I think time horizons are getting shorter, not longer. We're not in danger of people expanding their time horizons when they're judging managers. I think time arbitrage will be the "last man standing," pretty clearly.

G&D: Your career has really been, from an investment standpoint, composed of two parts. Earlier in your career, you made more concentrated investments in special situations. Now, you invest in a more diversified manner in higher quality companies. What drove this shift?

JG: I already talked about the research we did on Graham's strategies. Around 2003, my partner, Rob Goldstein, and I decided to do some research on our own strategies, which had evolved to resemble the way Buffett looks at the world. Graham's investment world view was to "buy it cheap." Buffett added a little twist that probably made him one of the richest people in the world. He essentially said, "well if I can buy a good business cheap, that's even better."

So we tested the principles behind what we look at when we value companies. The results were very robust. My write-up of the

"...those companies that were in the top decile, based on quantitative measures indicating that they were both cheap and good, performed better than those in the second decile, which performed better than those in the third, and so on in order. It was quite powerful and surprising. It just started us on a long path of research which tried to systematize the way we'd always valued companies."

results of our very first test formed the basis for *The Little Book That Beats the Market*. The upshot was that those companies that were in the top decile,

based on quantitative measures indicating that they were both cheap and good, performed better than those in the second decile, which performed better than those in the third, and so on in order. It was quite powerful and surprising. It just started us on a long path of research which tried to systematize the way we'd always valued companies. We were able to achieve very robust long/short returns. We were able to add as much value on the short side as we were on the long side. So we were able to create very diversified long/short portfolios with relatively smooth returns. We didn't even know we could do that before seeing the results of our research.

There's absolutely nothing wrong with what I wrote in *You Could Be a Stock Market Genius* – it's what I did for almost 30 years. But about three or four years ago, my partner and I decided that conducting really in-depth research on a handful of companies is a full-time job if you want to do it well. Alternatively, more systematically valuing a large number of companies over time is a huge job itself due to risk management and other responsibilities. Though they're a little different, both strategies are great and they're both full-time jobs. I had been doing one thing for a long time and I was fascinated by our research results of the systematic valuation approach.

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Pictured: Bill Miller of Legg Mason Capital Management at CSIMA Conference in February 2012.

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“Part of the future is unknowable but there are some instances where you can take a calculated risk/reward bet. One thing I would say is that a common characteristic of many of the stocks that we buy is that everyone hates them. We do that a lot.”

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When you are very concentrated, you have the chance to make 20, 30, 40% annualized returns. Perhaps if I'm willing to accept somewhat lower returns, say mid-teens, and achieve a smoother return compounded at the same time, then that's pretty attractive too. One approach is not better than the other. There's an interesting trade-off between how much volatility you're willing to accept and how much money you're potentially going to make. If I were starting all over again, I'd do exactly what I did before. And now that we're well established, I think the main attraction of the systematic approach is that it's something a bit new and different, although I would reiterate that it's really the same thing that we've always done with just a slightly different approach.

G&D: We've heard other investors who use their own formulaic approach to investing say that, from time to time, they get an itch to change their model or to otherwise override it. Have you ever had this urge and is it difficult to resist?

JG: The only way Rob and I know how to value companies is through various measures of absolute and relative value. Of course it won't work for every company, but on average it works quite well. There are some companies that we buy that might make you scratch your head. On the other hand, we've been

pretty good stock pickers over history, and we have not been able to improve our results by picking the things that we clearly don't want. There's a certain medication on the market that's made by a small pharmaceutical company. This company was considered a very attractive buy according to one of our screens. But I knew why it looked cheap – its key medication was coming off of patent the next year and the stock was priced accordingly. My inclination could have possibly been to override the formulaic recommendation because I knew exactly what was going on. It wasn't like it was a big secret. I didn't override anything, however, and the company subsequently figured out a way to extend the patent a little longer which then led to a doubling of the stock price over the next six months. I think that's really been our experience. Part of the future is unknowable but there are some instances where you can take a calculated risk/reward bet. One thing I would say is that a common characteristic of many of the stocks that we buy is that everyone hates them. We do that a lot.

G&D: You mentioned taking short positions earlier. Can you be successful in this area merely by shorting the companies in the lowest deciles of your screens – that is, by systematically doing the opposite of your long approach?

JG: When we buy things, we like companies that invest their capital well; they generate large amounts of cash flow relative to the price we're paying. On the short side, we would like to be short, in general, high-priced, cash-eating companies. So it is essentially the opposite of our long approach. You do have to balance your risk, though.

In the original edition of *The Little Book That Beats the Market*, I grouped the “magic formula” stocks as I called them – or stocks which were systematically considered good and cheap – into deciles. Decile one was the best combination of good and cheap. Decile two was the second best, and the tenth decile was composed of companies that earn lousy returns on tangible capital, yet nevertheless were expensive. There was a big performance spread between decile one and decile ten when we did the study, and it worked in order as I mentioned earlier. Decile one beat two, two beat three, three beat four, all the way down through decile ten. Pretty much every student I've had, and hundreds of e-mails after the book was published, have said, “Joel, I have this great idea for you. Why don't you buy decile one and short decile ten? You'll take out the market risk and you'll make 15% or 16% a year.” I did that experiment in the afterword of the revised addition of *The Little*

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Book, and the results showed that you couldn't figure out a compounded rate of return because you lost all of your money. Somewhere around the first quarter of 2000, the shorts went up a lot and the longs went down such that the combined loss was so severe you went broke.

There were a couple things a bit unfair about that because we kept the portfolios for a year, and we didn't re-adjust as we lost money. What I was trying to show at a high level was that if I wrote a book that had a formula and it worked every day and every month and every year, everyone would use it and it would stop working. So, the magic formula, like all value investing, can give you noisy returns over the short term, but that's also why it continues to work.

G&D: In class, you talked about how you try to assess how cheap or expensive the market is at any point in time. Can you talk about your views on the market today and how you look at it?

JG: Sure. Well we've looked bottoms-up at each stock in the Russell 1000 Index, the thousand largest stocks in the U.S. by market cap. We've looked at those over history, meaning the market-cap-weighted free cash flow yield of the Russell 1000 on each day over the last twenty years and right now we're in about

the 87th percentile towards cheap, meaning that the market as measured by the Russell 1000 on a free cash flow basis has only been cheaper 13% of the time over the last 23 years. When it has been this cheap, the forward return for the Russell has been about 17% and then about the mid-30's two years out. That's not to say that the market's prospects are better or worse going forward – they're probably a little below average for the forward period and therefore you could say that perhaps you won't do quite as well as would be implied by historical returns. But, even in the 50th percentile, you would expect to make 8% or 9% based on the history of the last twenty-something years, so I would just say that if I had a choice between being more long or more short, I'd be more long. It's a very attractive time to invest in the market, despite the run-ups that we've seen in the last year.

G&D: Harkening back to the first part of your investing career, you talked about passing on ideas. How many ideas did you pass on for every idea that you ended up acting upon?

JG: It's a tough one. I would say it obviously depends on how selective you are. If I looked at 40 or 50 ideas, and while perhaps 12 or 13 of them would have worked out, if I end up only buying one, that's okay. That's fine as long as the

one I choose works out. It doesn't matter that I missed out on 11 or 12. Not losing money is a good way to ensure that your portfolio has a good risk/reward profile. One of the things I said in *You Can Be a Stock Market Genius* is if you don't lose money, most of the alternatives are good. Even if you don't know what the upside is – if you just know there's upside – you can create scenarios where you have an excellent risk/reward. Positions with limited downside are the types of positions that I have loaded up on in the past. Not the positions with the biggest payoff. I could buy a lot knowing that I wouldn't lose much and that there were good possibilities that it was worth a lot more over time. At the very least, I knew that my downside was well-protected and so I could create an asymmetric risk/reward by saying if I don't lose much, there are not many alternatives other than to make money.

Something else that I've said in my class is that if you are trying to analyze an investment and there's a lot of uncertainty regarding a company – whether it's new technology or new competitors, or something else – or the industry in general is uncertain such that it's very hard to predict what's going to happen in the future, just skip that one and find one you can analyze. If you invest in six or eight things that you've analyzed closely,

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“If you’re a long-term holder and you own a chain of stores in the Midwest and something bad happens to Greece, there may be some small impact, but you’re not going to sell your business for half of what you think it’s worth all of a sudden. If I’m a shareowner in businesses, I need to have a long-term perspective that things will work out roughly as I expect, otherwise I shouldn’t own them.”

and if you’re pretty good at valuation and you have a long time horizon to see your target valuation eventually play out, then you’re going to do incredibly well even if you’re right on only four or five of the ideas. This is especially true if you include a margin of safety so that you’re not losing too much on the ones where you’re wrong.

