

Twitter Thread by [Ram Bhupatiraju](#)



[Ram Bhupatiraju](#)

[@RamBhupatiraju](#)



One of my fav docs to come back to during all market cycles. Covering Investment principles, checklists, economic cycles/bubbles, value traps & more. Phenomenal compilation by [@pcordway](#)■

cc: [@dmuthuk](#) [@Gautam__Baid](#) [@saxena_puru](#)

[Some](#) of my fav content.■■■

<https://t.co/TIkvktVoJC>

INVESTMENT PRINCIPLES & CHECKLISTS

“You need a different checklist and different mental models for different companies. I can never make it easy by saying, ‘Here are three things.’ You have to derive it yourself to ingrain it in your head for the rest of your life.” – Charlie Munger

Table of Contents

PROCESS	2
PLACES TO LOOK FOR VALUE	5
KEY CONCEPTS FROM GREAT INVESTORS	8
Seth Klarman’s Thoughts on Risk	8
“Becoming a Portfolio Manager Who Hits .400” (Buffett)	8
An Investing Principles Checklist	9
Charlie Munger’s “ultra-simple general notions”	10
“Tenets of the Warren Buffett Way”	10
Howard Marks and Oaktree	11
Phil Fisher’s 15 Questions	14
And more Fisher: 10 Don’ts:	14
J.M. Keynes’s policy report for the Chest Fund, outlining his investment principles	14
Lessons from Ben Graham	15
Joel Greenblatt’s Four Things NOT to Do	17
Greenblatt: The process of valuation	17
How does this investment increase my “look-through” earnings 5-10 years in the future? (Buffett)	18
Ray Dalio on “The Economic Machine”	18
Why Smart People Make Big Money Mistakes (Belsky and Gilovich)	19
Richard Chandler Corporation’s Principles of Good Corporate Governance	20
Tom Gayner’s Four “North Stars” of investing	20
David Dreman’s “Contrarian Investment Rules”	21
Principles of Focus Investing	23
Lou Simpson	24
Don Keough’s “Ten Commandments for Business Failure”	24
Jim Chanos’s value traps	25
Major areas for forensic analysis (O’Glove)	25
Seven Major Shenanigans (Schilit)	25
Walter Schloss: “Factors needed to make money in the stock market”	26
Chuck Akre’s criteria of outstanding investments	27
Bill Ruane’s Four Rules of Smart Investing	27
Richard Pzena	28
Sam Zell’s “Fundamentals”	29
Thoughts from Jim Chanos on Shorting	29
James Montier’s 10 tenets of the value approach	31
James Montier: The Seven Immutable Laws of Investing	32
Jeremy Grantham’s “Investment Advice [for individual investors] from Your Uncle Polonius”	32
Sir John Templeton’s “16 Rules for Investment Success”	32
Four sources of economic moats (all of which much be durable and be hard to replicate) (Sellers)	33
Seven traits shared by great investors (Sellers)	33
APPENDIX – OTHER CONSIDERATIONS AND DATAPOINTS	34

Pretty good process and checklist.

- **Good checklists** are precise, efficient, easy to use even under difficult conditions, do not try to spell out everything, and provide reminders of only the most critical and important steps; the power of checklists is limited
 - **Bad checklists** are vague, imprecise, too long, hard to use, impractical, and try to spell out every single step
- **Do-confirm** checklist: perform jobs/tasks from memory and experience, but then stop, run the checklist and confirm that everything was done correctly
- **Read-do** checklist: carry out tasks as they are checked off – more like a recipe

PROCESS

Focus on original source documents, working from in to out

- **SEC filings**
 - Read 10-Qs, 10-Ks, proxies and other filings in reverse chronological order
- **Press releases and earnings calls/transcripts**
- **Other public information**
 - Court documents, real estate records, etc.
- **Industry publications**
- **Third-party analysts**
 - Sell-side research only as a consensus-checking exercise
- **Research the company's competitors** with the same process
 - Research and speak to competitors, (former) employees, and people in the supply chain
- **Estimate valuation before looking at market valuation**
 - **Valuation** – What would a rational, long-term, private buyer would pay in cash today for the entire business?
 - **Asset value**
 - **Earning power**
 - if $EP > NAV$, then franchise value
 - **Growth value**
- **Requirements**
 - **Large, well understood margin of safety**
 - **Reinvestment opportunities for capital in the business**
 - **Quality, ownership stake, and shareholder-orientation of management**
 - **Ability to bear pain, both the company's and my own**

