Twitter Thread by Max Koh

Max Koh
@heymaxkoh

"The best investments comes from the best businesses"

One of the investors who's made a big impact on me:

@JohnHuber72 of Saber Capital

I spent days pouring thru his articles and interviews in my early days...

Even had a doc with 20 pages of notes!

Here's my top 15 lessons:

1. You don't need original or unique investing ideas

You can simply wait for great businesses to be mispriced.

And then pounce when that happens.

In the meanwhile, don't dilute your portfolio with simply "good ideas"

Only accept the "great" ones

> Our results over the years have been earned by **investing in stocks of great businesses when they become temporarily mispriced**
>
> **I'm convinced that long-term results don't need to come from being original, finding underfollowed companies, solving complicated situations, or even generating unique insights. Great results come from acting on the very rare ideas that seem obvious, without diluting those great ideas with mediocre or even "good" ideas. When it comes to picking stocks, Good is the enemy of Great**

2. John's investing criteria for idiots

• Easy to understand businesses

• Generate lots of FCF

• Partner with good management teams

And then...

Sit back and WAIT for the fat pitch

> **So, we like the simple principles that are hardly unique: stick exclusively to businesses that are easy to understand, invest in companies that generate lots of free cash flow, partner with good management teams, and then the most important ingredient: wait, wait, wait. I think this last part – the waiting – is what separates the good from the great.**

3. Distaste for strikeouts > Desire for homeruns

John is okay with not making 10x returns in a short time.

And he has come to accept that.

Every investment strategy comes with its own features.

The key is knowing what they are and making sure it fits your personality.

> our preference for owning profitable and durable companies reduces the likelihood of major permanent losses. Of course, this also means we don't own the type of stocks that can rise 10-fold in a short period of time – **our distaste for strikeouts is stronger than our desire for home runs.**

4. One years results don't mean much

This was taken from John's 2016 letter...

1 year results can be random.

Don't feel too sad if you underperform...

Or get too confident when you outperform.

Zoom out and look at your performance over multi year periods instead.

Regarding our performance in 2016, I want issue a reminder that **I really place very little weight on any one year's results.**

I consider results in one year to be more or less random, and our performance measuring tools should always be **calibrated for multi-year periods.**

5. It's all about the value proposition

Don't just understand the moat or business model.

Seek to see things from the customer POV.

Why do customers use their products over others?

What is the value that people see in them?

I try to focus on restricting our investments to companies that implement a business model that makes sense to me. I want to **not only understand how the company makes money**, but **I want to understand the value proposition it offers its customers.**

Good businesses have good economics such as high returns on invested capital and consistent free cash flow, but **they also provide a product or service that offers value to the buyer on the other end of the transaction (the customer).**

6. Find businesses that do NOT take advantage of customers

Some businesses can be great...

But they are profiting off their customers' reliance on them.

They abuse their bargaining power.

These short term profits usually don't last long.

As I've learned over the past few years watching debacles such as Valeant and SunEdison, a business with good economics that is coupled with **a business model that extracts value from its customers (rather than adds value to its customers) is not a good business**. The financial metrics might appear attractive, but a parasitic relationship with customers usually ends up destroying shareholder value at some point.

7. Long term focus is even more valuable in a short term world today

With so much focus purely on the next quarter...

It creates a lot of opportunities for investors who are not playing that game.

They can afford to buy into "weakness"...

They can afford to wait.

> The first is to maintain a long-term time horizon, which I believe is now a bigger advantage than ever. Fifty years ago, the average stock was held for 14 years—today it is disposed of after about 11 months. The short-termism that is pervasive in the stock market creates **lots of irrational buying and selling for all sorts of reasons that have everything to do with the short-term direction of the stock, but nothing to do with long-term value of the business.** By the very nature of the **ever increasing focus on the next quarter**, I believe this long-term mindset—when actually implemented—is a sustainable advantage, and one that is likely to strengthen over time.

8. The limits of information advantage

Information is useful.

It helps you see where the company is trending the next few months.

It could even be profitable to invest that way.

But it also makes you think short term.

Be careful of placing too much weight on recent news.

> ***** Informational-Focus Goes Hand-in-hand With Short-Term Focus:**
> **Investors that focus on trying to gain an information edge are typically focused on the short-term.** There was recently an article in the paper that mentioned how various hedge funds are now paying for satellite imagery of farms in order to predict crop yields in the upcoming harvest. These funds are also using satellites to help them analyze traffic patterns at retailers like Walmart by counting cars in the parking lot and plotting the change in cars over a period of time. This type of information might be useful in predicting whether or not a company will “beat expectations” in the next quarter, but **it isn’t all that much of an advantage in determining the long-term value of the enterprise or its longer-term competitive position**.

9. Low risk, High uncertainty

You profit when you are willing to:

• buy the stock of a high quality company...

• when it is likely going to drop further in the short run

There is huge uncertainty.

But the risk is actually low.

> **Buy into low risk, high uncertainty companies:** Long-term oriented investors who were willing to buy into an uncertain short-term outlook could have purchased stock in a well-capitalized stable bank at really cheap prices relative to normal earning power. And this was simply because the buyer of the stock could take a different time horizon than the seller, who was selling shares simply because they thought the news would be bad for a few quarters (and by extension that the stock price would perform poorly in the short-term).

10. Nobody likes short term pain

Nobody wants to buy a stock that will go down in the next 3 months...

Even if it will be worth way much more in 3 years.

That's the price you pay to find and ride big winners.

Are you willing to pay that price?

Most investors are not.