What I said in the beginning is true: if you’re good at valuing businesses, the market will eventually agree with you. But that’s eventually. It could be in a couple weeks or a couple years, and that’s a big difference. The traditional definition of arbitrage always went something like this: buy gold in New York and sell it simultaneously in London, and you’ll make a dollar. But if I told you, “well, I guarantee you’ll make a dollar, but you could lose half of your money first, and it could take three years for you to make that dollar, and it’s going to bounce around randomly in the interim,” that’s not quite arbitrage in the traditional sense. It’s certainly not riskless arbitrage, but it is a type of arbitrage – it’s a type of time arbitrage. That’s very hard for people to do. Throw in the fact that you don’t always get the valuation right. Yes, if you did good valuation work, the market will agree with you. I would submit that most people cannot value most companies well. If you’re very selective, however, you can

value certain companies well. And that’s what I would think about doing.

G&D: With respect to your risk management strategy, appropriately sizing positions has traditionally been one area of focus for you, correct?

JG: Yes, people would say ‘how can you own only six or eight companies,’ because during a lot of my career, six or eight positions represented 80+% of my portfolio. People thought that was crazy because of the volatility and the Sharpe ratio or whatever you might want to look at, but the point is that I look at it differently. I look at stocks not as pieces of paper that bounce around. I look at them as ownership stakes in businesses.

One of the examples that Buffett gives is as follows: suppose you sold your business and you had \$1 million. You walk into a town and you want to invest the money conservatively. You might look around and see that there are 50 businesses in the town but you want to try to pick ones that you think have a nice future that you could buy at a reasonable price. If you pick six or eight of them, most people would think that owning a stake in the barbershop, the hotel, and whatever other businesses you thought had nice repeat customers that would continue to grow over time as the town grew, was a pretty conservative

way to go. You’re not throwing all of your money into one business, you’re picking six or eight businesses that you researched carefully; have strong management and look like they have good franchises. That sounds fairly conservative to me. That’s how I look at owning a portfolio of stocks. Once again, they’re not pieces of paper that bounce around.

If you’re a long-term holder and you own a chain of stores in the Midwest and something bad happens to Greece, there may be some small impact, but you’re not going to sell your business for half of what you think it’s worth all of a sudden. If I’m a shareowner in businesses, I need to have a long-term perspective that things will work out roughly as I expect, otherwise I shouldn’t own them.

G&D: Is there something in your background that made you predisposed to having a long-term mindset and a commitment to ensuring a margin of safety for each investment, or is this something which you developed over time?

JG: This is a mindset I developed as early as an undergraduate student. As I mentioned earlier, I became interested in this business by reading Ben Graham. That’s what resonated with me, so what can I say? Margin of safety and how to think about Mr. Market are

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things that I thought about very early in my investing career. Graham's tenets seemed logical and simple – simple enough even for me to understand actually! So I started reading and thinking and experiencing. Some things you have to learn by doing them wrong, so I encourage people to risk being wrong. You can't be a good investor without investing. As you gain experience you start to understand risk/reward; you start understanding what looks like a good opportunity and what doesn't; you recognize when you have more knowledge than the market about a given issue and when you don't. So it's a matter of comparing situations to your history of opportunities. I've also said in class that one of the important things to look at is not just what's available now but what you think might be available in the future, and that perspective comes with time.

Here's the other thing – unfortunately you don't learn from your successes all that much; you learn from the things you screwed up. You have to screw up a little bit to learn what not to do again and to remember it as well. But you have to combine this with the right thought process, which I think is the key. There are a lot of smart people out there. A lot of people have financial skills and most of them fail. The difference between those who are successful and

those who fail is perspective – the viewpoint of how they look at the market – which really just comes back to Ben Graham and keeping that long-term horizon and understanding how to filter out the noise. People are bombarded left, right, and center with information, even more so now; you can bury yourself as much as you want. Therefore, you need a simple filter through which to look at the world. Those who have a baseline from which they can really contextualize everything they look at are the people who are successful. A lot of things are driven by emotion. When things get bouncy, as long as I continue to believe that my work was good, and my thought process was right, I have to ride it out. As easy as it sounds, it's really hard to do.

G&D: Over the years you've seeded some different investors – Robert Goldstein, Brian Gaines and some others along the way. Was there some commonality that you saw amongst these investors that gave you the confidence to provide them with capital relatively early in their careers?

JG: I really just look at thought process. I found them before they had a track record, right? So you want to find people who think correctly. When I listen to an investment pitch or an investment thesis, I'm looking to see if all of the right questions were asked

and that the thought process was clear. Those who think clearly, stand out. Some people are good at it; some people are great at it. I've graded a zillion papers and I've talked to many people, and I've listened to many ideas over time. There is a certain thought process and clarity of thought that those who are great at it have. Or maybe they're going through the steps that I would hopefully go through if I were looking at the same idea. It doesn't mean that what they're saying will always work out, but it does indicate that they could have a pretty good batting average over time. It doesn't mean that there aren't other ways to make money – those just aren't my areas of expertise. In my circle of competence, I can perhaps recognize other people that think similarly, who I think do the work, and that's really who I'm drawn to over time.

G&D: A couple of school related things... Do you find it more difficult teaching what you know about investing to MBA students than actually investing? Are there parts that are more difficult or frustrating for you?

JG: This is my 17th year teaching, so I think that the frustrating part was present more so when I first got started. I wasn't particularly good at expressing myself and what I was thinking early on. The great part

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“The difference between those who are successful and those who fail is perspective – the viewpoint of how they look at the market – which really just comes back to Ben Graham and keeping that long-term horizon and understanding how to filter out the noise.”

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Pictured: Ellen Ellison (Executive Director of Investments at University of Miami) at CSIMA Conference in February 2012.

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about teaching is that you really have to boil down to the basic principles of why you did certain things and why you didn't, what has been successful and what has not. You boil that down into some principles that people can learn to use so that they can do well themselves. Learning to do that has actually been very helpful to me – it was helpful in writing, it's been helpful for my own investing. I try to sit down and figure out what's the best way to explain something that I'm looking at in a very simple, straightforward way. If you can't explain it very simply and straightforwardly, then you probably don't understand it all that well yourself. I'm not a rocket scientist and none of this is rocket science. It is just about understanding some very simple, basic principles that for some reason many people can't stick to. But there are others who can. Columbia MBAs have tools to be successful investors but many won't be. Some, however, if they have the right mindset and the right work ethic, will be successful.

G&D: As you said, this is your 17th year teaching. Have you noticed any change in the students over the years?

JG: I think the “money management business” has become more popular over the years than it was when I got started. I took my first job in 1981 and the market

hadn't gone up in 13 years, so it wasn't a very popular thing to do. There have been waves. During the internet bubble, teaching value investing was, let's just say, not appreciated as much. I would say that the growth of the hedge fund business and the money management business over the years has caused more people to be interested in

“I just ask that if they learn the skills in the class and are successful with them, that they use that success for good. In other words, I ask my students to figure out a way to give back in some way that's meaningful to them.”

this area. I think it's become a more popular field and that's why, on the first day of each semester, I tell my students that I don't think that there's a great social value from this career. On top of that, if I'm teaching it, that's even one more step removed from doing something socially valuable. So, I just ask that if they learn the skills in the class and are

successful with them, that they use that success for good. In other words, I ask my students to figure out a way to give back in some way that's meaningful to them.

G&D: On that note, we know that the Success Academy Charter Schools organization is something about which you're particularly passionate. Could you tell us a bit about this organization?

JG: Sure. It really goes back to teaching a man to fish. You want to give back in a way that's leveraged and that allows you to help someone have a nice life that might not have that opportunity otherwise. You could do this in such a way whereby they're helping themselves and doing it with the tools that you give them.