Munger's "Four Filters"

- Understand the business
- Sustainable competitive advantages (aka, favorable long-term economics)
- Able and trustworthy management
- Price that affords a margin of safety (aka, a sensible purchase price)

Tenets from "The Warren Buffett Way"

"TENETS OF THE WARREN BUFFETT WAY"

Business Tenets

- Is the business simple and understandable?
- Does the business have a consistent operating history?
- Does the business have favorable long-term prospects?

Management Tenets

- Is management rational?
- Is management candid with its shareholders?
- Does management resist the institutional imperative?

Financial Tenets

- Focus on return on equity, not earnings per share
- Calculate "owner earnings"
- Look for companies with high profit margins
- For every dollar retained, make sure the company has created [or can create] at least one dollar of market value

Market Tenets

- What is the value of the business?
- Can the business be purchased at a significant discount from its value?

Buffett: Is It a Good Investment?³

"To ascertain the probability of achieving a return on your initial stake, Buffett encourages you to keep four primary factors clearly in mind:

1. The certainty with which the long-term economic characteristics of the business can be evaluated.
2. The certainty with which management can be evaluated, both as to its ability to realize the full potential of the business and to wisely employ its cash flows.
3. The certainty with which management can be counted on to channel the rewards from the business to the shareholders rather than to itself.
4. The purchase price of the business."

Some lessons from Ben Graham

- “If you are shopping for common stocks, chose them the way you would buy groceries, not the way you would buy perfume.”
- “Obvious prospects for physical growth in a business do not translate into obvious profits for investors.”
- “Most businesses change in character and quality over the years, sometimes for the better, perhaps more often for the worse. The investor need not watch his companies’ performance like a hawk; but he should give it a good, hard look from time to time.”
- “Basically, price fluctuations have only one significant meaning for the true investor. They provide him with an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal. At other times he will do better if he forgets about the stock market and pays attention to his dividend returns and to the operating results of his companies.”
- “The most realistic distinction between the investor and the speculator is found in their attitude toward stock-market movements. The speculator’s primary interest lies in anticipating and profiting from market fluctuations. The investor’s primary interest lies in acquiring and holding suitable securities at suitable prices. Market movements are important to him in a practical sense, because they alternately create low price levels at which he would be wise to buy and high price levels at which he certainly should refrain from buying and probably would be wise to sell.”
- “The risk of paying too high a price for good-quality stocks – while a real one – is not the chief hazard confronting the average buyer of securities. Observation over many years has taught us that the chief losses to investors come from the purchase of low-quality securities at times of favorable business conditions. The purchasers view the current good earnings as equivalent to “earning power” and assume that prosperity is synonymous with safety.”
- “Even with a margin [of safety] in the investor’s favor, an individual security may work out badly. For the margin guarantees only that he has a better chance for profit than for loss – not that loss is impossible.”
- “To achieve satisfactory investment results is easier than most people realize; to achieve superior results is harder than it looks.”
- “Wall Street people learn nothing and forget everything.”
- “Most of the time stocks are subject to irrational and excessive price fluctuations in both directions as the consequence of the ingrained tendency of most people to speculate or gamble ... to give way to hope, fear and greed.”

Phil Fisher's 15 Questions and 10 Don'ts.

PHIL FISHER'S 15 QUESTIONS

- Does the company have products or services with sufficient market potential to make possible a sizable increase in sales for at least several years?
- Does the management have a determination to continue to develop products or processes that will still further increase total sales potentials when the growth potentials of currently attractive product lines have largely been exploited?
- How effective are the company's research-and-development efforts in relation to its size?
- Does the company have an above-average sales organization?
- Does the company have a worthwhile profit margin?
- What is the company doing to maintain or improve profit margins?
- Does the company have outstanding labor and personnel relations?
- Does the company have outstanding executive relations?
- Does the company have depth to its management?
- How good are the company's cost analysis and accounting controls?
- Are there other aspects of the business, somewhat peculiar to the industry involved, which will give the investor important clues as to how outstanding the company may be in relation to its competition?
- Does the company have a short-range or long-range outlook in regard to profits?
- In the foreseeable future will the growth of the company require sufficient equity financing so that the larger number of shares then outstanding will largely cancel the existing stockholders' benefit from this anticipated growth?
- Does management talk freely to investors about its affairs when things are going well but "clam up" when troubles and disappointments occur?
- Does the company have a management of unquestionable integrity?

