Graham & Doddsville

An investment newsletter from the students of Columbia Business School

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Yen Liow, Aravt Global

Yen Liow

Yen Liow is the Managing Partner at Aravt Global LLC. Mr. Liow directs the firm´s research process and actively researches many of the investments in the portfolio. Mr. Liow was previously a Principal at Ziff Brothers Investments (ZBI) and a Managing Director at ZBI Equities, ZBI´s equity market-neutral fund in New York. Mr. Liow joined ZBI in 2001 and ran a team that oversaw ZBI Equities´ investments in the media, telecom, energy, and agriculture sectors.

Prior to ZBI, Mr. Liow was a Consultant at Bain & Company in its San Francisco, Sydney, Singapore, and Beijing offices.

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Bill Stewart, Stewart Asset Management

Bill Stewart

William P. Stewart is the Executive Chairman and a founder of Stewart Asset Management, LLC. He began working on Wall Street in 1955 as an employee on the floor of the New York Stock Exchange. Subsequently he worked for Spingarn, Heine & Co. as an Investment Analyst, before going on to Pyne, Kendall & Hollister, later known as Riter, Pyne, Kendall & Hollister. He became a Research Director at the firm, then President of the investment banking subsidiary, and finally Chief Executive officer. Riter, Pyne grew to become the tenth largest NYSE member firm in the years he was

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John Hempton, Bronte Capital

John Hempton

John Hempton is the Founder and Chief Investment Officer of Bronte Capital. Prior to founding Bronte in 2009, he was the youngest Partner at Platinum Asset Management and Head of the Financials group. He was also previously an Analyst and Executive Assistant to the Chief Executive Officer at ANZ Bank, Chief Analyst of Tax Policies in the New Zealand Treasury, and has also served in various positions at the Australian Treasury. Mr. Hempton earned a B.A. in Economics from Adelaide University.

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Bill Stewart, Stewart Asset Management

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Bill Stewart

there. The firm was sold in 1973. He joined Ruane Cunniff and Stires as Vice Chairman.

In 1974 he founded W.P. Stewart & Company as a broker dealer and investment advisor, which became a publicly traded company on the New York Stock Exchange in 2000. At the time it went public, the firm had $12 billion in assets under management in separate accounts, as well as US and European registered mutual funds. From the firm´s founding in 1974 to 2013, the year in which the firm was acquired by AllianceBernstein L.P., W.P. Stewart & Co. outperformed the S&P 500 Index by an average of 430 basis points annually, net of fees.

After the sale of W.P. Stewart & Co. to AllianceBernstein in 2013, Bill formed WPS Advisors Ltd., a Bermuda company. A group of analysts was assembled to pursue an investment philosophy similar to the one that earned Bill´s clients over 16% a year after fees for the 38-year history of W.P. Stewart and Co. The new business was domesticated to the US in 2017, as Stewart Asset Management, LLC, an SEC Registered Investment Advisor. Over the four and a half years since its inception, the new firm has continued to grow its clients´ portfolios at a rate slightly faster than its predecessor did. Initial clients of the new firm have now more than doubled their investment.

Graham & Doddsville (G&D): Could you tell us about your background and how you got into investing?

Bill Stewart (BS): I got into investment management by accident. I initially took a temporary job on the floor of the New York Stock Exchange as a page boy in 1955 while I was waiting to start college at the University of Maine. It turned out that I liked what I saw on the floor and I decided that I should learn that business. At the time, I was planning to be a Forest Ranger and had no interest in investing. But after watching the money being made by smart investors, I decided that if I played it right, I could buy my own forest. In time, along with others, I was eventually able to buy several of them as well as a farm and turn them over to conservation groups to manage in perpetuity.

G&D: What was it about your time as a page that made you realize this was the industry you wanted to be in?

BS: It was a time you probably can´t even imagine. There were no phones on the open floor, let alone cell phones, because no electronic communication was permitted. There were telephones around the rim of the floor, but nothing in the middle, nothing at the posts. If you wanted to do serious trading, you had to physically be on the floor to see your counterparts and deal with them directly. I saw some smart guys doing things I thought were interesting, while making a lot of money at it; hence I figured I ought to learn something about this industry.

