

Our Interview with the Partners of Tweedy Browne

Tweedy Browne was founded in 1927 and is now one of the industry's most respected value investors, with approximately \$14.6 billion under management. Chris Browne, one of the five managing partners of the firm, is the author of [The Little Book of Value Investing](#). More information about their investment philosophy is available on their site at [What Has Worked in Investing](#). We interviewed Chris Browne, John Spears, Bob Wyckoff, and Tom Shrager on December 7, 2007.



Will Browne (sitting) , Bob Wyckoff (standing), Chris Browne (sitting), Tom Shrager (standing) and John Spears (sitting)

By Elaine Floyd, CFP®

Your firm has had close ties with several direct students of Benjamin Graham, including Warren Buffett. Your value philosophy has not wavered over the years. However, you have adapted your definition of value to accommodate changes in the U.S. economy and opportunities overseas. What are some of the ways you've tweaked Graham's original value philosophy for today's world?

The globalization of the world has expanded our horizons dramatically. We haven't tweaked Graham's philosophy as much as we've tweaked the implementation of it. Graham's big idea was that there are two prices for every share of stock: the price that shows up on the stock exchange and the price that would accrue to the shareholder in the event the company were purchased at an arms-length transaction. That is very much the framework by which we practice our craft to this very day.

There's been a good deal of merger-and-acquisition activity all over the globe, much more so in recent years. We are able to observe these transactions, to see and measure what is actually being paid by business acquirers for businesses worldwide. To find undervalued companies, we compare those valuations, which are usually multiples of cash flow, operating income, earnings, or book value to what a business is selling for in the stock market.



Is it hard to find good stocks today? What do you do if nothing good shows up on your screens?

The opportunity set that we're confronted with varies dramatically from time to time. Five or six years ago stocks in Europe were very cheap. But in the last several years we've been in a bull market that has driven asset values up throughout the world. This doesn't make for fertile conditions if you are deep value investors as we are. But it will change. It always does. Lately there is a lot of uncertainty in the market. Volatility has increased and we're seeing more ideas as a result of that volatility.

One of Graham's tenets is that the market will eventually come to realize an undervalued stock's true value. You profess that the value strategy that you employ will deliver superior results over the long term, although it may fail to beat the index over the short term – or for even as long as a few years. For advisors, who are being measured in the same way as institutions (i.e., against the index) by their clients, what advice can you offer to allay the concerns of their impatient clients?

In measuring the performance of our managed accounts against the S&P 500 in rolling 10-year periods since 1975, our performance has been worse in 30% of the time and better in 70%. In order to beat the index, it goes without saying that you have to have a portfolio that is different from the index. There will be periods of time when the results of the index will be different from your results and probably better. Without this inconsistency of return, you may not get the great long-term result that you're seeking. In order to get good long-term results you have to be able to tolerate inconsistency in the short run.

Have you ever gotten tired of waiting for a stock to reach its intrinsic value? Can you give some examples where you either gave up or were rewarded for waiting a long time?

We have no idea when the market will recognize the value we see in a company. We bought ABN-AMRO five or six years ago at 10 times earnings. In the process of restructuring, it had a very difficult time. But because it was cheap, it attracted the attention of suitors. This past year a consortium stepped up and acquired the bank at a big premium and we had a very nice return over the five-year period. A good bit of that return came in the last year we owned the stock. We don't know when value recognition will occur, but if you're diversified and have a significant number of undervalued stocks we believe that you'll get value recognition in a group of them.

Sometimes a stock will go down right after we buy it. In 1998 we bought Asarco, a copper mining company that was trading at about 50% of book value. It wasn't



a great business, but when it gets really cheap we won't hesitate to participate. We bought Asarco in the low 20s , and as it drifted down to about \$14 a share, we kept buying it for new clients. Several months into our ownership of the stock, Phelps Dodge came along and initially bid in the low 20s for Asarco. A bidding war ensued, and then Grupo Mexico, which was one of the largest copper miners in the world, won the contest paying \$30 a share. It turned out to be a great investment. But we had to watch it go down before it went up.

Chris, In your book, *The Little Book of Value Investing*, you tell a great story about getting a client out of stocks just before the October 1987 crash. It wasn't because you forecasted the crash but because the client was going to need the funds later in the year. How long must a client be willing to leave the funds invested to take advantage of your value-based investment strategy?

The longer the better, but at least three years. Going back to 1975, in any 3-year period clients have made money using this value approach. But if beating the market over 3 years is the goal, 40% of the time it hasn't worked out.

