

Financial Game 2: Explanation

Financial Game 2:

Value Investor

- Each group is required to pick up a stock from the Stock Exchange of Thailand, which is best for long-term investment. Explain your reasons, including financial ratios.

Value Investing (1)

- Value investing is an investment paradigm that derives from the ideas on investment that Ben Graham and David Dodd began teaching at Columbia Business School in 1928 and subsequently developed in their 1934 text *Security Analysis*
- Although value investing has taken many forms since its inception, it generally involves buying securities that appear underpriced by some form of fundamental analysis
- High-profile proponents of value investing, including Berkshire Hathaway chairman **Warren Buffett**, have argued that the essence of value investing is buying stocks at less than their intrinsic value

How?

- <http://www.investopedia.com/university/value-investing/value-investing1.asp>
- From examining the performance of simple value strategies, such as buying low PE ratio stocks, low price-to-cash-flow ratio stocks, or low price-to-book ratio stocks, numerous academics have published studies investigating the effects of buying value stocks
- These studies have consistently found that value stocks outperform growth stocks and the market as a whole!

However, it might be better to know great stocks!

- For the last 25 years, Warren Buffett has taken the value investing concept even further with a focus on "*finding an outstanding company at a sensible price*" rather than generic companies at a bargain price

(Source: https://en.wikipedia.org/wiki/Value_investing)

- The big problem for value investing is estimating intrinsic value and there is no "correct" intrinsic value. For this reason, another central concept to value investing is that of "margin of safety". This just means that you buy at a big enough discount to allow some room for error in your estimation of value.

(Source: <http://www.investopedia.com/terms/v/valueinvesting.asp#ixzz40njXVXQh>)

But, how to find a great stock? (1)

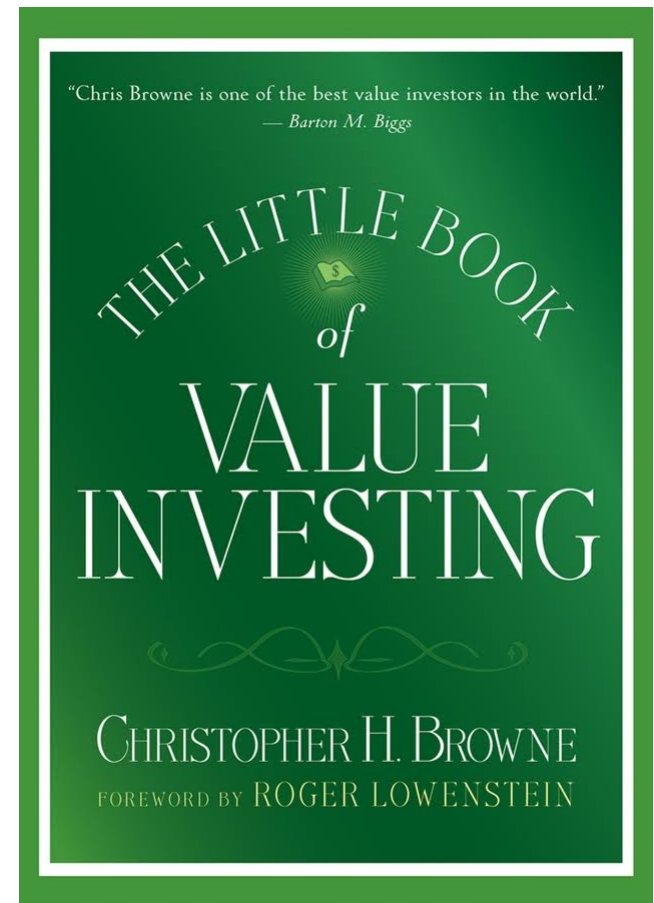
- Remember that
$$P_0 = \sum_{t=1}^{\infty} \frac{D_t}{(1+k_e)^t}$$

and dividend payments actually depend on the company's operating performances into the future

- That means we have to be able to project the future prospect of the company

But, how to find a great stock? (2)

- Value investor Christopher H. Browne recommends in his book “The Little Book of Value Investing” to think about the company's future prospects:
 - Can the company increase its revenue by raising prices? Increasing sales? Lowering expenses? Selling or closing unprofitable divisions? Growing the company? Who are the company's competitors and how strong are they?