I started going to night school in the city instead of attending the University of Maine. I went through various floor positions at the Exchange, started developing a business, and became a broker on my 21st birthday. I learned enough about research to go out and start seeing companies, visiting management, doing spreadsheets, and writing up reports on stocks I liked. I was selling these ideas to dentists, pharmacists and furniture dealers.

The market environment was relatively quiet. IBM was the stock of the decade, growing at 14% a year and trading at 50 times earnings, the average ratio for good quality growth at the time. Many companies were growing at 7% per annum and trading at around 25 times earnings, much higher than today. IBM was at the top of the list of what we considered high-quality growth companies, along with National Cash Register, American Home Products, Merck, Pfizer, Abbott and General Foods.

This was around the time when Ben Graham said that he would only invest in high-quality growth companies if he could, but generally speaking they were too expensive, and he´d have to amortize a lot of P/E ratio. He took a 7-year look, and if he envisioned a market multiple of 17 in the terminal year and was paying 50 times up front, amortizing that was too big a headwind. So, he concentrated on what came to be called value stocks.

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Graham published a formula with his idea of fair P/E ratios relative to underlying growth rates: 8.5 + twice the future growth rate. I began to look for companies that were priced below his recommended levels and tried to work out for myself what constituted an appropriate P/E ratio. My Security Analysis course at the New York Institute of Finance was taught by one of Graham´s partners at Graham-Newman, and he was basically teaching Graham & Dodd´s philosophy. I took his teachings to heart and started building out a very concentrated portfolio of companies, only eight different businesses, albeit in different industries to provide some diversification.

G&D: Is that portfolio construction still what you´re trying to attain?

BS: Roughly 5-10 years after that first portfolio, I realized I needed to have a bigger investment universe. Having a portfolio of eight companies is maybe a little bit too concentrated, so we increased our portfolio size to 15-20 companies. In fact, we still have 15-20 stocks in our clients´ portfolios today, consistent with what we´ve done for more than 40 years.

I adopted a value approach, but one that requires highly predictable earnings growth, with the goal of having a very concentrated portfolio with aggregate earnings that go up every year. That means that if you pay too much, it still gets cheaper next year. That´s our hedge. In a cyclical, you never know when the next cycle will occur, and you can be out of phase for a long period of time.

Going back over 50 years, we´ve never had a sharp fall in earnings power behind our clients´ portfolios - what Buffett calls "look-through" earnings. Our portfolio proved to be much less cyclical than the S&P 500, for which the annual rate of earnings change, up or down, can be very dramatic. The look-through earning power growth behind our clients´ managed accounts has averaged about 15% a year for over 40 years now and has never declined. That earnings growth drives performance in the long run.

"At the time, I was planning to be a Forest Ranger and had no interest in investing. But after watching the money being made by smart investors, I decided that if I played it right, I could buy my own forest."

Our goal has always been to double our clients´ money every five years, which is compounding at a little less than 15% a year and we´ve done that since we´ve been in business. At my old firm, we ended up with an average of 16.2% appreciation per annum after fees for 38 years. As of last week, we were at 16.3% growth per annum, net of fees, since we started Stewart Asset Management four-and-a-half years ago. Our initial clients in the new firm have already just about doubled their capital.

G&D: Was there anything in particular that convinced you that predictable earnings growth was the way you wanted to look at investing?

BS: When I first started out, I took lots of courses on analysis and accounting and thought I could find great value. Some things worked but other things didn´t – and I really disliked the ones that didn´t work. Earnings shortfalls were almost always the reason an investment didn´t work out. Everything we do when investing people´s capital is based on compounding. The whole reason for being in the investment world is to compound money. We all know that 7% per annum doubles in about 10 years and 15% a year more than doubles in five years. I want that magic working for me all the time.

The thing that screws up compounding is down years. In order to harness compounding, I wanted to make sure I didn´t have those down years in earnings. There are only two variables in this business: future earning power and future P/E ratio. I believed and still believe that we can get a pretty good handle on future earning power in a very limited number of leading businesses. P/E ratios are considerably more volatile and tougher to accurately forecast – though we try. In all 38 years at my last firm, W. P. Stewart & Co., we had about 15% to 16% compounded growth per

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annum in underlying earnings power, basically more than doubling every five years. The after-fee rate of return for our portfolio was similar. The performance of the portfolio followed the performance of earnings; to be sure, they weren´t the same in every year because they can get out of whack with each other, but over the long run that´s what it averaged out to.