Education to me is one of the most leverageable ways to give back. Typical public school systems are soviet-style systems, where there are no rewards or punishments for good or bad performance. The usual excuse for the lack of success of kids in need is that there is not enough money or that the parents don't care or that the kids are stupid. Those are usually the reasons given. Rather than argue against those points – because I'm not very political – what I hoped to do through the Success Academy was to be involved in a

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project where we could use the same or fewer resources compared to the existing schools and be successful with the same kids. We thought about it like a business model – you set up a prototype and then you replicate that and refine that process over and over again. My hope was that if we could replicate such a thing 30 or 40 times with the same kids, with less money, then those old excuses would stop. Well it's the same kids, we have less money, and parents do care and these kids are pretty darn smart. Even a kid who may have been considered average in another school can achieve at an extremely high level.

We now have 14 schools and we're hoping to build 40. We'll open another six schools next year while trying to replicate the success we've had to date. So far these kids in high-need communities are beating out Scarsdale and all the top school districts in New York. The problem has been replication. You can always just throw money at an individual school, turn it into a private school, and maybe it'll be very good. The challenge, however, is

to do it with less money or the same money as the state and then to replicate it over and over, which is the really hard thing to do while keeping the culture and achievement levels high. Since we have the same kids as the regular public schools, all of our kids are selected by lottery. If the Success schools can show that it can be done, hopefully they will help move the system.



Pictured: Value Investing Program member Patrick Staub '13 discussing current events with Success Academy students.

The great thing about this business is that if we are successful, other communities can look at what's working here and can "steal" the intellectual property of the organization. The goal is to first demonstrate that we've been successful with this system and then share it with as many people as possible who want to learn how to do it too. If it works, hopefully it becomes built into the system. Right now every school we open is challenged in one way or another. Hopefully just by

putting facts in black and white, we're able to make a nice statement.

G&D: Any other parting words of wisdom for our readers?

JG: If you want to get good at investing, read a lot and practice a lot. Even if it's not a lot of money, it's real money. Don't fool yourself into thinking that this is all you need to do to lead a successful life. This is fun for me; it's fascinating. There's nothing wrong with this field but, as I said before, I don't think there's much social value in it. You can probably say that about a lot of occupations that aren't saving lives every day, so you don't have to feel bad about it. But I would just encourage people

pursuing an investing career who are ultimately successful in it, to figure out a way to give back. Many people reading this are Columbia MBAs and pretty much all of them are, or will be, successful in some field or another. If you can figure out a nice way to give back that's meaningful for you, that's even more fun than being successful in whatever you choose to do. Keep that in mind.

G&D: It was a pleasure speaking with you, Professor Greenblatt.



Pictured: Julian Robertson of Tiger Management and Anna Baghdasaryan '12 (Co-Editor of G&D).

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G&D: You were recently labeled the “dealmaker who won’t make a deal” in a widely read financial publication due to the fact that Loews hasn’t done a large deal in over five years despite its solid cushion of investable cash. What’s your reaction to this?

Jim Tisch (JT): Some would say that this patience is part of our strategy, but I would say it’s more than that. I’d say it’s part of our DNA. I like to say, “If there’s nothing to do, do nothing.” We don’t have to do deals. We’ve got businesses that generate income and do very well on their own. We are constantly looking to improve those businesses. We are also always on the lookout for other companies to add to our portfolio of businesses but we don’t feel the need to do it. And we may hear in the press that we haven’t done something for a while but we tend not to hear it from our shareholders. You know if you say something long enough people will ultimately realize that you mean it – if you say it consistently. One of the things that we say consistently is that we don’t manage earnings and we’re not in a rush to add a new business. We’ve said this for so long and so consistently that people who select to buy our stock understand that it’s part and parcel with ownership of the stock. These people understand that I have a very significant stake in Loews, that the

family has a very significant stake in Loews, and that we have a history of over 52 years with the company. In essence it is a follow the fortunes type of thing.

G&D: We’ve heard about the famous ‘Jim Tisch \$5 million test’ that you formulated aboard an oil tanker in the 1980s that preceded your purchase of six oil tankers. The test is elegant in its simplicity. Do you look for a way like this to synthesize the thesis behind each investment you make?

JT: So, honest to God, the ‘\$5 million test’ originated just the way I said it – when I was standing on the deck of a ship – 30 years younger. It was a way of saying “Wow! I can’t believe how cheap this is!” Then I coined this pithy little phrase – the ‘\$5 million test’. In fact the ships did cost \$5 million. We bought two of them. It is just a pithy way of saying that sometimes something is so cheap that it is almost beyond belief. It’s like getting this building we are sitting in now for \$20 million.

G&D: Have you felt that way in general with every deal that you’ve done?

JT: No, not a lot of them. But I definitely felt that way with the ships.

G&D: What were others missing?

JT: Oh! It’s very simple. In the mid-1970s, the VLCC

fleet had built up significantly because the amount of oil coming out of the Persian Gulf was increasing dramatically. Then in the early 1980s there was the Iranian oil embargo and as a result oil prices shot up and demand for oil went down. Since the Persian Gulf is the marginal producer of oil, and since the Iranians had shut down, there was no demand for ships. So all of a sudden there were three times as many ships as there was demand for them. So the oil companies took their four and five year old ships and they laid them up. These ships were such a drag on the market that they were being scrapped so the scrap value of the ship was \$6 million but it cost \$1 million to get from Europe to the scrap yard in Taiwan. So we found them for \$5 million. We bought these ships like you buy hamburger meat, but instead of dollars per pound of hamburger it was dollars per ton of steel. The market for the ships had collapsed. We thought it could be an interesting investment because there wasn’t much downside, as the ships were trading for scrap value, and we figured maybe something good could happen. Once we got into it and found the right person, sort of serendipitously, we really constructed for ourselves a very credible case for how the ships can go from scrap value to being worth a lot of money – which in fact they did. The ships cost \$50

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Joe Rosenberg and Jim Tisch

“Some would say that this patience is part of our strategy, but I would say it’s more than that. I’d say it’s part of our DNA. I like to say, ‘If there’s nothing to do, do nothing.’”

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million to build. So we knew there was a long way to go between \$5 million and \$50 million before somebody else would ever build another ship. The other thing we knew is that ships were being scrapped, so they were being taken out of the market forever, never to come back again – supply was coming down. The other thing we saw was that at some point the demand for oil from the Persian Gulf was going to increase again. It was just a classic microeconomic case. We saw the supply coming down and the potential for demand going up. We also understood, because it takes three years to make a new ship, that the supply curve would go vertical at some point. When a supply curve goes vertical and you have a small shift in the demand curve, you get extraordinary increases in rates, which is why there is such volatility in shipping markets. The people that were in the business that owned the ships thought the ships were a plague on the market. They were focused on the shipping markets and their own need for the ships. They weren't thinking like an investor or speculator.

We bought two ships from Shell, three ships from Exxon, and then a few others. The problem we had was that the day we decided to go into this whole hog it was like somebody had a tap or bug in the room and was eavesdropping on us. The

market just went up. So we have bragging rights in ships but that's about it, because we couldn't put enough money to work doing more deals like the ones we did. The best part about the whole thing was that we were introduced to Jack Devanney. He was instrumental in helping us get into the offshore drilling business where we did go in whole hog and were able to make some real money. Devanney, who was a naval engineering professor at MIT, had worked on nuclear submarines and was the most academically honest business person. Jack watched over our ships for us and then one day in 1988 he realized that the offshore drilling market at that point in time was like the tanker market seven years prior. I asked Devanney to arrange for us to look at some assets to do our diligence. Three weeks later we were on the deck of a semisubmersible rig and the '\$5 million test' came into play again, though the \$5 million price tag was purely coincidental. If the rigs had been \$7 million we still would have bought them. Except at this time we remembered to go big. We bought a small company in 1989, again serendipitously, called Diamond M Drilling. Diamond owned seven rigs and we already owned three prior to that. In 1992 we went big when we bought a company called ODECO, which owned 30 rigs or so. So, doing the deal for the ships introduced us to Jack

Devanney, and he helped us get into offshore drilling.

Joe Rosenberg (JR): Today a deep water rig will run you in the ballpark \$635 million.

G&D: Loews owns companies in their entirety and holds both majority and minority stakes in public companies. Given the different ways you are willing to invest, have you had instances where being a majority owner of a company gave you insight that helped you invest capital in public companies, or where developments in the public market alerted you to private assets you ultimately purchased?

JT: You know, I would say to the extent that we own an insurance company, sometimes we'll invest in insurance stocks but not that often. Likewise, we don't invest in offshore drilling stocks because we figure we have enough with Diamond Offshore. So we really keep the different buckets separate.

