Take stock (pun intended) of the predominantly fearful news flooding today's media, and what better time to go against the crowd? And to do so by taking a value investing approach. Whether based on that of Benjamin Graham, or Warren Buffett or John Templeton, or one's own set disciplines, be assured of the superior long-term investment wealth this approach will increasingly bring!

VALUE INVESTING

by
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Pioneered by the iconic Benjamin Graham, value investing involves estimating the true, or underlying, intrinsic value of a prospective investment and comparing the value so obtained with the prevailing price so as to judge relative cheapness or expensiveness.

In essence, Mr. Graham recommended estimating the stream of future earnings a corporation is judged capable of generating, and then discounting these earnings back to the present at an interest rate judged to be appropriate against the foreseen risks and the levels of prevailing interest rates. If the resulting calculation gives a value higher than the prevailing market price, the investment might not only be worth undertaking, but could well be an undervalued bargain: If lower, it is likely too expensive and probably best avoided in favour of another candidate.

Mr. Graham also took criteria such as the record of sales and earnings into consideration. The soundness of a candidate's balance sheet was another criterion that he focused on. In the final instance, however, it was the discounted present value of future earnings that counted most with him. And so much the better if there were a "moat" between his derived intrinsic value and the prevailing stock market price – the wider the margin of safety the better!

Comparing investments in price-to-earnings terms i.e. on the basis of their P/E ratios, is a commonly-used, short-form adaptation of the Benjamin Graham approach developed in his epic *The Intelligent Investor*, long considered the bible of value investing. And, as hard and as contrary as it may sometimes seem, no more so than in terms of discounted future earnings in the volatile and unpredictable markets of recent years – and now!

In the U.S., after 2015 turned out to be the worst stock market year since the Great Recession of 2008, who would have thought benchmark stock market indices would make record new all-time highs less than a year later: And do so in the face of a never-ending gauntlet of risk – currently a bruising and highly–controversial U.S. presidential election.

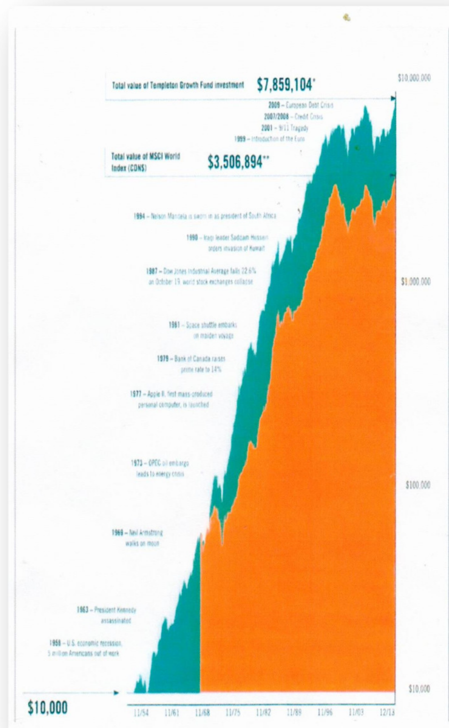
To think, as well, that this impressive rebound occurred in the wake of Black Monday of August 24th, 2015 when the Dow Jones Industrial Average opened a thousand points lower, a similarly-torrid beginning to 2016 and most recently Britain's startling "Brexit" vote to extricate itself from referendum vote to leave the European Union.

Even that consummate value investor Warren Buffett had a lousy 2015 when Berkshire Hathaway fell by a year-over-year 12%, all of which has since been handsomely recouped. And so bleak did the outlook seem a year ago that his acerbic partner Charlie Munger was moved to comment: "Everything that's important is counter-intuitive and everything that's obvious is wrong."

Yet, while the unexpected must remain an integral part of the investment process, and despite interruptions like 2015-16, Benjamin Graham's credo of investing being most intelligent when gone about in a business-like manner (i.e. on a value basis) is standing the tests of today's markets better than ever.

Canada's investment and foreign exchange markets had an *annus horribilus* of their own in 2015 when an 11% decline in the benchmark TSX Composite index became 27% in international currency-adjusted terms. But what a difference in 2016 when a well-received new government and recovering oil and commodity prices have combined to lift this same market bellwether 14% higher year-to-date (Sept. 8th). Add a Canadian dollar that had sunk below the 70-cents (U.S.) level and has since recovered to the USD $0.77 range, and this year's average currency-adjusted investment return on average Canadian equities is running in the order of 20%. A freshly growing international recognition of Canada's bargain cheapness and relative value attraction are further pluses, as they increasingly deserve to be!

If there were a central lesson in the extreme volatility of the past years, it is that the stock markets, while good longer-term barometers, can seldom be relied upon over the shorter term. A *New York Times* editorial of earlier this year aptly concluded that: "If there were one prediction to be sure of it is that Wall Street will be wrong".



Hence, the need for a dispassionate stand back approach – of which there is none better than in my experience value investing.

What can often seem to be a contrary approach is also reflected in the late (and great) Sir John Templeton's reminder that bear markets are born at the heights of euphoria, bull markets in the depths of despair. And all the more at an unsettled stage like now there is Sir John's steadfast belief that "time in" rather than "timing" the markets is much the more effective way to go about successful (long-term) investing. His famous Templeton Mountain chart (on the previous page) stands as a timeless reminder of what a disciplined longer-term approach to investing can bring.

Whether based on the Benjamin Graham, or Warren Buffett, or John Templeton approach, or one's own assessment of what that estimated stream of future earnings might be worth, why not step away from the hyper day-to-day market "crowd" and take a longer-term value approach? It shouldn't be long before superior annual total returns are forthcoming: And before value-based portfolios begin visibly building that sought-after, longer-term wealth (e.g. for retirement) in gratifyingly superior fashion!

Michael Graham

Dr. Graham is a fifty-plus year veteran of the Canadian investment industry, the co-author of two investment books (Portfolio First Aid and Financial First Aid for Canadians), an investment industry speaker and frequent guest on BNN and Money Talk. His website at: Michaelgrahamis.com offers a subscription newsletter with two successful sample portfolios, their ongoing research and rebalancing, and featured extra stock picks.