This method works, and it´s a simple one. First, you find a small group of great companies and get to know them very, very well. Then, you evaluate them. We have a strict appraisal system and we forecast earnings over five years. For 99% of the public companies, you can´t do that very well because they´re very volatile, but a few of them are pretty predictable. These companies typically have a commanding position in their markets and showcase great profitability as well as a high degree of predictability. They also have great management in depth and wonderful balance sheets. When a business meets these criteria, you can start appraising value five years out.

Once we find a business that we like with predictable earnings growth, we´ll then work with the spreadsheets. We use all our qualitative work and interviews with management to try to estimate earnings in five years´ time, as well as the terminal growth rate. We then evaluate a prospective premium or discount versus the market as a whole, for which we also forecast a multiple. Right now, it´s an easy 17x, in line with the historical average and probably a little lower than it should be with the low interest rates we have today. If we say a company is going to be worth a 30% premium, we´ll use a 22x multiple in the model in the terminal year, and then discount the resulting value, plus accrued dividends, back to present value. We discount at 8% to 10% even if the Treasury market yields less than 3%. So that´s probably too high a discount rate. But that´s a margin of safety and it goes back to Graham and Dodd. You want a margin of safety in everything you do.

"Everything we do when investing people´s capital is based on compounding. The whole reason for being in the investment world is to compound money."

We then want to buy stocks well below their fair present value as a further cushion. This is not a science but more of a guessing game. We try to make the best guesses we can, but you need those cushions.

G&D: Can you go into more detail on what you call the appraisal system? When you´re digging into a company, what does it look like?

BS: You might start out with the addressable market, then get to how many units a company will sell, what the value per unit is, and what the margins are going to be. Ultimately you build a five-year model and come up with a final earnings power projection. It comes down to earning power per share.

We then take a market multiple and, because our companies typically grow twice as fast as the overall market, are market leaders, have great balance sheets, and have outstanding management teams, we´ll come up with a premium multiple. In a few cases there might be a discount, but generally speaking it´s a premium.

Mathematically, if a company is growing twice as fast as the market, the near-term P/E multiple premium amortizes very quickly because the earnings grow.

Typically, we´ve been giving the growth businesses we invest in a 10% to 50% premium to the market, depending upon how well we think things are going to go for that company five years from now. I guess the highest terminal multiple we have is 26x for Amazon, in five years. It´s currently at about 60x our idea of current capitalizable earning power.

G&D: In terms of earnings predictability, how do you analyze a company like Amazon, which five years ago looked much different than what it does today?

BS: Obviously, Amazon Web Services is huge and is the most profitable division now. These situations are dynamic, so you make the best guess you can and try to be more on the conservative side when figuring out what all these things are likely to be worth, but the lovely part about a

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model is that it´s not fixed. It may be a five-year model, but you can change it every day. What you´re really doing is laying out your decision tree and adjusting it. You can come back saying, I think I got this a little high, or that a little low. It´s not fixed. In essence, we´re always operating with the best guess we can make. If it changes weekly, it changes weekly. It doesn´t usually change weekly, but it could. Nobody´s got a lock on what´s right, a model is only a model and it´s not fixed in stone.

Sometimes, nothing´s changed but you changed your mind. That´s good. The purpose of the process is to bring out our best guesses. Everything we do is guessing. I think we all get a little carried away with the science of the matter, because there are lots of formulas, whereas you´re essentially making a guess.

In essence, we´re looking at investment opportunities as a businessman would look at them. We´re thinking about buying a business today for $100 million and figuring out whether or not we could sell it for $200 million five years later. We make reasonably conservative guesses, and as I´ve mentioned we have succeeded in growing look-through earnings behind our clients´ portfolios every single year. That´s very important. We try to have one of the two big variables reasonably under control.

G&D: Coming back to Amazon, are there certain assumptions that you and your team think about in terms of what the company will look like in five years?

BS: Absolutely. For example, take the retailing section, which is huge, but where the margin is only about 7%. For marketplace products sold by 3rd parties, they don´t take in the sales price of the products sold, but they record their commission on the sale, which starts out at 100% gross profit. That business is booming for them. Now they invest a lot of it away, but you have to try and make an assumption about actual future earnings power.

