THE SUNNY SIDE OF STALKING

There are only two market circumstances which consistently present investors with the opportunity to purchase equities at a *steep* discount to their intrinsic value:

1. A precipitous, broad decline in the market overall, and
2. A significant, company-specific decline.

The common thread? Both are impossible to exploit without having a clear and confident sense of the intrinsic value of the equity at the time the opportunity arises. A rare minority of investors possesses both the financial genius and preternatural emotional detachment necessary to quickly size up an unfamiliar asset under market combat conditions. But because I at best aspire to these qualities, prudence dictates that I not depend upon them for my success.

So I stalk…

Not in the creepy sense that typically entails court intervention and restraining orders; I prefer companies to celebrities. And I shadow them relentlessly, because I want to be ready.

There are some companies that I have literally followed for close to a decade without investing in them, monitoring their progress and evaluating their financial results from quarter to quarter. However arduous, to my experience it's the only consistently reliable strategy for exploiting those rare windows of opportunity.

It's not difficult to grasp why investing in this manner has its advantages. A fundamentally solid business trading at a marginally attractive multiple of earnings or cash flow may be a great investment. But there's no debating that the same business selling at a 40% discount is much easier to recognize as a superb investment. It's the *same business* selling at a *much cheaper* price.

My adherence to this philosophy, as well as my conservatism and aversion to losses in general, has admittedly led to some truly regrettable errors of omission. What constitutes an attractive price is highly subjective in two senses: Valuation of the asset is itself subjective, and what comprises a sufficiently attractive discount (or "margin of safety") to that valuation is also extremely subjective. As a result, it can be agonizingly easy to miss outstanding opportunities.

The key to committing casual but not cardinal investment sins is to aggressively exploit those rare, extraordinary opportunities when they arise. Of course, when panic is pervasive it can be challenging to remain objective and focused. It stands to reason that if exercising the necessary detachment is likely to be most difficult when it is most critical, it's best to determine what you would like to own and the price you would be willing to pay before the fact, and wait for the market to give you the opportunity to do so. Which is where the stalking comes in.

Rigorous analysis is *courage when you need it most.*

I have always been highly skeptical of the likelihood that, on any given day, an investor is going to just stumble across a business that is not only intrinsically attractive but also dramatically underpriced. The fact that the market may not be efficient all of the time does not mean that it is *in*efficient *most* of the time. It's not. The reality is that the market is for the most part efficient. This applies to company-specific developments in particular; more often than not, the re-pricing catalyzed by the event is justified. Whether it is in fact an overreaction and thus an opportunity can only be determined through careful, in-depth analysis. The reasoning isn't complicated: If the market is for the most part efficient, which should you prefer to rely on – consistent *luck* in discovering great investment opportunities that the rest of the world has somehow overlooked, or consistent *competence* in your own analysis? (It's a rhetorical question.)

To make what sounds like another obvious or even circular point, identifying what is over- or undervalued is of course impossible without determining the value to begin with. Too many investors treat valuation as a conclusion rather than a complex, demanding process. It is axiomatic that if you're not generating a detailed valuation, you're not really analyzing anything – you're pretending to. Properly executed it's an inarguably time-consuming effort, but provided you're objective, the quality of the outcome generally reflects the rigour of the process. Hard work pays off.

As one might expect, taking this approach results in a list of target investments that continues to grow over time – mine is near triple digits. Naturally, the longer this list becomes, the more statistically likely it is that some company- or market-related event will cause one or more of those companies on your list to decline to your predetermined purchase price. The passage of time makes it inevitable, really.

I wholeheartedly admit that this strategy flies in the face of mainstream academic theory. Most observers believe that the increased dissemination of information and greater overall participation in the equity markets should result in more efficient pricing, and thus fewer attractively-mispriced opportunities. This argument, however, fails to draw one critical distinction: The nature of the flows is much more important than the volume.

Specifically, efficiency only increases if the degree of stock-specific scrutiny increases with the dollar amount invested, and the massive daily trading volume currently attributed to asset-class allocations and algorithmic trading indicate that exactly the opposite is happening. The dollars invested based upon ad-hoc intrinsic worth analysis is now dwarfed by fund flows that are utterly indifferent to the specific attributes of individual stocks. The notion that such massive yet indiscriminate liquidity would result in more efficient pricing of individual stocks is just absurd.

All of that said, good opportunities still take time to arise. In addition to entailing a significant amount of effort, the stalker approach thus requires some real patience. Unfortunately, many would-be investors exhibit a lethal addiction to action.

Successful investing requires being able to NOT invest.

Ultimately, the best investment selection system is probably more aptly described as an investment *rejection* system. It's a mathematical fact that most outstanding investors owe their success more to the avoidance of losses than the consistent selection of wildly profitable investments. Why? Because provided significant losses are avoided, the investor *doesn't need* any home runs; patience and the power of compounding are enough.

At day's end, the stalker's wager is a simple one: That human beings will continue to be *human* beings. Provided we don't as a species evolve beyond the province of our own emotions, the efficient market will continue to be sporadically and wildly inefficient, and the prepared and patient will be rewarded. So load both chambers and walk in the direction of the tall weeds; whether next week or next month, your time will come…

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