AND MORE FISHER: 10 DON'TS:

- Don't buy into promotional companies.
- Don't ignore a good stock just because it trades "over the counter."
- Don't buy a stock just because you like the "tone" of its annual report.
- Don't assume that the high price at which a stock may be selling in relation to earnings is necessarily an indication that further growth in those earnings has largely been already discounted in the price.
- Don't quibble over eights and quarters.
- Don't overstress diversification
- Don't be afraid to buy on a war scare.
- Don't forget your Gilbert and Sullivan, i.e., don't be influenced by what doesn't matter.
- Don't fail to consider time as well as price in buying a true growth stock.
- Don't follow the crowd.

Mistakes and biases from the book "Why Smart People Make Big Money Mistakes".

- House money (a form of mental accounting) -- the parable of the groom on his honeymoon in Vegas; he set out with \$5, made a long series of winning bets, betting his entire bankroll each time; after a while he had a bankroll of several million and, again, bet it all; this time he lost, and upon returning to his wife, was asked how he did. "not bad, I lost \$5."
- Disposition effect -- the name Shefrin and Statman gave to the tendency to hold losers too long and sell winners too quickly; an extension of loss aversion and prospect theory
- "Sunk cost fallacy" -- the significance or value of a decision should not change based on a prior expenditure
- Trade-off contrast -- Tversky and Simonson; a phenomenon whereby choices are enhanced or hindered by the trade-offs between options, even options we wouldn't choose anyway
- Remember the effects of inflation! How much purchasing power do your investment dollars by now?
- Principles to ponder
 - every dollar spends the same (mental accounting)
 - losses hurt more than gains please (loss aversion)
 - money that's spent is money that doesn't matter (sunk cost fallacy)
 - the way decisions are framed -- e.g., coding gains and losses -- profoundly influences choices and decision-making
 - too many choices make choosing tough
 - all numbers count, even if they're small or if you don't like them
 - don't pay too much attention to things that matter too little
 - overconfidence is very common
 - it's hard to prove yourself wrong
 - the herd mentality is often dangerous
 - knowing too much or just a little can be dangerous
 - emotions often affect decisions more than is realized
- Biases
 - anchoring bias -- the failure to make sufficient adjustments from an original estimate; especially problematic in complex decision making environments and/or where the original estimate is far off the mark
 - availability -- a heuristic by which people "assess the frequency of a class or the probability of an event by the ease with which instance or occurrences can be brought to mind."
 - e.g., shark attacks vs. falling airplane parts
 - cognitive bias -- the tendency to make logical errors when applying intuitive rules of thumb
 - hindsight bias -- people's mistaken belief that past errors could have been seen much more clearly if only they hadn't been wearing dark or rose-colored glasses; seriously impairs proper assessment of past errors and limits what can be learned from experience
 - law of small numbers -- a tongue in cheek reference to the tendency to overstate the importance of findings taken from small samples which often leads to erroneous conclusions; contrast to the statistically valid law of large numbers.
 - recency and saliency -- two aspects of events (how recent they are and how much of an emotional impact they have, often establishing a case rate) that contribute to their being given greater weight than prior probabilities (i.e., the base rate)
 - representativeness -- a subjective judgment of the extent to which the event in question is similar in essential properties to its parent population or reflects the salient feature of the process by which it is generated
 - survivorship bias -- the failure to use all stocks/samples (i.e., those that no longer exist) in studies or decisions

Howard Marks' wisdom.

The 2nd pic with "Investment and Credit Cycles" is an essential understanding.