"Frank [Rooney] was one of the great retailers and I learned a lot from him. We´d drive around the country, go into the parking lot of a shopping center, and he could tell me the average annual income of the people who shopped there just by the size of the grease spots in the parking lot."

Web Services is another big operation as we discussed, and they´re also getting into retailing with their own stores, which may, in effect be mini distribution centers. It´s very dynamic, which is one reason why we still assign Amazon a relatively high multiple of 26x in year 5 which, by the way, isn´t really that high. We have capitalizable earnings per share of a bit more than $140 in the model´s terminal year, 2024. A terminal multiple of 26x gives us a price that, discounted back at 9%, yields a present value of $2,250. That´s why it´s our largest position and has been for a long time. MasterCard is our second largest position and, including at my old firm, we´ve owned MasterCard since they went public.

G&D: Before we go into individual positions, can you talk more about your analytical process and the way you make assumptions? Do you have analysts by sector in your firm?

BS: We have 5 investment people, excluding me, and we always have a team of two on each investment: one does primary coverage, and another is the backup, to ensure continuity. We have a small operation, but it works. Each analyst is a generalist and is getting out there asking questions, visiting management, digging around.

G&D: You ran a firm for 38 years before this and now you have this new firm, which is only four and a half years old. Can you talk about what prompted the change?

BS: I had partly retired from the old firm in 2001 and then fully retired in 2004. Yet, by 2007 the new management was having some problems and the board asked me to come back. Initially I didn´t want to, but I did come back and stayed with them until AllianceBernstein purchased the company in 2013, which

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was probably the appropriate thing to do. They seem to be happy at AB.

After the sale, I wanted to go back to retirement, which I did for a few months. Then the former CEO of W. P. Stewart & Co. and I thought we might start a new investment manager. I love being in the market trying to figure out what´s happening next ; but these very smart young people at Stewart Asset Management are doing the heavy lifting now, not me.

G&D: How important is management when it comes to looking at a stock?

BS: Ben Graham always said "don´t count management twice". The projected numbers will reflect the management´s performance, which means you don´t have to re-evaluate management.

That being said, I learned as a young analyst that management is not a given. It´s dynamic. The management team changes, individuals change, policies and procedures change, unforeseen challenges develop, opportunities occur. I think you´ve got to look people in the eyes, talk to them, and get a feel for their personality. To me, investing is all about people. Good managers doing a great job. I want to know that management is going to achieve its plan, and I need to make a judgment on that. There are people you end up trusting and other people who, when you walk out of their offices, the hair on the back of your neck is standing up. I think good management is vital.

You don´t put an extra point on or take a point off, but management gives you conviction. We always ask ourselves "Do we want to be in this business?" Coming back to what I already said, when you´re investing you have to think as a businessman buying a business, and then ask yourself "Do I want to be in this business with these people? Did they seem like they´ve got their heads screwed on right? Are they long-term thinkers or are they opportunists?" That´s the type of thing you want to know. Then, if the questions are answered positively and you want to be in this business with these people, you end up asking if you want to be in this business with these people *at this price*? You apply the whole appraisal process and get to your discounted present value – what Graham used to call "fair value," a price that a share seems likely to sell at on the way up or down within a reasonable period of time.

This process is very different than the one from the typical value shop, where you´re primarily looking at the balance sheet and underlying earning power. They´re often seeking a discount to tangible value, which is also a very valid way to play. Such shops usually have a huge number of stocks and use good theory in general, so if they´re wrong on some names it averages out. We take the opposite point of view. We have a very narrowly -focused portfolio where we have to be right more often. Sticking with really fine, particularly well-managed businesses helps us do that.

G&D: Are there any instances where you had conviction in a management team and it just didn´t work out?

BS: Oh, sure. I´m always telling our guys, success in this business is three steps forward and two steps back. You don´t just keep marching on in a straight line, although thankfully we´ve had far more successes than failures.

G&D: How long do you typically hold an investment for?

BS: My horizon is 10 to 15 years on average, and at least 5 years. We held major positions in retailing for the better part of 20 years - great growth businesses like Walmart and Home Depot in their dynamic growth years. My best ever would be Melville Corporation: 26 years at 26% per annum. It was phenomenal.