G&D: Do you look at things from a valuation basis differently for these different types of ownership stakes, given that when you own a company outright or have a majority stake you have more impact on capital allocation decisions?

JT: We only have control over the cash flows to the extent that either, one, the

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cash is reinvested in that business or two, the company pays a dividend and we get the cash up to Loews. We can only use it for Loews once it's paid out to us and to other shareholders in the form of a dividend. What we do with each of these businesses is work with the management and come up with an intermediate- and long-term strategic plan for them that focuses on the finances and also focuses on the capital spending. Then we figure out what earnings or what cash they have in the company that could be available to pay dividends – that's how the dividend policy is determined. We like getting cash back but we also want to make sure that the companies only pay dividends after we are absolutely, positively sure that they aren't going to need the cash at the parent. We currently have three majority-owned companies (CNA Financial, Diamond Offshore Drilling, and Boardwalk Pipeline Partners) that are public, and we also used to have a tobacco company (Lorillard) that was public through Carolina Group. So we are accustomed to being a control shareholder. The thing that we found out over the years is that even though we are the control shareholders, we need to treat the minority like they are the majority because the valuation of Loews is driven based upon the value of our subsidiaries. To the extent that the minority shareholders of our subsidiaries feel

“...Even though we are the control shareholders, we need to treat the minority like they are the majority because the valuation of Loews is driven based upon the value of our subsidiaries. To the extent that the minority shareholders of our subsidiaries feel good about those businesses and bid them up in the marketplace, it will inure to the benefit of Loews shareholders...”

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good about those businesses and bid them up in the marketplace, it will inure to the benefit of Loews shareholders through a higher valuation based on the sum of the parts valuation for Loews.

G&D: Joe, what was your introduction to investing? Do you remember any good investment ideas from your early days?

JR: Actually I didn't start college until I was 24. Two weeks after high school, I went to Israel for three years. I came back to the States, joined the army, and within a year I was stationed in Germany. After returning from Germany, I went to college at night, I really didn't know anything about Wall Street. One day a friend of mine and I were sitting on the floor of the apartment we had, as we didn't have any furniture, and we were talking about an investment idea. He recommended that since I loved talking about investment ideas so much, I should pursue a career in the field. I tried getting a job on Wall Street but no one would hire me, since I was still in college. I didn't even have a bachelor's degree and at this point I was 26.

Shortly after finishing college I started working for Bache & Co. (now part of Prudential). I really took to it like a duck to water. I was very serious about it. In pretty short order, I

moved from someone answering questions at the information desk to being a sellside junior analyst. I started following the airline industry. There was no senior transportation analyst at Bache, and no one wanted to cover the industry because they thought it was a dead end following airlines. From the beginning of the airlines industry in the mid-1920s until today, they've never made any money if you took the aggregate of the business. But in 1962, which is when I was analyzing the sector, I got the sense that there was something dramatic going on in the industry in the form of conversions from piston air planes to jet air planes. Most old-line transportation analysts covering the industry thought only about how expensive it was going to be to make this transition. What I saw was that the planes would fly two to three times the speed with the same number of crew members. It was a reduction in unit labor cost. This was one of a few times in history when you could make money with airlines and I was in the right place at the right time. I didn't fully understand what I was doing, which was fortunate because I would have been more fearful. I started recommending airlines and they had a meteoric 10-fold rise.

After Bache I moved to Empire Trust Company on the buy side and, in the eve-

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nings, took classes at NYU for my MBA. I soon became head of research at Empire Trust. Then, in my final year of business school I wrote my thesis on the airline industry. What was happening then in the airline industry is the same thing that happened to the tanker industry some 20 years later. Airlines became so profitable that they soon became unprofitable because they began over-ordering equipment. From interviewing airline management teams, I realized that each company was increasing capacity and at the same time underestimating the capacity that other airlines were adding. I started to aggregate what they were all telling me and realized that it was nearing the end of the party.

G&D: What brought you to Loews?

JR: In 1971 I was working for Schroders, a British bank where I ran an internal hedge fund. At this time in my career I would sometimes go to investment luncheons. At one of these luncheons, I met Larry Tisch who, during our conversation, suggested that I consider joining him at Loews. I didn't take him up on the offer at the time, but we kept in touch, often talking about investment ideas. About a year and a half later, in 1973, I called Larry and asked him if his earlier offer was just a throwaway line or a real offer. He said, "I meant it." I took the

summer off and joined Loews in the fall of 1973. Three or four years into my career, Larry walked into my office and mumbled that his son Jimmy was coming to Loews, and he was going to be working for me. I asked Larry what he wanted me to do with Jimmy and he said, "Why don't you take half an hour and tell him everything you know." (Laughs) I still remember his first assignment. I asked him for a spreadsheet on the metals industry. We didn't use computers then; we had slide rules. Jimmy was a very good analyst. He was very inquisitive and came up with an idea a minute.

G&D: Jim, can you talk about running Loews at the holding company level? What is your idea generation process and how many people are scouring for ideas?

JT: Let me tell you about the structure here. We have an investment department in which the vast majority of people deal with fixed income. We manage, under a management agreement, the roughly \$40 billion investment assets of CNA Financial. We also manage the cash of Loews, which is about \$3.7 billion. In addition we also manage our pension funds. So overall we are managing roughly \$50 billion. We have a Chief Investment Officer, and Joe is our Chief Investment Strategist. At the holding company we have

two fellows who look over our subsidiaries. One handles Boardwalk and High-Mount and the other handles Loews Hotels, CNA, and Diamond Offshore. Then we have a development officer who is charged with looking for other businesses for Loews to pursue. Our subsidiaries tend to have their own development people who look for businesses that they buy. Our development officer has five analysts working for him. This place is an open door place. All senior execs are here together and we see each other and talk all the time. I have meetings once a week, both informally and formally, with our top guys to talk about our businesses. We have an acquisitions meeting once every other week and we have a strategy committee meeting every 3-4 weeks to discuss the major issues at Loews and our subsidiaries. So there's a lot of talk. People know to chime in and state their opinion. It's a very collegial place. I like to think it's also a place without a lot of politics, though I may not see that because I've been here so long and I appreciate when people suck up! (Laughs) Generally, when I talk to senior executives before they're hired, I talk to them about the culture and atmosphere. Then six months or a year later I ask them if what I said is true or not and, of course, they say 'yes'; but what can they say? We do not impose our culture on

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our subsidiaries. We leave it to each one of those CEOs to manage their businesses on a day-to-day basis, and we just get involved with them on major strategic and finance issues and management selection and succession issues.

G&D: Over the last few years a few hedge fund managers have started P&C insurance businesses. Given how well you know the space, what are your thoughts on this?

JT: I think they are crazy! I haven't looked at this carefully at all but the thing I know is that they are generally going into the reinsurance business. It's really easy to lose a lot of money in the reinsurance business. There are a lot of people in that business who sound like they are really smart and who know a lot about it. One thing I think these upstarts need to remember is that it's not written that your losses can be only 100% of your premiums. They can go much higher than that. And I assume that these hedge funds are getting into this business because they see it as a source of permanent capital, but the reinsurance business is not an easy business, as it's basically blind risk that you are taking. You don't really know what the risk is and it's easy to lose a lot of money.

G&D: Following your comments on hedge funds wanting permanent capital, how

important is having permanent capital to your ability to make investments at the right time?

JT: There is good news and bad news that comes with permanent capital. We have permanent capital, but other investors that we compete with for assets can be much more cavalier with their capital than we can afford to be. Private equity funds are often willing to pay much more than we are because we think of investing like owners of the business, and they're thinking of it as a call option. We couldn't even countenance buying a subsidiary thinking that at some point it might go bankrupt, but for the private equity guys, that's their business. Each of our investments stands on its own. For us, each investment represents a significant portion of our capital, and I like to sleep at night. Being on the cusp financially does not lead to sound sleep. From time to time this makes it difficult to compete with private equity firms. On the other hand they are also really jealous of us. I have a lot of friends in the hedge fund and private equity businesses and they would love to get their hands on permanent capital. They could quit going out on road shows to raise money. And there are times, in fact, when we can be very competitive versus the private equity funds in buying businesses. Today is one of those times because banks aren't lending as

much as they were in 2007. The private equity guys have to put up more equity, which reduces their leverage and returns, making it more difficult for them to

“We couldn't even countenance buying a subsidiary thinking that at some point it might go bankrupt, but for the private equity guys that's their business. Each of our investments stands on its own. For us, each investment represents a significant portion of our capital, and I like to sleep at night.”

do deals.