Tenets of Oaktree Capital Management

1. The primacy of risk control
 - Superior investment performance is not our primary goal, but rather superior performance with less-than-commensurate risk. Above average gains in good times are not proof of a manager's skill; it takes superior performance in bad times to prove that those good-time gains were earned through skill, not simply the acceptance of above average risk. Thus, rather than merely searching for prospective profits, we place the highest priority on preventing losses. It is our overriding belief that, especially in the opportunistic markets in which we work, "if we avoid the losers, the winners will take care of themselves."
2. Emphasis on consistency
 - Oscillating between top-quartile results in good years and bottom-quartile results in bad years is not acceptable to us. It is our belief that a superior record is best built on a high batting average rather than a mix of brilliant successes and dismal failures.
3. The importance of market inefficiency
 - We feel skill and hard work can lead to a "knowledge advantage," and thus to potentially superior investment results, but not in so-called efficient markets where large numbers of participants share roughly equal access to information and act in an unbiased fashion to incorporate that information into asset prices. We believe less efficient markets exist in which dispassionate application of skill and effort should pay off for our clients, and it is only in such markets that we will invest.
4. The benefits of specialization
 - Specialization offers the surest path to the results we, and our clients, seek. Thus, we insist that each of our portfolios should do just one thing — practice a single investment specialty — and do it absolutely as well as it can be done. We establish the charter for each investment specialty as explicitly as possible and do not deviate. In this way, there are no surprises; our actions and performance always follow directly from the job we're hired to do. The availability of specialized portfolios enables Oaktree clients interested in a single asset class to get exactly what they want; clients interested in more than one class can combine our portfolios for the mix they desire.
5. Macro-forecasting not critical to investing
 - We believe consistently excellent performance can only be achieved through superior knowledge of companies and their securities, not through attempts at predicting what is in store for the economy, interest rates or the securities markets. Therefore, our investment process is entirely bottom-up, based upon proprietary, company-specific research. We use overall portfolio structuring as a defensive tool to help us avoid dangerous concentration, rather than as an aggressive weapon expected to enable us to hold more of the things that do best.
6. Disavowal of market timing
 - Because we do not believe in the predictive ability required to correctly time markets, we keep portfolios fully invested whenever attractively priced assets can be bought. Concern about the market climate may cause us to tilt toward more defensive investments, increase selectivity or act more deliberately, but we never move to raise cash. Clients hire us to invest in specific market niches, and we must never fail to do our job. Holding investments that decline in price is unpleasant, but missing out on returns because we failed to buy what we were hired to buy is inexcusable.

- ✓■ Principles of Good Corporate Governance
- ✓■ Principles of Focused Investing
- ✓■ Bill Ruane's Four Rules of Smart Investing

RICHARD CHANDLER CORPORATION'S PRINCIPLES OF GOOD CORPORATE GOVERNANCE

1. Shareholders are owners, with the attendant rights and responsibilities of ownership.
2. Companies should have a democratic capital structure which enshrines the principle of "one share equals one vote." Shareholders are responsible for electing the board of directors who in turn appoint the company's management.
3. The board of directors and management are accountable to shareholders for the capital entrusted to them and for their financial and ethical actions.
4. Management's role is to maximize long-term shareholder value through the productive use of capital and resources in an ethical and socially responsible manner.
5. Management has a Corporate Social Responsibility to respect and nurture the physical, economic, moral, social and regulatory environment within which it operates.
6. Capital is a valuable resource which must be prudently managed. When management cannot deploy capital productively in the business, it should be returned to shareholders for reinvestment.
7. Commerce and capital are based on trust. Capital will naturally flow to markets where there is a fair and impartial application of just laws. Government has a responsibility to create trust-based capital markets which protect investor property rights through the rule of law being applied without discrimination as to race, nationality, religion, gender or affiliation.
8. Prosperity is possible if all market participants work together. This requires responsible investors exercising proper oversight of management, ethical business leadership using capital and resources wisely, and independent regulators applying just laws fairly.

TOM GAYNER'S FOUR "NORTH STARS" OF INVESTING

- Profitable; good returns on capital without use of excessive leverage
 - Must be sustainable profitability/returns
 - Look at the business as a long-running movie, not a snapshot
 - Proven track record of profits across cycles (5-10 years)
- Management teams with talent and integrity – one without the other is useless
- Good reinvestment opportunities
 - Compounding machines

Some Financial shenanigans

SEVEN MAJOR SHENANIGANS (SCHILIT)