(Source: <http://www.investopedia.com/university/value-investing/value-investing3.asp#ixzz40nsSu4Wo>)

But, how to find a great stock? (3)

- To increase your odds of accurately answering these questions, it's wise to buy companies that you understand. Warren Buffett takes this approach.
- Companies that you understand will most likely be those in industries you have worked in or sell consumer goods products that you are familiar with. If you've worked for a biotech company for several years, you probably have a better-than-average understanding of the biotechnology business.
- And if you buy basic items like cars, clothes, appliances and food, you know a thing or two about consumer goods

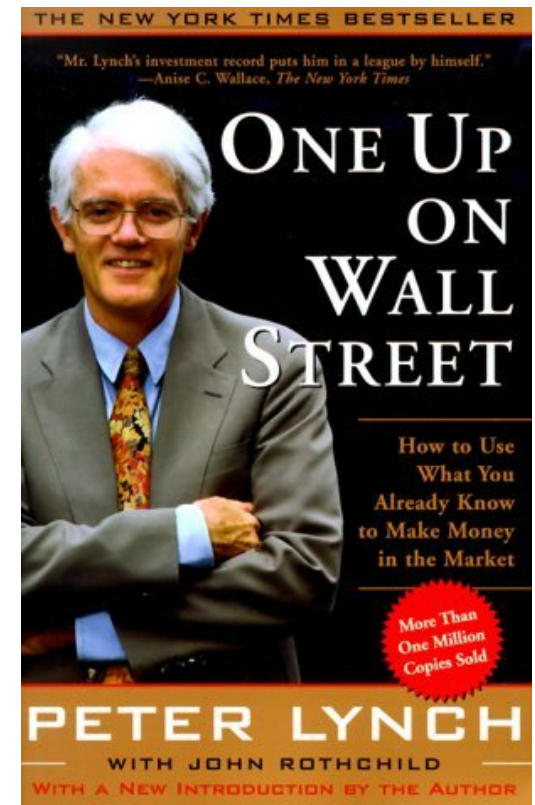
(Source: <http://www.investopedia.com/university/value-investing/value-investing3.asp#ixzz40nsSu4Wo>)

Some clues

- <http://www.investopedia.com/university/value-investing/value-investing3.asp>
- <http://www.investopedia.com/university/value-investing/value-investing4.asp>
- <http://www.investopedia.com/university/value-investing/value-investing5.asp>

But, how to find a great stock? (4)

- And Peter Lynch said “I’ve said before that an amateur who devotes a small amount of study to companies in an industry he or she knows something about can outperform 95 percent of the paid experts who manage the mutual funds, plus have fun in doing it.” (Lynch and Rothchild, 1993)



The St. Agnes Portfolio

- Ms. Joan Morrissey, a seventh-grade teacher, divide her class into teams of four every year. Each team is funded with a theoretical \$250,000 and then competes to see who can make the most of it.
- During 1990 – 1991, St. Agnes portfolio produced a 70 percent gain.
- The gain outperformed the S&P 500 composite, which gained 26 percent in the same time frame, and also outperformed 99 percent of all equity mutual funds.

Table 1-1. ST. AGNES PORTFOLIO

<i>Company</i>	<i>1990-91 Performance (%)</i>
Wal-Mart	164.7
Nike	178.5
Walt Disney	3.4
Limited	68.8
L.A. Gear	- 64.3
Pentech	53.1
Gap	320.3
PepsiCo	63.8
Food Lion	146.9
Topps	55.7
Savannah Foods	- 38.5
IBM	3.6
NYNEX	- .22
Mobil	19.1
Total Return for Portfolio	69.6
S&P 500	26.08

Total return performance January 1, 1990-December 31, 1991

The Secrets of St.Agnes

- The students learn to read the financial newspaper Investor's Business Daily. They come up with a list of potentially attractive companies, research each one, checking the earnings and the relative strength.
- Then they sit down and review the data and decide which stocks to choose.

Ms. Morrissey's Conditions

- “... a portfolio should have at least ten companies, with one or two providing a fairly good dividend,”
- “But before my students can put any stock in the portfolio, they have to explain exactly what the company does. If they can't tell the class the service it provides or the products it makes, then they aren't allowed to buy.”

Financial Game 2

What to tell?

- Each group pick one stock, from SET or MAI.
- You must be able to tell the service the company provides or the products the company makes or sells.
- You must check financial strength of the company e.g. earnings, dividends, financial ratios, debts, other interesting features etc.
- Other interesting factors.

Starting Points

- Form 56_1
 - <http://market.sec.or.th/public/idisc/FinancialStatement.aspx?lang=en&reportcode=PP06>
- Opportunity Day
 - <http://www.set.or.th/set/opofdaybyperiod.do?language=en&country=US>
- Analysts' reports
 - http://portal.settrade.com/C17_ResearchList.jsp?select_category=all&select_security_type=SETmai