G&D: Speaking of deals, is it frustrating when you like an asset, and do your diligence, but a more cavalier buyer is willing to pay more than you?

JT: No, I learned from our previous General Counsel to never fall in love with an asset. If you get deal fever

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you can do really stupid things. So if it's going to be, it'll be. If not, it won't be. And the thing we always focus on is to make sure we are not overpaying. So we tend not to get our heart focused on one deal or another, and we try to inculcate that in our subsidiaries when they are trying to buy bolt-on acquisitions. When we can buy something at the right price, it makes sense for us. If not, it wasn't meant to be.

G&D: How many different deals do you look at for each deal you actually do?

JT: We look at lots and lots of stuff – we have five people to keep busy, and it can be several years between purchases. We are happy to look and kick tires and learn and only buy something when we think it's right.

G&D: How do those five people decide where they are going to look for attractive assets?

JT: We focus on a few specific industries, which is evident in what we own. We wouldn't want to venture too far from those industries to, say, focus on the tech industry. We tend to go where you'd think a value investor would go. We try to get knowledgeable in those industries and see what's available.

G&D: Companies in which you have majority or complete ownership have US-

centric operations. Would you invest in something that has a majority of its operations outside of the United States?

JT: We are looking to buy businesses that are headquartered in the United States and whose primary business is in the United States. I have a few things to say about opportunities in foreign countries: They don't make airplanes that travel fast enough; they haven't eliminated time zones; and I'll always wonder why we are buying this company instead of the local guy. This is combined with the fact that we feel somewhat comfortable with the political environment here – the laws, the rules, and the customs. That's all completely different when we go to a foreign country. As a general rule we wouldn't take on the chore of buying a foreign-based company. It doesn't mean that our subsidiaries can't expand overseas – we are happy for them to do that – but we don't want to start by buying a business that is based overseas.

G&D: You once said that buying a company is like walking into a room that is pitch black, with danger lurking everywhere. Can you give any specific examples of how this is so?

JT: Yeah! Look what happened to us in the E&P business. We bought High-Mount when gas was \$7.50 per Mcf. We thought we

were really smart when it went to \$8 and by the time it went to \$15 within a year – we thought “Wow! This is really good!” And then boom! The next stop had a \$1 handle on it! I think that we, along with everyone else in the industry, missed a major trend. Exxon Mobil bought XTO Energy for about \$40 billion. Even beyond the big macro issues, if you are not working in the industry, you don't really have the same feel for it that you do by being in it and talking to the people in it. It's just different. It's the difference between reading a book and actually experiencing something. When we think about buying subsidiaries, we always try to remember that there is a lot more about the industry that we don't know relative to what we do know, and therefore when we think about whether we really want to do a specific deal, we think about whether we considered the downside enough. The way we think about it is that there are three things to do with our cash. First, we can keep it on our balance sheet. Second, we can buy in shares. Third, we can buy a new business. It's easy to keep it on our balance sheet. When we buy in shares we know exactly what we are buying. But when we buy a new business from somebody else, we are never really sure what we are getting. It has to be a really good value. Over time we've gotten better at kick-

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“...never fall in love with an asset. If you get deal fever you can do really stupid things. So if it's going to be, it'll be. If not, it won't be. And the thing we always focus on is to make sure we are not overpaying, so we tend not to get our heart focused on one deal or another and we try to inculcate that in our subsidiaries when they are trying to buy bolt-on acquisitions.”

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ing the tires, but it doesn't matter. We still recognize that we are not in the industry.

G&D: Joe, are there any sectors where you are currently finding value in the public market?

JR: I've publicly spoken negatively about the big banks, but in the last two to three months I have changed my mind a bit. I still don't know what the banks own, but given the fact that it has been a few years since the crisis, they have had time to clean up most of their problems. Also, because of the banking crisis in the rest of the world – particularly in Europe – there could turn out to be a tremendous bonanza for U.S. banks. Think about it. If you are a large corporate or individual depositor or wealthy person, and you have an option of putting your money in banks that have already been through the crisis and are now in a good shape like the U.S. banks – let's say a bank like Citi or J.P. Morgan – or putting your money in a European bank, what are you going to do? A company in Mumbai is going to go with a U.S. bank because they are afraid of what's going to happen with the European banks. This could become a major benefit to these banks, as they aren't paying anything for these deposits today.

I still view the market in general as cheap. There has

been immense skepticism in the stock market and I view this as beneficial for someone who is bullish, like me. A lot of investment fiduciaries and the public are liquidating equities and buying bonds. The amount of selling the public is doing in domestic equity funds is

“I still view the market in general as cheap. There has been immense skepticism in the stock market and I view this as beneficial for someone who is bullish, like me.”

more than offset by the amount of buying that corporations are engaging in through share repurchases. That the public is doing the wrong thing at the wrong time is nothing new in the history of investing, but the fact that professionals are is what surprises me.

G&D: What do you read and are there any investment books that you would recommend?

JT: I tend not to read investment books. I read lots and lots of other stuff though, and this contraption here (points to iPad) has totally lightened my briefcase. It makes it really easy

to read stuff. I spend hours over the weekend reading different reports and commentaries on the markets, as does Joe.

JR: We alert each other to things so that sometimes he doesn't have to read stuff – someone has alerted him to it and if they are smart they are reading what they send him carefully so it's not a waste of Jim's time. When you are in this kind of a position, people alert you to things.

JT: It probably takes four to five hours a day just to read stuff and respond to emails before you can even think about being productive. It's just what you need to do to stay afloat, not to move forward.

JR: My favorite book to recommend is *The True Believer: Thoughts on the Nature of Mass Movements* by Eric Hoffer. There is no discussion about investing in the book, but in my opinion it is extremely helpful in understanding markets. It conveys the nature of human behavior in mass – how people act as a group. One of his great examples is explaining why people riot. There is no reason and no logic. People just get caught up in it. Riots don't end all at once, they end person by person – that's markets. People panic in a group, but they come back to their senses one by one. That's why stocks move incrementally the way they do.

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G&D: What's the best piece of advice that your father (Larry Tisch) ever gave to you?

JT: Watch out for the downside. Don't worry about the upside.

JR: [to Jim] In the early years, I think your father also encouraged you a great deal to pursue an idea when you had one and to go bigger than you might have because you were young and cautious. He would say, "if you like it then why don't you do much more?"

JT: My father was really an investor. I would say that I am a combination of an investor, capital allocator and manager. But my father bought a whole bunch of businesses and he was a phenomenal delegator rather than a control freak. So he had an enormous amount of bandwidth because he didn't clutter himself with day-to-day things.

JR: He never wrote a memo in all the years that I was at Loews with him. I defy you to show me one memo signed by him.

JT: He also had a very good stock market instinct. He was a CEO but he was also a stock trader, though he never had three screens (points to his screens)!

JR: He was a phenomenal delegator.

JT: Two things. He was a

phenomenal delegator and he wasn't a second guesser.

JR: He'd never look back. He never said "I told you so" or anything like that. He assumed you knew your own mistakes and he didn't have to remind you of them. He was at his best when you were at your worst, which was very important because most people are the opposite of that. Most people, when you make a mistake are ready to beat up on you. He would encourage you.

JT: Joe would pile into stocks and they would go down and his response would be, "buy more."

G&D: Jim, you were recently a director of the Federal Reserve Bank of New York. Is there anything that you learned in your time there that changed the way you look at things?

JT: There's a massive misunderstanding about what the directors of the Federal Reserve Bank branches do. Each of the 12 Federal Reserve Banks has nine directors – A, B and C directors. The A Directors are from bank companies – one from a big bank, one from an intermediate size bank, and one from a small bank. The B directors are recommended by the banks; I was a B director. The C directors are independent directors. When people complain about Jamie Dimon being on the board of the New York Fed, he's there

because the law states that he or Vikram Pandit or someone like him should be on the board. That's number one. Number two – the board does not get involved in supervision and it does not get involved in monetary policy. The board is there for two reasons. First, it oversees the business operations of the bank and second, it gives the president of the bank and other bank officials a view of what's going on in the business world and with the economy. We received no information, no winks, no nods, nothing from the officials of the bank as to what the Fed was doing. It was all basically a one-way conversation in terms of the economy. To the extent they would tell us something, I would have already read it a long time ago so they didn't enlighten me as to the economy or to monetary policy. Where there was a lot of color added was in my meeting the personalities; getting to see how they worked and getting to see the interactions. It was a good experience. I had to leave after two and a half years because I had joined the board of General Electric, and I couldn't be on the board of the Fed too because there might have been a perception of conflict because the Fed regulates General Electric.