1. Recording revenue before it is earned
 - A. Shipping goods before a sale is finalized
 - B. Recording revenue when important uncertainties exist
 - C. Recording revenue when future services are still to be done
2. Creating fictitious revenue
 - A. Recording income on the exchange of similar assets
 - B. Recording refunds from suppliers as revenue
 - C. Using bogus estimates on interim financial reports
3. Boosting profits with non-recurring transactions
 - A. Boosting profits by selling undervalued assets
 - B. Boosting profits by retiring debt
 - C. Failing to segregating unusual and nonrecurring gains or losses from recurring income
 - D. Burying losses under non-continuing operations
4. Shifting current expenses to a later period
 - A. Improperly capitalizing costs
 - B. Depreciating or amortizing costs too slowly
 - C. Failing to write-off worthless assets
5. Failing to record or disclose liabilities
 - A. Reporting revenue rather than a liability when cash is received
 - B. Failure to accrue expected or contingent liabilities
 - C. Failure to disclose commitments and contingencies
 - D. Engaging in transactions to keep debt off the books
6. Shifting current income to a later period
 - A. Creating reserves to shift sales revenue to a later period
7. Shifting future expenses to an earlier period
 - A. Accelerating discretionary expenses into the current period
 - B. Writing off future years' depreciation or amortization

Lessons from Jim Chanos on shorting (and stuff to avoid on the long side)

THOUGHTS FROM JIM CHANOS ON SHORTING

- Value Stocks: Definitive Traits
 - Predictable, consistent cash flow
 - Defensive and/or defensible business
 - Not dependent on superior management
 - Low/reasonable valuation
 - Margin of safety using many metrics
 - Reliable, transparent financial statements
- Always start with source documents
- Don't short on valuation alone. Focus on businesses where something is going wrong.
 - "We look more at the business to see if there is something structurally wrong or about to go wrong, and enter the valuation last."
- Better yet, we look for companies that are trying – often legally but aggressively – to hide the fact that things are going wrong through their accounting, acquisition policy, or other means.⁶
- Drown out what the Street is saying.⁷
- Never get too close to management. Usually best to avoid management altogether.
- Always read all of the documents.
- Stay intellectually curious.
- The best short ideas often looking cheap all the way down and often ensnare a lot of value investors
- Financial services, consumer products, natural resources are all good hunting grounds
- Ditto companies that grow rapidly by acquisition
- Mid- and large-caps only
- No derivatives or leverage
- Other potential signs of a value trap
 - The sector is in long-term secular decline
 - There is a high risk of technical obsolescence
 - The business model is fundamentally flawed
 - The balance sheet is highly leveraged
 - The accounting is aggressive
 - Estimates are frequently revised
 - Competition is fierce and growing
 - The business is susceptible to consumer fads
 - Weak corporate governance
 - Growth by acquisition
- Chanos's focus points for short-selling
 - **Not** about knowing better knowledge of a product or market cycle
 - Track the cash flows
 - Focus on return on capital
 - Is this company able to stand alone without aid from the capital markets? Or is it in a cash flow spiral and cannot exist apart from capital raising or loans?
 - Companies who cannot earn their cost of capital will eventually have an existential crisis
 - Bet against companies whose finances are dependent on manias and fads
- **Chanos's four recurring themes in short-selling**
 - **Booms that go bust** – booms are defined as anything fueled by debt/credit in which the asset's cash flows do not cover the cost of the debt; Dot-com Bubble was not a "boom," but the Telecom Bubble was a "boom"
 - **Consumer fads** – the fallacy of extrapolating very high growth rates indefinitely
 - **Technological obsolescence** – the old/incumbent product is usually replaced faster than the consensus believes it will be
 - **Structurally-flawed accounting** – beware serial acquires, as they often writedown the assets on the sly; watch for "spring-loaded" acquisitions via artificially depressed inventory, A/R, etc. that is written down at acquisition, only to book gains when needed in the future (without the offsetting write-up in the purchase price of the company)
- Also:
 - Selling \$1.00 for \$2.00 (or more)
 - Value traps (see above)

Seven traits shared by great investors

SEVEN TRAITS SHARED BY GREAT INVESTORS⁹ (SELLERS)