Melville went from a little shoe chain headquartered in New York to becoming the 10th largest retailer in America. That was a great story. My interest started when I saw an article in the Times saying Frank Rooney had been appointed President of Melville. I knew it was a sleepy shoe retailer and the only thing it had going for it was its strong balance sheet. I called Frank to congratulate him on his new job but also asked him "What is a smart Wharton School graduate like you doing at a crummy old shoe company?" He said, "Well come on up and I´ll tell you." They had their office in Midtown Manhattan. I got in a cab and went over there, and he explained to me how shopping centers were pushing Main Street off the map and would go up all over this country.

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Frank already knew that Saks, JCPenney, Sears and the likes would become the anchors in these centers. But nobody dominated the space between the anchors yet.

So, he figured, if he could control a shoe company, that would be a good place to start, because everybody needs to have shoes. Eventually, his goal was to dominate the space between the anchors like nobody else had done, and through multiple acquisitions, including chains like CVS and Marshalls, and fast store growth, he did it.

G&D: At what point did you sell your position in Melville?

BS: I sold my position in 1972, having held it for about 11 or 12 years. It went to 40 times earnings and I felt it was too expensive. I wrote a report saying I loved the company but the price was too rich. And then it fell down to about 12 or 15, during the big crash in 1974 and it briefly dropped to $5 a share. We bought back a lot more stock and then it went to the hundreds from there.

Frank retired at 65, following the institution of a rule defining 65 as the mandatory retirement age that he established 20 years earlier. At that point, we sold all of our stock. Frank, by the way, went on to work for Warren Buffett for the next 18 years or so. I called to congratulate him on his 80th birthday and he said, "You know what Warren just gave me for my birthday? A new 20-year contract."

Frank was one of the great retailers and I learned a lot from him. We´d drive around the country, go into the parking lot of a shopping center, and he could tell me the average annual income of the people who shopped there, just by the size of the grease spots in the parking lot.

G&D: Do you have an opinion on the future of brick-and-mortar retailing?

BS: Brick-and-mortar retail is gradually declining. Yet, I´m looking for the next thing that´s going to happen. On one hand, some shopping center developers are putting medical centers in, and other things like that, which I think is working well. Some retailers are developing stores as mini distribution centers as part of the evolving omni-channel trend.

On the other hand, you are seeing some disrupters, like Restoration Hardware. They are creating stores that attract you. You want to go there because, for example, they´ve got a restaurant and people to show you how to decorate your home. People go there as a destination, and they can´t get that from Amazon. Best Buy is becoming another destination store. Both are omni-channel operators.

Restoration Hardware is doing well and growing very nicely. Our guys here are taking a look at it and are planning another visit with the company next week. It seems they are trying to do something different. They´ve opened maybe a couple dozen stores around the country, which are attracting people from a wide area. It´s a destination. You go there, drive there, spend several hours and have lunch. It might work, I don´t know.

The CEO has a vision and I wrote a letter to him the other day. I want to get more flavor on his vision. They only have a small percentage of the market right now so if he´s successful, it could be one of those companies that enables you to make a 10x, 20x return on your money in future decades.

I also see some things that bother me, such as stock buybacks. RH bought stock back at a good price and it has gone higher, but there´s a lot of debt. When they were in their high-growth phases, companies like Walmart, Home Depot, and Walgreens just focused on building their businesses and put all their cash flow into that. They didn´t try to buy much of their own stock because they needed every penny to build another store, another distribution center. Yet Restoration Hardware borrowed a lot of money and seems to be a little bit capital constrained now, despite a huge addressable market.

They seem to have a winning formula, but the debt may be constraining growth. They´re only growing sales at 7% or 8%, why not 12% or 15%? It´s still a relatively small company, but I like to spot opportunities at that stage.

I think Costco knows just how to do it. It´s been a major position of ours for years. A large part of its profits come from the fees that they charge for all those membership cards being renewed every year, which constitutes a recurring

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revenue stream. That´s a beautiful story. Amazon is now following that concept with Amazon Prime and delivering an awful lot of stuff for the money.

G&D: Do you think there are pockets of retail that are still insulated from Amazon?

BS: I´m sure there are, although I´m not sure what they are. I´d love to find out. Williams-Sonoma seems to be doing a good job . Drugstore businesses on the other hand will probably face more competition from Amazon.