G&D: What do you have to say to young people and business school students

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“Watch out for the downside. Don't worry about the upside” - Best piece of advice Larry Tisch gave to his son, Jim Tisch

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who would want to be on the buy side? How should they think about investment and time horizon?

JR: Young people today in business are much more macro-oriented than micro-oriented. They spend much more time on what is going on in Europe or Federal Reserve policies. They don't focus much on company specifics. Even when they do they have a very low level of confidence in what they are doing. It's very unfortunate. I hate that they don't teach financial history in business schools. If it was up to me, I would make financial history and all history a number one requirement for business schools. Understanding how a spreadsheet works can be learned on the job pretty easily, but understanding the continuum of history requires certain intellect. I cannot for the life of me understand why business schools are not teaching financial history.

My advice to young people, if they really want to be successful in this business, is to learn financial history. Learn history in general and then dig deeper into financial history and you will not be in such awe of everything that's going on. I see the same problem in my office. People just don't know any financial history and they think that everything that is happening is unusual. Everything else can be learned on the job.

G&D: Since you mentioned the importance of being able to sleep at night, is there anything today that keeps you up at night related to Loews or to the economy?

JT: Nothing keeps me up at night. I like to consider myself a realistic optimist.

“My advice to young people, if they really want to be successful in this business, is to learn financial history. Learn history in general and then dig deeper into financial history and you will not be in such awe of everything that's going on.

First of all, we maintain a very conservative financial structure because I like to sleep at night and because I realize that from time to time, there are three, four, five and six-sigma events and times like 2008 and 2009 when you can't rely on others to help you out. You have to build your proverbial house out of bricks rather than hay or whatever else there is. I tend not to

be kept up at night worrying about our businesses. They are all well-managed. I have learned that when bad news hits, the thing that you really have to do to is just think calmly, sanely and rationally. Rather than keep it to yourself, you should talk to everyone around you. Often when it looks like there's no solution and no way out of the box, a way develops. It might be that the combination of a little change in things here and a little change in things there, make a big difference in the problem. By thinking about it and constantly focusing on it, a solution appears or the problem dissipates. That's the manager in me as opposed to the investor in me.

G&D: Thank you both very much for your time.

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G&D: Whitney, Buzz and Charlie, what inspired each of you to join Royce & Associates?

Whitney George (WG): I started off as a broker and worked at several different firms in the 1980s, eventually conducting value-based research with a couple of colleagues, though we were not necessarily focusing on small caps. We were introduced to Chuck in early 1987 and my two colleagues, who had much more experience than me, were embarrassed by how much more Chuck knew about each idea they presented than they did. My partners soon decided that I would be the one who solicited Chuck for orders.

I had the opportunity to see how he conducted himself through the crash in '87, which was quite impressive. Being a great contrarian, he was buying stocks when you couldn't get anyone else on the telephone. When the time came for me to become serious about my career after my first child was born, I approached Chuck. After lengthy discussions on his porch, I convinced him to give me a job as a senior analyst in 1991.

Charlie Dreifus (CD): I first met Chuck in 1974 or '75 through a broker at Oppenheimer. This broker said there's a guy who's

doing similar things to what you're doing. In those days we were doing something very radical – screening. This was a big deal at the time because there were no personal computers. There were only mainframes at firms like Merrill Lynch and you needed to find someone who had programming experience. In those days, Chuck and I were separately conducting the same screens based on return on assets. Independent from one another, and over time, we modified our screens to



Charlie Dreifus, Chuck Royce, Buzz Zaino, Whitney George

search based on returns on invested capital. Chuck also shared the idea of looking for really great companies or, said another way, businesses that had sizeable moats.

The clincher for me, however, occurred in March of 1987. Chuck and I and three others were selected to manage a fund of funds in Australia and New Zealand. It was an entourage of about 40 people – four of the five managers showed up and the rest were sales people. Remember that this was 1987 so cell phones, laptops and computers weren't available. I would

bump into Chuck on weekday mornings at the front desk of the hotel sending telexes to submit trade orders.

On one of the weekends while we were in Australia, we visited the Great Barrier Reef where 38 out of the 40 people from our group were either snorkeling, swimming with the dolphins, playing golf or doing something similar. Meanwhile, I was walking two or three miles to the next town in search of some way of

keeping up with the market – *The Financial Times* or something. Unbeknownst to me at the time was that Chuck was doing the very same thing.

Once I learned that he was doing that too, it convinced me that Chuck shared the passion that I had for this business. We were obviously friendly competitors over the years, but I told myself if I were to ever change firms, I'd see if Chuck would have me. In 1997, I decided to leave Lazard and in January of '98 I was fortunate enough to join Royce and work with Chuck.

Chuck Royce (CR): The cool thing about this period of time was that both Buzz and Charlie joined within two months of each other. I had known them both in-

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“I had the opportunity to see how he (Chuck Royce) conducted himself through the crash in '87, which was quite impressive. Being a great contrarian, he was buying stocks when you couldn't get anyone else on the telephone.”

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“But even within the firm’s core approach, there will regularly be minor differences. In fact, I just bought a stock from Charlie last week! It’s perfectly acceptable and a normal business practice. We’re a large firm in this space so it’s expected and completely okay.”

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dependently – Buzz was at TCW and Charlie was at Lazard. I’d known them very well for a long time and both “raised the flag” at the same time indicating to me that it was a good time to change firms. I had tried, unsuccessfully, to convince Buzz to join the firm in prior years too.

BZ: I joined the firm from TCW. The atmosphere when I joined TCW was very free and easy. The most important thing for a manager is that they’re able to do what they do without internal pressures. TCW was very much like that initially. The founder, Robert Day, was very well off at the time so the firm and the investment staff were free to spend what money they needed on the business while still operating without internal pressures. Day continued to spend money to grow the business. Then he decided to sell the company to cash in on those prior investments. He hired a corporate manager and then everything changed for employees of TCW. It was around this time that I decided to join Chuck.

G&D: How have you shaped each others’ approach to small-cap value investing, if at all?

CR: Charlie and Buzz were both very successful investors when they joined the firm. I felt my role was to be as non-disruptive as possible and to not really try to

shape anything. They both have very different value approaches, but both have superb records and both continue to do what they’ve always done. We’ve created the ability to do that here. We do have a group that Whitney leads which represents the core side of the firm. But Charlie basically runs his own shop, as does Buzz.

WG: Today we have a large team. While Chuck invented the discipline, I like to think of myself as the chief disciplinarian. It’s a straightforward discipline. It can be replicated in the right environment with the right kind of people. So we have built out a team of portfolio managers and analysts on a variety of products that use the core approach to small-cap investing that Chuck invented.

G&D: Are there instances where a couple of you have diametrically opposed views regarding a company or an industry?

CR: Absolutely.

WG: All the time. I’ve bought stocks that Buzz was selling and sold stocks to Buzz.

CR: You have to remember that Whitney and Buzz have completely different approaches more often than not. But even within the firm’s core approach, there will regularly be minor differences. In fact, I just bought a stock from Charlie

last week! It’s perfectly acceptable and a normal business practice. We’re a large firm in this space so it’s expected and completely okay.

CD: I’m a classic margin of safety guy. If it’s really cheap by my standards, it doesn’t need a catalyst. It doesn’t need anything other than the fact that it’s cheap and I’m comfortable that the earnings are not going to erode. Most other investors, including the other portfolio managers in the room, are willing to pay a little more for the prospect of a catalyst. Something may look fully valued to me, based on the lower of trailing earnings and forecasted earnings for the next period, but there may be a very good reason to pay something higher for the stock due to some impending event or some outlook for the stock. That’s just not my approach. It’s a nuance that non-investment professionals don’t necessarily grasp. Think of our different approaches, and the resulting differing opinions on specific stocks, as refinements on the basic definition of value investing.