- Trait #1: the ability to buy stocks while others are panicking and sell stocks while others are euphoric
- Trait #2: obsessive about playing the game and wanting to win. These people don't just enjoy investing; they live it.
- Trait #3: the willingness to learn from past mistakes
- Trait #4: an inherent sense of risk based on common sense
- Trait #5: confidence in their own convictions and stick with them, even when facing criticism.
- Trait #6: have both sides of your brain working, not just the left side (the side that's good at math and organization)
- Trait #7: the most important, and rarest, trait of all: The ability to live through volatility without changing your investment thought process

What NOT to do

- Act without a clearly defined margin of safety
- Project earnings or anything else far into the future
- Slap a multiple on an estimates, which compounds the potential error of estimation
- Base a decision on relative value
- Rely on growth to justify present value
- Stray beyond industries and businesses we understand
- Speculate on the direction of commodities or currencies
- Speculate on what other people will be willing to pay for an asset as a justification for owning it

Common mental mistakes and behavioral biases (from Whitney Tilson)

• Common Mental Mistakes (Tilson)

1. Overconfidence
2. Projecting the immediate past into the distant future
3. Herd-like behavior (social proof), driven by a desire to be part of the crowd or an assumption that the crowd is omniscient
4. Misunderstanding randomness; seeing patterns that don't exist
5. Commitment and consistency bias
6. Fear of change, resulting in a strong bias for the status quo
7. "Anchoring" on irrelevant data
8. Excessive aversion to loss
9. Using mental accounting to treat some money (such as gambling winnings or an unexpected bonus) differently than other money
10. Allowing emotional connections to over-ride reason
11. Fear of uncertainty
12. Embracing certainty (however irrelevant)
13. Overestimating the likelihood of certain events based on very memorable data or experiences (vividness bias)
14. Becoming paralyzed by information overload
15. Failing to act due to an abundance of attractive options
16. Fear of making an incorrect decision and feeling stupid (regret aversion)
17. Ignoring important data points and focusing excessively on less important ones; drawing conclusions from a limited sample size
18. Reluctance to admit mistakes
19. After finding out whether or not an event occurred, overestimating the degree to which one would have predicted the correct outcome (hindsight bias)
20. Believing that one's investment success is due to wisdom rather than a rising market, but failures are not one's fault
21. Failing to accurately assess one's investment time horizon
22. A tendency to seek only information that confirms one's opinions or decisions
23. Failing to recognize the large cumulative impact of small amounts over time
24. Forgetting the powerful tendency of regression to the mean
25. Confusing familiarity with knowledge

• Tilson – Behavioral

- Be humble.
 - Avoid leverage, diversify, and minimize trading.
- Be patient.
 - Don't try to get rich quick.
 - A watched stock never rises.
 - Tune out the noise.
 - Make sure time is on your side (stocks instead of options; no leverage).
- Get a partner – someone you really trust – even if not at your firm.
- Have written checklists; e.g., my four questions:
 - Is this within my circle of competence?
 - Is it a good business?
 - Do I like management? (Operators, capital allocators, integrity).
 - Is the stock incredibly cheap? Am I trembling with greed?
- Actively seek out contrary opinions.
 - Try to rebut rather than confirm hypotheses; seek out contrary viewpoints; assign someone to taking the opposing position or invite bearish analyst to give presentation (Pzena's method).
 - Use secret ballots.
 - "What would cause me to change my mind?"
- Don't anchor on historical information/perceptions/stock prices.
 - Keep an open mind.
 - Update your initial estimate of intrinsic value.
 - Erase historical prices from your mind; don't fall into the "I missed it" trap — think in terms of enterprise value, not stock price.
 - Set buy and sell targets.
- Admit and learn from mistakes — but learn the right lessons and don't obsess.
 - Put the initial investment thesis in writing so you can refer back to it.
 - Sell your mistakes and move on; you don't have to make it back the same way you lost it.
 - But be careful of panicking and selling at the bottom.
- Don't get fooled by randomness.
- Understand and profit from regression to the mean.
- Mental tricks.
 - Pretend like you don't own it (Steinhardt going to cash).
 - Sell a little bit and sleep on it (Einhorn).

Business checklist from Tom Gardner

People**Would I want to report to this CEO?**

- Is this CEO likeable?
- Is this CEO admired by employees and customers?

Would I want this CEO babysitting my kids?

- Is this CEO responsible?
- Is this CEO trustworthy?

Does this CEO demonstrate passion?

