

Easy, But Hard

Curt R. Stauffer

June 3, 2021

[Subscribe](#)



Before I was a professional investor, I was a corporate credit analyst and corporate banker. Within the corporate banking industry, analysts and bankers work directly with business owners and corporate executives to understand the strengths and weaknesses of companies. Before I bought my first stock as a

professional money manager, I analyzed hundreds of companies. I visited businesses ranging from manufacturers, professional services firms, non-profit enterprises, and retailers. Because of this experience, I always view a stock as an ownership share of a business enterprise, and a bond as a debt obligation of a corporation.

The success of owning equity in the form of stock or holding debt in the form of a bond is purely dependent upon the future performance of the underlying business. When analyzing a business, one must first and foremost know what the company sells to generate revenues. Wall Street firms are businesses, and their business success is dependent upon manufacturing products and selling transactions. From roughly 3,500 publicly traded companies, Wall Street firms have created over 10,000 Exchange Traded Funds (ETF's) and mutual funds to buy. For each publicly traded company, there are hundreds of put and call options available to trade. If it was not bad enough that Wall Street continually manufactures tradable products to sell, now investors can trade over 1,600 newly invented cryptocurrencies.

At this point, I want to clarify that options, cryptocurrencies, and trading anything based upon price dynamics alone are not forms of investing; they are simply different versions of betting on the behavior of other speculative traders. Just because a financial service firm chooses to allow its customers to trade something does not lend credibility to a security's investment fundamentals; it simply means that transaction fees are simply too great for the firm to ignore. Most financial service firms do not make money making you money; they make money tempting and inducing you to engage in transactions that generate fees.

With just twenty-three years of researching investments, designing strategies, and managing portfolios, I feel like an "old soul" given what is going on in the investment world today. I learned the craft of investing from reading and listening to Warren Buffett, John Templeton, Marty Whitman, Mario Gabelli, and my first boss as an investment professional, William Martindale. William Martindale, now retired, was the founder and manager of the Conestoga family of funds. The legends who I look up to and my mentor had one thing in common. That one thing is that they start all stock due diligence by valuing the underlying business.

Warren Buffett once said, "what I do is simple, but not easy." This concise statement is very accurate. The simple part is understanding that investing is nothing more than buying something today at a price that is sufficiently less than a hypothesized future value. The not-so-easy part is being confident enough in one's assessment of a future value to make the initial investment and having sufficient conviction in one's research to hold on long enough. Patience is often essential because it usually takes a long time for the value that was not initially evident to most market participants to be reflected in the price.

I have made a career out of seeing value, having conviction, and being patient. In January of 2013, I took an initial position in Sony Corporation's stock at approximately \$17 per share. After researching the company, I was convinced that Sony Corporation was worth at least double what that \$17 stock price reflected in market capitalization. Based upon the outstanding shares in the company, the market capitalization of Sony Corporation in early 2013 was just under \$20 billion. Sony Corporation was a sizeable international conglomerate with business lines ranging from consumer electronics, finance, semiconductors, video game hardware, and entertainment/media. Conglomerate companies are famously challenging to value and tend to trade with a complexity discount, but the price level I saw in Sony Corporation stock was just "stupid cheap." Sony Corporation was one of many instances that I can think of throughout my career when I knew immediately, without looking at ratios, profit margins, and competitive position, that the stock price was significantly under-valuing the business enterprise. It was simple, but I did the research, nonetheless. Over the coming year, I continued to add to the already sizeable Sony stock position that my clients owned anytime the stock fell meaningfully below my original purchase price. Again, simple, but hard.

Mario Gabelli was once quoted as saying, "The stocks that we tend to buy keep going down... And the cheaper it gets, the better we are." This quote represents the idea that I have most commonly had to defend over my career. When one is focused on a stock's future value, out one, three, or five years, the lower the stock's current price is relative to that value, the higher the future return on investment will be. Many of Seven Summits Capital clients, whose accounts we managed for five years or more, still own Sony Corporation stock today. With Sony stock currently priced at nearly \$100 per share, this amounts to an annualized return of over 55% since early 2013.

A better than 55% annualized return over eight years is roughly 40% per year better than the S&P 500 over the same period. This success was achieved even though we did not successfully pick the bottom in Sony stock, we bought more stock at lower prices after our initial purchases, and we had to wait nearly three years for the stock to hit our target price of \$35 per share.