Retail is a big part of the economy and it´s constantly changing, which provides opportunity. I think there´s always going to be opportunity in retail. I´m not sure where it is. I would hope that our young analysts shake the trees. I´m not doing that. I read books and magazines and keep my eyes open, looking for ideas, but I´m not shaking the trees nowadays - though I do attend virtually every research meeting in person or by conference call.

I can tell you that there´s probably 20 stocks out there that are going to double in the next year. Big stocks. I don´t know what they are though, which keeps me going. It´s such a fascinating business.

G&D: How do you harmonize finding an opportunity but also placing a high degree of importance on predictability?

BS: You have to have predictability. We´re not just buying a concept; we´re buying established businesses. We look for leaders in their field. We´re looking for great management, a great balance sheet, and a high degree of predictability. Obviously deciding what´s a high degree of predictability is subjective and I don´t want to attach too much scientific methodology to it, but we need to be able to make a best guess. Like anything else, it takes open eyes and hard work.

"The average baseball hitter can only hit about .255 and that´s been the average...for years and years. Yet a couple of guys can hit the ball a lot better, and they make the big bucks. I think our business is similar."

G&D: You´ve held ADP for a while. What do you like about the position?

BS: ADP is one of our major positions – our seventh or eighth largest position. I´ve owned it for decades. It has recurring revenue and is the largest player in the payroll and HR services business. It´s very well managed, with a lot of lovely recurring revenue that increases gently. It´s a very fine business, but the negative there is that it´s grown so big that the growth rate is going to be slower. Revenue growth is going to be about 6.5% per annum for the next five years, which may be the slowest of anything in our investment universe. Nevertheless, we are still looking for faster earnings per share growth, because the business mix is changing, and they should double their earnings over the coming five years.

G&D: Do you think there are any threats to that business?

BS: Maybe no major threats, but there are still some minor ones, mostly from the four or five other companies doing it. Also, there are new ways to provide these services that are being introduced by various software vendors all the time. Yet ADP has a commanding market position and they are holding or even increasing their market share, even though they have to fight for it.

The nice thing is it´s a relatively small part of anybody´s expense. And once you´ve got their system, taking it out to save a few percent on this thing, which is a tiny cost anyway, may not be reasonable. The inertia there is a positive, although there are definitely people shooting at them. They´re good at reinventing themselves and coming up with new ways to answer their market´s demands, or even attack new ones.

They weren´t doing HR for a long time, but they moved into that field and it´s working well for them. It´s a stock you keep. I would´ve said 10 years ago they couldn´t pass the test and continue growing at the size they´re at now, but they keep finding ways to do it. That´s why we still hold a sizeable position.^

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G&D: Could your share your view on Disney, which I think is also among your largest holdings?

BS: We recently increased our position in Disney, which looks like it could be a relatively slow grower yet is still a very strong company. It is dominating in its business. They may be over the top regarding streaming as they´re putting billions into it now, but within four or five years it could pay off very handsomely for them. I´m not suggesting they´re going to be as big as Netflix, but they´re going to be a serious competitor in five years, especially given their very broad base around the world.

They have their basic growth business with the movies and parks that generates a lot of money, and we think that the new streaming business is going to have fair growth and will make them a better company in five years. Yet they have a relatively low multiple of 14.7x this year´s earnings, while we think they´ll be worth 17x 2024 projected EPS. That gives us a discounted present value of about $160. Furthermore, if they do what they say they can do and actually succeed, it´ll probably be a 24x multiple by 2023-24. But right now, it´s selling at 8.9x our 2023 earnings forecast. With the shares at around $113, there is a lot of appreciation potential there.

Disney is a company which is probably a lot better than people think it is. We have good friends in Hollywood who really know the industry well and they think that Disney´s management is terrific. This is why it looks attractive to us, even with relatively modest top-line growth. Their margins are going to be under pressure over the next two years, maybe three, because of the new operations. We have to look through that because if we were to wait until they´re already successful, we´ll miss most of the prospective gain. If they mess up, we might lose a little bit, but if they are successful, we will make a lot. It´s a great global company, one of America´s best, with a lot of good properties. That´s why it´s our fourth largest position.

G&D: Do you have any favorite investing reading material?