- Has this CEO pursued mastery in the field over the long term (10 years +)?
- Is this CEO invested in the company's future, both financially and emotionally?

Does this CEO have a long term vision?

- Is this leader on board for the long haul?
- Does this CEO measure success with longer-term metrics?

Does this CEO strive to understand the customers and the market?

- Is this CEO eager to learn?

Is this CEO an effective motivator?**Would I want the executive team at this company managing my money?**

- Are they honest?
- Are they competent?

Does management disclose significant matters in clear, unambiguous language?

- Could my mother understand this company's public filings?

Is management upfront about mistakes?**Is tenure within the company important?**

- Is upper management promoted from within?
- Are employees and management sticking around for the long term?

Profit**Is this business solid?**

- Does the business have access to a significant amount of cash relative to its size?
- Does the business carry more cash than debt?
- If the business carries more debt than cash, are payments on that debt sustainable over the long term?
- If the business carries more debt than cash, has the management team demonstrated an ability to manage debt properly over the long term?
- Is the business built to survive prolonged periods of difficulty?
- Can this company pursue its goals without additional debt or equity financing?

Is this business growing?

- Is this business operating in a growth industry?
- Are consumers moving toward this company and its products?
- Is the company able to consistently grow revenues?

Akre Capital Management

Investment Approach

SELECT OPPORTUNITIES CONSERVATIVELY TO PRESERVE CAPITAL

FOLLOW BOTTOM-UP INVESTING PRINCIPLES TO IDENTIFY COMPANIES WITH:

1. A strong business model demonstrating consistent earnings growth, high return on equity or high compound growth rate in book value per share
2. High quality management who:
 - Have demonstrated a predisposition toward protecting shareholder value in decision making
 - Act with principle and integrity
 - Are highly skilled at managing the business
3. The reasonable certainty of opportunity to reinvest profits at a high compound rate of return
4. A market valuation allowing purchase at reasonable cost

THINK LIKE THE OWNER OF A BUSINESS, NOT A MARKET SPECULATOR

- Invest for long term results
- Seek superior financial strength
- Minimize business risk
- Use market volatility as a powerful opportunity

Following our initial evaluation of the target's business model, we further our study by collecting information from the following:

1. Senior management
2. Competitors
3. Suppliers
4. Industry specialists in the investment community
5. Investment community contacts with contrary views

We seek additional input through conferences, earnings call participation, literature searches and identification of useful analogous examples. We talk with our clients, drawing on their individual and industry knowledge.

Our Long Equity Approach

We approach the selection of long equity investments by a cascade of key questions and consequent assessment. The key questions are:

- Do we understand the business?
- Is historical return on equity/return on capital compelling?
- Is the company's financial strength evident?
- Is the business model sound and sustainable?
- Are we confident of future performance?
- Does management act with integrity and intelligence?
- Can returns be reinvested at above average compound rates?
- Is the stock attractively valued for purchase?

Risk Management

We manage risk in our portfolios by:

1. Carefully selecting individual core holdings by
 - Understanding the business model risk
 - Understanding balance sheet strength
2. Using a modest level of leverage (if any)
3. Balancing the net long exposure based on our outlook for the market and opportunities available (both long and short)

Good explanation of bubbles

John Stuart Mill's model of a bubble

- **Displacement:** the birth of a boom – generally an exogenous shock that triggers the creation of profit opportunities in some sectors while reducing profitability in other sectors; investment in both physical and financial assets is likely to occur; “a new confidence begins to germinate early in this period, but its growth is slow”
- **Credit Creation:** the nurturing of a bubble – a boom needs credit on which to feed; monetary expansion and credit creation are largely endogenous to the system (i.e., money can be created by the government or existing banks, but also by the creation of new banks, new financial instruments, and the expansion of credit outside the financial system); “the rate of interest [is] almost uniformly low...credit continues to grow more robust, enterprise to increase, and profits to enlarge”
- **Euphoria** – everyone into the pool; price seen as capable only of rising; traditional valuation standards are abandoned and new measures are introduced to justify prices; overoptimism and overconfidence rule; the “new era” dominates conversation, even outside the typical realm; “this time is different” is often uttered; “the tendency is for speculation to attain its most rapid growth exactly when its growth is most dangerous”
- **Critical Stage/Financial Distress** – the bubble peaks and begins to deflate; often characterized by insiders cashing out; rapidly followed by financial distress, in which the excess leverage built up during the boom becomes a major problem; fraud also emerges during this stage
- **Revulsion** – the final stage of the process; investors are so scarred by the events in which they themselves participated that they cannot bring themselves to participate in the market at all; bargain-basement asset prices usually result;