The Sony investment was the epitome of easy, but hard. It did not take a genius to know that Sony stock was cheap in early 2013. What is hard for most investors is believing that they could be correct, and the market could be that wrong. Since the early 1970s and the advent of Modern Portfolio Theory, which defined a security's risk in terms of its historical volatility, as well as the idea that markets are efficient, most investors have been taught that it is a fool's game to try to be smarter than the market. Nothing could be further from the truth. Certain aspects of of Modern Portfolio Theory have been discredited over the last 20 years because of the theory's total reliance on backward-looking factors, and the concept of markets being efficient has always been misunderstood. Market efficiency is a concept that has much more to do with a market's ability to assimilate all available public information at a point in time versus markets being "right."

At Seven Summits Capital, we acknowledge that markets efficiently translate existing public information into current security prices. However, we also recognize that all available general information is inherently backward-looking data and that successful investing is not backward-looking; it is forward-looking.

In the case of Sony Corporation in early 2013, using backward-looking information, a data-informed investor saw Sony stock as one of the worst-performing large corporation stocks over the preceding ten years. They saw a former consumer electronic product leader which entirely missed the digital music and smartphone paradigm shift that occurred in the early 2000s and a television technology leader that has struggled to compete in an environment where advancements in LED technology commoditized the flat-screen television market. With Sony stock, in early 2013, all of the troublesome backward-looking information was priced into the stock of Sony. This rearview mirror pricing is why the entire Sony company was being valued on par with the much smaller Japanese gaming company, Nintendo, despite Sony's gaming hardware division alone being the global leader in this high growth industry. I saw a conglomerate with a sum of the parts valuation significantly higher than the current market capitalization, minimal downside risk, and an ambitious new CEO who took over in the spring of 2012. This new CEO appeared willing to take bold steps to leverage Sony's untarnished consumer brand, eliminate bureaucracy, capitalize on Sony's technological leadership in digital camera technology, and improve the profitability of Sony's media franchises. CEO Kazuo Hirai named his initiatives "One Sony."

The Sony example reflects markets that are efficient at pricing in backward-looking information. This efficiency at assimilating backward-looking data can significantly distort an investor's ability to see a future that can differ substantially from the past. This concept conversely applies to "market darlings," where early past success is foolishly extrapolated forward by the market. Some well-known examples over the last twenty years when past success did not translate into ever higher stock price would be Yahoo, General Electric, Intel, and Nokia.

The concept of investing is easy so long as one understands that value is created in the future, not the past. Successfully executing an investment strategy is problematic because what the market shows us today reflects all known public information from the past, plus future expectations, which are substantially informed by extrapolating this past information. Thus, current market prices are not to be implicitly trusted if one is a long-term investor. A successful investor understands that this flaw in market-to-market pricing creates an opportunity for significant wealth creation. Our investment philosophy and process have been built upon this foundational principle.

No matter how markets change with the introduction of artificial intelligence software, high-frequency trading algorithms, or even newly created trading vehicles such as cryptocurrencies, our process will

always be effective. Evermore computing power and faster processing speed only serve to increase the reaction speed of markets but do not change the reality that market pricing will always be biased and blinded by historical data. Trading strategies can undoubtedly benefit from the evolution of market reaction function, but from an investor's point of view, the short-term reaction function of markets is simply noise.

Curt R. Stauffer

President & CIO

Seven Summits Capital



CURT R. STAUFFER

(C) 717 877 7422

(O) 717 735 0013

cstauffer@ssummitcapital.com

Disclosure:

Advisory services offered through CS Planning Corp., an SEC registered investment advisor.

The views and opinions expressed are for informational and educational purposes only as of the date of writing and may change at any time based on market or other conditions and may not come to pass. This material is not intended to be relied upon as investment advice or recommendations, does not constitute a solicitation to buy or sell securities and should not be considered specific legal, investment or tax advice. The information provided does not take into account the specific objectives, financial situation, or particular needs of any specific person. All investments carry a certain degree of risk and there is no assurance that an investment will provide positive performance over any period of time. The information and data contained herein was obtained from sources we believe to be reliable but it has not been independently verified. Past performance is no guarantee of future results.



Get more personal finance tips

Weekly insights delivered directly to your inbox.

Sign Me Up

Information presented on this site is for informational purposes only and does not intend to make an offer or solicitation for the sale or purchase of any product or security. Investments involve risk and unless otherwise stated, are not guaranteed. Be sure to first consult with a qualified financial adviser and/or tax professional before implementing any strategy discussed here. The information being provided is strictly as a courtesy. When you link to any of the web sites provided here, you are leaving this web site. We make no representation as to the completeness or accuracy of information provided at these web sites.