BS: Philip Fisher´s book Common Stocks & Uncommon Profits is obviously great. Everyone should read MacKay´s Popular Delusions and the Madness of Crowds to see how crazy markets can get sometimes. Charles Ellis´ Classics is a very worthwhile compendium of instructive stories put out by the CFA guys.

I read quite a few trade magazines to see what´s going on. I also try to read blogs on businesses we´re interested in. For example, I´ve been trying to follow the Boeing 737 issue by going through pilots´ blogs to see what´s happening and what they think is right or wrong.

G&D: What do you think has been the biggest change in investment management since you first entered the industry?

BS: I think the fundamental reason for investing hasn´t changed at all: people put money at risk to make a return. And people haven´t changed much. Yet, the size and scope of this business has changed phenomenally.

My dad used to say that every once in a while, the market has to shake out the grocery clerks. It was grocery clerks then, hedge funds now, but they act the same way and panic when the market´s down. But instead of selling when the market´s down, it´s time to buy things cheaply. And when the market is up, it´s time to think about selling. Human beings tend to go the other way. That´s why having great conviction in what Graham called a fair "central value" for each current and prospective investment is so important.

Human emotions are still the same, but there is just tremendous efficiency today. You can now execute orders in milliseconds or even nanoseconds, and we have lots of trading machines working with algorithms nowadays, but I still think it´s the same game played on a much bigger, broader, and faster scale. Looking for great growth like we saw in Walgreens, Walmart, Amazon, Alphabet, Apple or Home Depot is the reason I am doing this. I´m not here to try beating the next buyer down the street by an eighth of a nanosecond or trade a thousand times a day to make it up. Automated trading is fantastic, but it´s a different business.

Furthermore, there is a huge move towards passive investing

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Bill Stewart, Stewart Asset Management

because most people can´t beat the averages but, honestly, a few people can. The average baseball hitter can only hit about .255 and that´s been the average, within a couple of points, for years and years. Yet a couple of guys can hit the ball a lot better, and they make the big bucks. I think our business is similar, and there will still be people flocking to the investors who can do it well. Typically, though, those individuals stop taking new clients when they get to a certain size, because size can be a restraint.

I think opportunities to invest in good companies still exist. True, you can´t really buy good businesses dirt cheap anymore, but you can buy them at a reasonable price. I like to think in terms of earnings yields and compare it to a 10-year T-Bond, whose 2.6% yield is going to be fixed. Compare that to buying an average S&P 500 stock at 18x current earning power, which is a 5.6% earnings yield today, it can double earnings to provide an 11.2% earnings yield in 10 years (or an average earnings yield of about 8.4% over the coming decade). That´s a lot of edge in favor of stocks.

G&D: Do you have any advice for MBAs going into investment management?

BS: If you have the right mindset, it´s a wonderful business. It´s constantly challenging and fascinating. You are visiting the companies you´re investing in and it means meeting smart people, seeing great businesses being built by a team or a man or woman who has fresh ideas. I would say it´s business school cases in real time. The best part of the business was always growing with the companies that we invested in and visiting them regularly. Of course, the other side of the coin is that stocks go up and down, and always will, which can be both exciting and depressing. Personally, I find it exciting and interesting. It is never boring - frightening sometimes, but never boring.

So many people are stuck in jobs in which they are advancing well financially but are not happy. They´re bored yet they stick with it because they can´t afford to leave. I made lots of money, thank God, but I´ve always had challenges and always had fun. In this business, you have the opportunity to never get bored. For sure, there are 20 big stocks out there that are going to double next year, and the challenge is to go out and find them. I think that challenge is wonderful, and you never get all the way there. You can always improve your methodology, there´s always room to do a little bit better, to go an extra mile. If you´re talking to a company that you´ve really got a good story from, you want to check with a competitor, talk to customers; you can always go deeper and learn more. The job is never done.

Developing conviction is possibly one of the two or three most important things you can do when you´re forecasting the future and you do that every day. You´re never going to be right all the time, so when you´re wrong, you bite your tongue and then go on to the next prospect.

This is a fun business as far as I´m concerned. I know there are people who are miserable in it, but you´ve got to feel it´s the right place for you. I´ve had a lifetime of fun doing this, met wonderful people and helped a lot of clients substantially improve their prospects in the process. What could be better?

G&D: Thank you so much for your time.