G&D: Chuck, when you began looking at the small-cap space, it was really uncharted territory. The same can’t be said today. What about this world of the market has changed over the years?

CR: The big change, which

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has affected each of the investors in the room, is that information is available instantly to everybody. All filings appear simultaneously on our monitors and are available to everybody. That wasn't the case until the early '90s. Prior to this period, you had informational advantages that do not exist today. Of course what you do with the information is always the trickier part – discerning noise from what's important.

CD: Another change is the idea discovery process. Early in my career, I'd go through the pink sheets or the Moody's manuals looking for ideas. I'd find companies that were trading over-the-counter that people didn't even know existed and then I'd try to research them. Occasionally, I'd come across \$100 bills selling for \$10.

BZ: It's also worth noting that around the time Charlie is referencing, there were public quotes and then there was an "inside" market. If you were a member of the general public and wanted to buy 200 shares of a pink sheet company, you'd pay an extraordinary price. If you were an institutional investor buying 10,000 shares, it was more of a negotiated price somewhere between the high and the low offer prices.

CR: These are examples of structural inefficiencies which were additive to the informational inefficiencies

which I mentioned. These were natural market inefficiencies that really don't exist anymore.

WG: Now, there are other kinds of inefficiencies, such as human nature and emotion, which are still very much present and haven't changed. If anything, investor and client investment horizons have shortened. If you have a longer term view, you can take advantage of the market's inefficiencies that result from other investors' biases.

CR: One thing that I think we all would say is that we arbitrage time horizons. Our time horizon is long while for other investors it's short. When they are panicking, we must not panic.

G&D: Given the non-permanent nature of the capital within the funds the firm manages, how are you able to maintain a commitment to a long-term investment horizon when your clients, or potential clients, are likely to be much less patient?

CR: It's a great question and I don't have a perfect answer for you. Money goes in and money goes out within our open-end fund products. We have to be prepared for it and we have to almost program ourselves for that; it's just a fact of life but it's not as bad as you'd think.

WG: We have a lot of investors in a lot of different

places, so the money movements are more like tides coming and going rather than daily surprises. So you can see trends and start to react to those trends, in both directions, when they happen because they don't jump around on a daily or weekly basis.

CD: The other thing that we've done, perhaps more successfully at certain times than others, is educate our investors with respect to appropriate expectations. If you frame what your investors should reasonably expect, and you deliver on those appropriately set expectations, over time you build a reasonably stable audience that's investing with you for the right reasons. What you don't want is a mismatch of client expectations relative to what the product can be reasonably expected to do.

CR: Something else which we all do in our written and web communications is try to lower investor expectations, reiterate our long-term principle, and remind investors that it's perfectly appropriate to be out of sync with the market or out of sync with the benchmark, which is a defining feature of strong long-term performance. Now, we say these things over and over again to our investors, but it doesn't mean they absolutely know it. Nevertheless, we spend a great amount of time trying to set the right expectations.

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Pictured: Bill Ackman of Pershing Square Capital Management at Pershing Square Challenge in April 2012.

“Prior to this period, you had informational advantages that do not exist today. Of course what you do with the information is always the trickier part.”

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WG: And we try to manage what we have under management responsibly. Money always chases performance, so it tends to mostly show up after you've done really well for a long period of time, probably ten minutes before you're about to look really silly. So over time, we've been willing to close funds to new investors when we get to the point where the number of ideas is diminishing relative to the cash flowing into the fund. That does help when the downturn comes because at least you didn't catch the latecomers who would be very disappointed and run for the door immediately.

G&D: Some investors believe that meeting with management is nearly always a waste of time, as management teams can be trained to deceive, while others place more weight on management interactions. Where do you gentlemen fall in this spectrum?

BZ: There are many industries and there's much to learn about each of those, but we're all experienced investors and we've analyzed companies and industries many times so we tend to understand what's going on. However, management can provide a useful refresher on their industry or teach us about some of the newest developments within their industry. They can also educate us on the nuts and bolts of how things work within their organization.

With Regulation FD, the danger these days is associated with the managers of smaller companies, who aren't trained in exactly what to say by a team of lawyers and who may have the tendency to talk off the top of their heads. An investor can run the risk of freezing himself from trading in a name merely because a member of the firm's management accidentally disclosed material non-public information. That's one negative of talking to management teams.

CD: Of the investors here today, I'm probably the one who travels the least to meet with management teams. The critical question to me when I see management teams relates to how they allocate capital. I want to get into their minds to see how they might allocate capital in future periods.

The problem with meeting with management is that it is the classic case of salesmanship. The executive could be "on" that day and they sell you a bill of goods. Over the years, we've all developed a sense for who we can trust, is ethical, and responsible. Physically seeing a person can help you in this regard.

Rather than relying on meetings with management, I instead rely on deep dives into firms' accounting. If the company's business hasn't changed, and management hasn't changed, my litmus test is the numbers. Don't

sell me a bill of goods; let me see what you've done.

CR: My view of interacting with management is mixed. Maybe I enjoy meeting management too much, but I like getting to know the people running these firms. The real problem in meeting management is that it's a social experience and you risk being unduly attracted to the way the executive is presenting the idea. It can work the other way too if management does a poor job presenting a good idea. The real way to get a feel for a company's strategy is through discussions with customers and competitors. Customers and competitors give you the truth. Management may or may not give you the truth.

WG: True. They'll sometimes give you the truth about their customers and competitors. There's something to be said about hearing what they have to say about their own competition. Through discussions with management, one tries to understand how their business got to be so strong and to see if they plan on continuing to do what made them successful. It's also important to meet with a new CEO because he may change a lot of things and not necessarily for the better. You might even find a new idea through management's discussion of their competitors. One aspect of our investment approach is to look around the

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 “neighborhood” at a given firm’s competitors when we find a name we think we like. This is because very often it’s not a company-specific issue that’s bothering the market and creating the value in our eyes – it could be a macro issue, an industry issue, or some other reason.

G&D: Could you describe the firm’s general valuation approach and perhaps highlight some similarities and differences in how you each conduct valuation?

CR: In the core part of our business, we try to approach valuation as if we were buying the whole company. If we were buying the whole company, would we be satisfied with the absolute return that we could take out in the form of dividends and free cash flow. Certainly, we want to understand the engine behind the company, which basically entails looking at returns on capital computed in a lot of different ways. That’s a critical part of the process. But ultimately we use a business buyer’s, or what I call a real estate, approach that focuses on earnings yield. There’s nothing unique about that approach – many, many investors use it – but we’ve used it for a long time and it’s the right way to do it. We’re not comparing the multiple of a company with the multiple of the Russell 2000, for example.

WG: Right, we use an ab-

solute standard and the same standard across all industries. Because of this, there may be whole industries that we’re not buying. It’s not a relative value approach.

CD: That’s an important point. It’s an absolute metric. There are different variations of it, but it essentially gets down to a cap rate, and it involves comparing this to a presumed cost of capital. If you have a spread between the two, and you’re comfortable that that earnings level is real and has permanency, then you’re likely to pursue the idea. But the important thing that both Whitney and Chuck said is that you’re buying absolute value. I think that absolute value will translate over time to absolute returns, although we’ve never done an official study.

WG: It’s really about what’s the business worth, at what price can we buy it, how can we double or triple our money over three to five years if we get it right, and what’s our risk if we get it wrong.

G&D: Given the focus on absolute return rather than relative returns, have you ever thought about venturing into a long/short product?

CR: We have experimented, largely unsuccessfully, with long/short strategies.

WG: We have tried it

quantitatively, by taking the opposite of our long approach for shorting stocks, and it hasn’t been successful. It’s a whole different discipline that takes a whole lot of time, so why bother when your job is to find great long-term investments.

CR: You can’t really do it by shorting all the stocks we think are overvalued and going long all the stocks we think are undervalued. I know that way doesn’t work.

CD: I’ve had clients ask me why I can’t just flip my metrics and I’ve screened for this, but amazingly you don’t get many short candidates. It’s not uncommon for people to ask that. Also, these days there are a scarcity of short ideas, so everyone ends up chasing the same ideas and it becomes expensive to short them. In our earlier days there were the ‘one-decision stocks’ that were overpriced for the longest time, so if you were shorting them you would need great patience.

G&D: The firm also tends to focus on strong balance sheets, and we know based on your investment history that you have avoided banks, which employ a lot of leverage relative to other industries. What is the genesis of this conservative view of leverage?