> No one wanted to own Bank of America in 2016 because they were worried about recessionary risks and low oil prices and what might happen to the stock if those risks materialized. It was priced at around 7 times normal earning power, but investors thought (probably accurately) that it would fall more if the economy slipped. **No one wants to own a stock that they think will go down in the next 6 months, even if they think in three years it will be worth much more. The time horizon edge could be summed up this way: the price of gaining this edge is the volatility that could occur in the near term. You have to be willing to accept the possibility that your stock will go down before it goes up.** Very few investors are willing to pay that price, which is why even large cap stocks can become disconnected from their long term fair values.

11. Moats are no longer impenetrable

The old school way of viewing moats as a fortress no longer stands.

Consumers today have much more choice.

The internet has given them power.

The best moat is a business who keeps giving more value to the customer over time.

High margins and consumer brands are still very valuable, but I think the key is determining whether a company's perceived brand comes from its market share, distribution, or advertising budget, or whether it comes from providing customers with great value. I think the former category will see their brands lose value. The latter category will still face plenty of competition, but I think it's much harder to dislodge a company with the best value proposition to the end customer.

Bezos said the following:
"The balance of power is shifting toward consumers and away from companies. The right way to respond to this if you are a company is to put the vast majority of your energy, attention and dollars into building a great product or service and put a smaller amount into shouting about it, marketing it."

- Brands are generally less powerful than they used to be
- Distribution and advertising costs are no longer insurmountable barriers to entry (companies can sell directly to consumers on a shoestring ad budget)
- Products can scale much faster
- Large market share and well-known products don't necessarily equal a moat

12. Are customers getting a good deal?

It's no longer about brand advantages...

Distribution advantages...

Or dominating shelf space in a super market.

It's about whether customers genuinely feel happy buying from you

Is the customer getting a good deal when they buy the company's products or services? I think spending time trying to think about and answer this question will go a long way in helping understand consumer behavior and also help value the business in question.

The upstarts are attacking Gillette and succeeding, by providing better value to the customer. The customer no longer has to settle for overpriced razor blades, produced by a company that was living off an incumbent distribution advantage. In other words, I don't believe Gillette had a "brand" that consumers demanded, it had shelf space at the grocery store with few customer alternatives. It also had a big ad budget, and huge profit margins. And it was a great business for many decades. But it wasn't providing significant value to the customer. No one ever felt like they were getting a deal when they walked out with a $15 refill of razor blades. **⇒ distribution advantage is no longer an advantage anymore today when consumers can buy things easily online!**

13. Study the businesses you have no intention to own

It develops pattern recognition.

Widens your mosaic of dots in your head...

Which then widens your opportunity set.

Plus, it gives you a blueprint of what future great businesses look like.

> I spend a fair amount of time **reading annual reports about businesses that I have no intention of owning**. Typically, these businesses are high quality companies that—although maybe too expensive to offer attractive investor returns—are great entities to study and learn about. Studying businesses that have a history of compounding their value (and their owner's equity) over time can **help you develop a blueprint of sorts—things to look for in an effort to find such businesses when they are more attractively priced, smaller, or otherwise more unknown.**

14. Size your positions according to risk of loss

John's biggest positions are not those with the highest possible return.

It's those he thinks have the lowest chance of losing $$.

John Huber, Saber Capital Management

really high returns on capital, long growth runways, and are developing a strong lead. Oftentimes they exhibit characteristics like a network effect, or some sort of feedback loop that grows stronger as the business grows, and, they have a long runway for reinvestment. Classic examples of this are stocks like Walmart, Home Depot, Starbucks, back in the '70s, '80s, and '90s, where they could reinvest capital into new store locations at 30% returns for a very long time. That leads to a very high rate of compounding over the long run.

Today, the examples might be companies like

JH: My biggest positions tend to be the ones where I think there's the lowest likelihood of permanent capital loss. The positions that I have highest conviction on tend to be the largest positions. It doesn't necessarily mean that emerging moats are always smaller, because sometimes you can have a business that has an enormous amount of growth potential, but is uncertain – in some ways, those can be like call options. But the current business might be valued at a level where you have a huge margin of safety, and you get a lot of that growth for free, or you're not paying for a lot of that embedded value of that call option.

business that still can grow very fast. Obviously, that's the home run type of investment. But typically, the emerging moats, there's more uncertainty. When there's more uncertainty, I tend to have slightly smaller positions.

G&D: How high are you willing to go with a position as far as a percent of your portfolio?

JH: I don't have any constraints. It goes back to the career risk point I made earlier - I try to structure my firm in a way where I don't face career risk. I have certain soft guidelines for position sizes, but I

15. The biggest mistakes come from picking the wrong business

Not from paying the wrong price

Always start with businesses that would first pass your quality filter.

We've observed that **most investment mistakes come from selecting the wrong business, not from paying the wrong price.** Stocks are pieces of businesses, and so we restrict our investments to those that we'd be comfortable owning outright. Our selectiveness means we miss many opportunities, but we also believe it helps us avoid many pitfalls.

I've learned to focus more and more of my time on **identifying the quality businesses, the ones that will be doing more business and be intrinsically worth more in the future than they are now.** This is such an obvious concept, but I've learned that **nearly all of my investment mistakes came not from overpaying for good businesses, but from paying what I thought was a cheap price for a mediocre business**. So I try to reduce unforced errors by just eliminating these options from my list of possible investment opportunities.

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https://t.co/vWvVqSnE0Y

Check out John's amazing blog here:

https://t.co/5pug8hDiJd

I also really enjoyed this interview with John:

https://t.co/xEB3WRizId

And also his podcast episode with Meb Faber.

One of my favourites I've listened to multiple times.

https://t.co/mG7wvqXCnj