Guy Spier's "25 Common Mental Mistakes"

Guy Spier's "25 Common Mental Mistakes:

1. overconfidence
2. projecting the immediate past in the distant future
3. herd-like behavior (social proof) driven by a desire to be part of the crowd; or an assumption that the crowd is omniscient
4. misunderstanding randomness; seeing patterns that don't exist
5. commitment and consistency bias
6. fear of change, resulting in a strong bias for the status quo
7. "anchoring" on irrelevant data
8. excessive aversion to loss
9. using mental accounting to treat some money (such as gambling winnings or an unexpected bonus) differently than other money
10. allowing emotional connections to override reason
11. fear of uncertainty
12. embracing certainty (however irrelevant)
13. overestimating the likelihood of certain events based on very memorable data or experiences (vividness bias)
14. becoming paralyzed by information overload
15. failing to act due to an abundance of attractive options
16. fear of making an incorrect decision and feeling stupid (regret aversion)
17. ignoring important data points and focusing excessively on less important ones; drawing conclusions from a limited sample size
18. reluctance to admit mistakes
19. after finding out whether or not an event occurred, overestimating the degree to which one would have predicted the outcome (hindsight bias)
20. believing that one's investment success is due to wisdom rather than a rising market, but failures are not one's fault
21. failing to accurately assess one's investment time horizon
22. a tendency to seek only information that confirms one's opinions or decisions
23. failing to recognize the large cumulative impact of small amounts over time
24. forgetting the powerful tendency of regression to the mean
25. confusing familiarity with knowledge

Guy Spier – New Highs/Dealing with Irrational Exuberance

Business Questions

- Has there been a fundamental change in the business? Or business conditions?
- Or is this a re-rating of the stock?
- What is the downside from the current price? The upside?
- What is my time horizon?
- Can I find a better opportunity?
- If not, is it because I am being lazy?

Psychological Factors

- How powerfully is the endowment effect acting on me?
- Have I made public statements to associate me with the stock?
- Does holding the investment enable me to derive non-pecuniary benefits?
- Am I substituting critical thinking for the comfortable company of other investors?

Ending with some Life lessons from Buffett & Munger

- Life lessons and checklist items from Buffett and Munger (paraphrased by Scott Dinsmore)
 - “Lose money for the firm and I will be understanding. Lose a shred of reputation and I will be ruthless.”
 - Choose the best who will have you. Time and relationships are precious. Aim high and don’t accept anyone who doesn’t make you better.
 - It’s a mistake to think that rationality will *always* hold up, even in able people. (see Sokol, David)
 - You can always tell a man to go to hell tomorrow if it’s still such a good idea.
 - Don’t worry about occasional failure – it happens.
 - You can be cheerful even when things are deteriorating. Be rationally optimistic.
 - Continuous learning is absolutely required to have any significant success in the world. Go to be a little wiser than when you woke up.
 - Own a business that requires very little capital to grow.
 - Don’t be in too much of a rush.
 - Conduct yourself in life so other people trust you. It helps even more if they’re right to trust you.
 - Think about how you want to be remembered, and act accordingly.
 - Reduced expectations is the best line of defense an investor has.
 - The problem with rules is that people break them.
 - There are no gray areas when it comes to integrity.
 - It’s more enjoyable to create partnerships with people you like and trust in order to do meaningful things than to try to outsmart other people out of money.
 - Learn to communicate.
 - Send letters to people you respect.
 - Never trade something you have and need for something you don’t have and don’t need, even if you really want it. Greed and envy are very dangerous.

Of course, for someone investing in individual stocks, the LT results primarily depend on the economics of the business (including quality, durability, financials), Valuation, holding period and reactions to (non business) volatility...

..but this document gives a pretty good overview of many good investing principles that could be incorporated as they fit into your process and being aware of all the detractors in the markets (poor quality Cos, bubbles, cycles, behavioral biases...)

/END