CR: There is fragility in small companies just by the

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“The real way to get a feel for a company’s strategy is through discussions with customers and competitors. Customers and competitors give you the truth. Management may or may not give you the truth.”

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nature of their size. They are probably only 10 or 15 years old, and they are likely still run by the founder. So there are a lot of business risks that relate to their size and maturity that you don't want to combine with financial leverage. Specifically regarding banks, there is no way to determine the value of the loans, so by and large we haven't done much investing in that space, though Buzz has done a little.

BZ: I don't necessarily focus on strong balance sheets. I have a different definition of a good balance sheet. It takes a little more stomach and a little more analysis. You are trying to project what the balance sheet will look like in the future. A lot of what I do is looking for companies that are going to go from negative cash flow to positive cash flow. The price of the stock usually reflects the recent past and not the opportunity to improve the balance sheet over time.

In the instance of banks, I went through the 1989-1991 timeframe, where their balance sheets were terrible. I started buying these things in 1989 and every time I bought one of them I got slapped and they would go lower and lower. Finally in 1991, I hired a guy and all we did for three months was travel around the country visiting banks. We realized that these bank managers didn't have the slightest idea what their assets were. Having said

that, you could have made a lot of money in many of those banks. There was a bank that had a \$10 per share book value which I started buying at \$9 and dollar cost averaged down to \$2. It continued to fall to \$1 per share and people were talking about it going out of business. Ten months later the stock was taken over at \$15 per share in a stock deal, and three years later the position was worth \$63 per share. So here was this very large gain with a balance sheet that you didn't really know much about.

WG: There's this saying: "Balance sheets don't really matter until the day that they do. Then they're all that matters." Something has to have gone a little wrong with a company for us to be interested, and we don't want the balance sheet to get in the way during the time it takes the company to improve itself or for the market to improve.

CR: The balance sheet is the barrier to the long-term arbitrage. We want to have our investment right even if we have the timing wrong.

CD: In the current environment, quality, in terms of great balance sheet strength and other attributes, is inexpensively priced in the market.

G&D: Can you talk about some themes around some of the companies you've

been buying recently?

WG: We've been buying a lot of economically sensitive companies because this is the third year in a row that everybody is worried about the economy falling off a cliff. Industrial companies have been fairly hard-hit because of those expectations. Energy stocks, even though oil prices are very high, have been punished pretty hard because they're viewed as early cycle kinds of stocks. I also like materials and especially certain mining companies. In fact, I own several silver mining companies that are generating free cash, paying dividends and even buying back stock.

Where I'm not finding a lot of value right now is where everyone has been running to, which is to anything with an above-average yield. These defensive stocks are actually expensive as businesses, and some really good businesses are inexpensive because people are worried about the business outlook. Lots of tech, not social media, not cutting-edge tech, is very inexpensive. I'm talking about good old analog semiconductor manufacturers and equipment makers. Because we've been worrying for three years about the economy slowing down these stocks have been beaten up to levels that probably already reflect a very slow or negative global economy. Everyone is putting their

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money into certain stocks for yield, such as these master limited partnerships (MLPs), where you get a pipeline that rusts and then it pays out all of its cash flow to investors. It's kind of like you giving me \$20 and me giving you \$1 a year over the next 20 years. You're basically just getting your money back slowly with nothing at the end. That desperation for yield, as the Fed has been beating up on savers pretty badly, has led to people buying things that aren't great businesses and that cannot sustain or increase their dividends. We're looking for companies that can grow their dividends and have the cash flow and balance sheet to back it up.

G&D: As another example of that search for yield, we've noticed that the drive into high yield fixed income products has been shockingly robust for a number of months now.

CR: Some firms have closed their high yield funds recently because they cannot invest the inflows they are getting. Companies have been doing whatever they can to issue as much debt as possible, but they still aren't doing it fast enough to keep up with the appetite of yield-starved investors.

CD: This is occurring while the underlying financial condition of a lot of these companies is deteriorating. Actually the number of rating

upgrades as a percentage of total rating changes has declined.

Going back to your question about what sectors we are looking at right now, I think of myself as a junk dealer. People have discarded whole industries right now based on some macro outlook. The question is has that outlook been more than adequately priced into the market? I agree with what Whitney said about there being a lot of real businesses that generate tremendous free cash flow and have a history of raising dividends. These 'dividend aristocrats' as they're called are probably a decent place if you can get them at the right valuation.

G&D: Can you talk about some mistakes that you've made and things you've learned from them throughout your career?

CR: (Laughs) How much time do you have?

CD: I always say that in my portfolio there are plenty of mistakes, the names of which I don't know. Come back in a year or two and I'll be able to tell you. (Laughs) Generally, my mistakes are some misunderstanding around the business model or underestimating the severity of some issue the company is facing, and as such, the earnings don't sustain themselves at the level I had expected.

WG: My mistakes have

generally been with businesses that make a little bit of money over and over again, and then the day that they don't, they lose a lot of money all at once. Engineering and construction firms come to my mind. We had a recent company like this in the financial world – it was this high profile company that made money every day, dominated its market, and was not a risk-taking type of model. Then one day a software program goes haywire and the company goes long \$7 billion worth of securities and shareholders end up getting diluted 80%.

G&D: Given all of the companies you've looked at over your careers, do you get a lot of your new ideas from just keeping track of things you've looked at in the past?

WG: If we find a really great business, we rarely liquidate our entire position (even if it has done everything we had hoped). Instead, we typically maintain a small position in the back of the portfolio so we continue to track it. There are a lot of companies that you can revisit through different parts of the business cycle. Energy companies are cyclical – as commodity prices go up, their stock prices go up, and when commodity prices go down the stock prices go down. We write down where we want to buy and sell things and keep track of that. It's much eas-

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Pictured: Tano Santos speaking at the Moon Lee Price Competition in January 2012.

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ier to buy companies with conviction if you’ve had a history with them. We know how management will react when things happen and we know that they will buy back stock when they say they will. You can be more aggressive when the valuation is right when you’ve seen something through a few cycles.

CD: We’ve all owned stocks that we’ve sold and bought back. If you have that accumulated history and knowledge and know what to expect of management, as Whitney says, you really do have an edge that you bring to the table.

G&D: For Columbia Business School alumni Chuck and Buzz, what did you learn at Columbia that impacted your career choice, investment style or life in general?

CR: From high school on I wanted to go into something related to the stock market, so it wasn’t Columbia Business School that did that. The school didn’t have the Value Investing Program that it has today, but its finance department has always had a great reputation. I loved it there.

BZ: What I got out of Columbia was a solid understanding of business and accounting. The credentials provided by the Columbia MBA open the door to many different things. I actually didn’t start out in the investment business. My

first job was with RCA Corp. in a financial training program, which was really a great third year to a MBA program because you spent six to eight weeks at a variety of the different divisions, which included a computer business, a semiconductor division, Hertz, NBC, and others. I then went to NBC for a short period of time before leaving to work at Lehman Brothers.

G&D: Do you have any words of wisdom or advice for business school students as they think about their careers and life ahead of them?

WG: I think making mistakes is important, and it’s better to make them early in life when they’re likely to be smaller. I have two sons in college, one about to graduate. I think you can look at life like college. The first 10 years after college are like your freshman years of life – you’ll figure out where you may want to live, who you may want to be with, find some things that are interesting, and find some people who are interesting and good role models and mentors. My first 10 years were very much like this. Then in your sophomore years of life you can start to be serious about having a career and you better be prepared to pick a major.

CD: Buffett always talks about enjoying his job so much that he tap-dances his way to work. Choose the

career that will be this way for you. Life is much easier, you’ll be much happier, and you’ll work longer if you are really passionate about what you’re doing. Try not to settle into something you won’t like. If your livelihood is that thing that you would do on your own if you weren’t getting paid, that’s the best of all worlds.

CR: I would say the same thing. A job can’t be a job. The world of investment management to me has everything one could want. You can be creative, it’s changing on a daily basis, you can be focused on the macro environment or the micro environment, you can have social interaction, and you have time to be a deep thinker. It’s competitive and you can approach each situation in multiple ways. Our big job is looking at other companies. After seeing what people do at these companies, many times I walk away appreciative that I don’t do what they do for a living. To me, investment management is just an inherently more interesting business.

G&D: Thank you for sharing your time with us.

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Graham & Doddsville 2012 / 2013 Editors



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