Twitter Thread by Max Koh

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This is value investor, Allan Mecham.

He dropped out of college at age 22 to start his fund, Arlington Value.

From 2008-2016, they did a CAGR of 30% over 8.5 years!

And in his fund letters, he shared his best frameworks for investing in companies.

Here's a breakdown of each:

1. Adopt a mindset for longevity

He focuses on variables that affect a business' durability.

Stuff like valuation doesn't matter if the business quality is misjudged.

Since a company's value is determined by its future cash flows...

Hence evaluating its future is key

> **"The value of a company is derived from what it produces for owners over its lifetime—usually many years, often decades.**
>
> This supports a mindset calibrated towards longevity, forcing us to hone in on variables related to durability: barriers to entry, technological obsolescence risk, bargaining power, value being provided to customers, and threats of all kinds.
>
> In most cases, what's critical is not next quarters earnings, or next year's numbers (what Wall Street emphasizes), but rather **the earnings over the next decade and beyond.**
>
> **If the valuation takes place upon a shaky qualitative backdrop or uncertain competitive understanding,** then valuations and a perceived margin of safety can turn out to be a mirage."

2. Stay within your circle of competence

Allan is aware that his CoC is tiny!

Thus, he rarely buys companies that he:

- Hasn't researched
- Hasn't followed for at least a few years.

Because the best way to study a business is to observe its execution overtime.

> "Over the past 13+ years, I've built up a base of companies that I understand well and would like to own at the right price.
>
> **We tend to stay within this small circle of companies, owning the same names multiple times.**
>
> **It's rare for us to buy a company we haven't researched and followed for a number of years — we like to stick to what we know."**

3. Embrace volatility as a gift

Public markets offer you amazing deals you will never get in the private markets!

It's all about being patient.

The underlying value of a business is much more stable than the stock.

So you can buy great businesses that are mispriced!

> "That's the beauty of the public markets:
>
> **If you can be patient, there's a good chance the volatility of the marketplace will give you the chance to own companies on your watch list.**
>
> The average stock price fluctuates by roughly 80% annually (when comparing 52-week high to 52-week low).
>
> Certainly, **the underlying value of a business doesn't fluctuate that much on an annual basis, so the public markets are a fantastic arena to buy businesses if you can sit still without growing tired of sitting still."**

4. Avoid noise and news

More information can give you a false sense of confidence.

It can create an illusion of "knowledge", and make you think many things are important.

The key is to know what are the 3-5 main variables in the company, and focus on those.

Ignore the rest.

> **“I disagree with the notion that more information is always better.”**

5. Extend your time horizon to see what's truly important

When you look years out, instead of next quarter:

• You place less emphasis on hiccups and fluctuations.

• You don't focus on what 99% of other analysts look at (guidance, beats).

This helps you think more clearly.

> **“Focusing on long-term investing (i.e., holding businesses for decades not decimal seconds) leads to a natural decline in the level of importance you place on quarterly results (earnings “beats”),** short-term headwinds and temporary compressions in earnings and margins.
>
> When you think long-term, all of that doesn’t really matter.
>
> More than that, if you keep thinking like this, **you’ll start to question why others even ask for quarterly guidance.”**

6. Dig below the numbers

Not everything that is in numbers gives you the full story.

The real returns are made from great business quality.

Many factors like psychology and customer love are what determines the longevity of the business.

Look beyond the financial statements!

> "Analysts tend to overweight what can be measured in numerical form, even when **the key variable(s) cannot easily be expressed in neat, crisp numbers.**"

7. Mentally prepare for speed bumps and ugly numbers

Learn to discern between:

Short term speed bumps VS. fundamental problems in the business.

Franchise value can still be firmly intact, even if the company is going through a rough patch.

> **"I think there are many instances where a company hits a speed bump and reports ugly "numbers," yet the long-term earnings power and franchise value remain intact.**
>
> Oftentimes a key cog of value is in a form that's difficult to measure:
>
> Brands, mindshare/loyal customers, exclusive distribution rights, locations, management, etc."

8. Pick the easy fights

He looks for layup type of investments, basically those that are easy.

Simple to understand.

In this business, there are no bonus points for doing backflips and somersaults in the air.

K.I.S.S!!!

> "While our focused portfolio is sometimes criticized by the financial mainstream, we think the judgements lack substance.
>
> **We are a risk-averse fund looking for low-risk layup-type investments while other funds are akin to a run-and-gun offense that routinely takes a smattering of low-percentage shots."**

RECAP:

1. Adopt a mindset for longevity
2. Stay within your circle of competence
3. Embrace volatility as a gift
4. Avoid noise and news
5. Extend your time horizon
6. Dig below the numbers
7. Mentally prepare for speed bumps
8. Pick the easy fights

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I share how I crossed 7 figures before age 30, and achieved my own version of financial freedom.

Stuff I tweet about:

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