In a speech at Columbia Business School, Chris Browne mentioned an interesting way to measure risk tolerance for two hypothetical clients, one with a portfolio of \$5 million and spending needs of \$60,000 per year, and another with \$20 million and \$120,000, respectively. Noting that their income requirements are just 1.2% and 0.6% respectively, Chris said their risk tolerance was very high, yet financial planners would have recommended an asset allocation of one-third bonds and two-thirds stocks. You would have recommended a 100% stock portfolio for these clients. Why the discrepancy?

Years ago a lot of wealth was handled in trust accounts. They needed income to live on and they didn't want to invade principal. So the practice started 30 to 40 years ago to have a fixed-income component to provide the cash, and equities for growth. The studies we've done show that stocks beat bonds hands down over long measurement periods. We believe that for most people with long term horizons and capital appreciation as a goal, bonds are lousy investments over the long term. If your income requirements aren't significant and you're not subject to a trust where you can't live off the total return generated from your portfolio, you can have a significant amount of your wealth invested in equities. If you have enough money, you can tolerate the volatility. Put three years of living expenses into a money market account and the rest in equities.



What do you say to clients when they can clearly stand more volatility from a financial perspective but psychologically it makes them very nervous?

We constantly have to remind our clients that a stock is not just a piece of paper that trades in the market. It's a dynamic business that has real value. We try to invest in businesses, which, if we couldn't go to the post and sell our shares on any given day, we are happy to be partners in that business. We know that more often than not, at some point in the future we will be offered a fair price for that business. Value investors view a downturn in the market as an opportunity,

You recommend coverage of all market capitalizations for optimum performance, as opposed to, say, John Bogle, who would just buy the S&P 500 (and have a large cap bias). What allocations would you recommend over the long term among small, mid, and large cap companies?

It varies. You throw the net out as far as you can. In some periods you will have more small caps other times mid or large caps. Right now we are finding more opportunities in large caps. Seven or eight years ago two-thirds of our money was invested in small caps and one-third in large caps. Today it's reversed. That's where the values are. We're thrilled to find values in large caps because there's nothing stopping us from buying all we want.

What is your most compelling argument against the efficient market hypothesis?

The efficient market hypothesis is taught at business schools and has been a big part of portfolio theory for 30 or 40 years. Fifteen or 20 years ago a new discipline began to creep into the business schools called behavioral finance. It came about because the efficient market folks were having a difficult time explaining Warren Buffett. The theory behind the efficient markets is that the price of a stock at any given point in time is the perfect price and incorporates everything that can be known about that business. People like Warren Buffett believe that the market from time to time irrationally prices securities and there becomes a de-linkage between price and value. The efficient market people couldn't explain this. If markets were perfectly efficient Warren Buffett would not have been able to beat the market over a long period of time, so they had to come up with a new theory. It's an effort to explain why certain investors can take advantage of the price opportunities that are created by the irrational behavior of investors. There are instances of huge differences between what companies are priced and what they are worth in takeover. That's an established fact. People are not pricing efficiently.



You give several reasons why it's hard to be a contrarian, including resistance to change and fear of failure. How can advisors and clients reprogram themselves to embrace value investing?

You have to be an iconoclast. You either are or you're not. You can't program yourself. Buffett said either the light goes on and the whole idea of value investing makes sense to you or it makes no sense.

Where are you finding the best values right now?

We have been seeing opportunities in a lot of regions of the world, mainly small- and mid-cap companies in Japan. Many companies in Asia have more cash than debt. In some cases the cash represents half the value of the company. If we bought the whole company and paid off the debt, we're buying at 5-12 times earnings after tax on a debt-free basis. After-tax earnings yields are 8-20%. These are much cheaper characteristics than the arithmetic afforded by an index fund where you're buying 18 times after-tax earnings and you're not even taking out the debt. If you take out the debt it's more like 20 times earnings.

How did your Global High Dividend Yield Strategy Fund come about?

We were asked by a client to manage a trust account where the beneficiary had a current income requirement and the trustee was also concerned with long term capital appreciation. So the trustee told us to buy only high yielding value stocks so the beneficiary could only spend the dividends. We discovered after 27 years that the rate of return equaled our traditional value strategy, so we decided to make it scalable.

We don't try to maximize the yield because companies with the highest yield in the marketplace may be under some kind of distress, and there's risk that the dividend may be cut. We try to buy good, sound businesses that are trading at some discount to underlying value and can grow with the economy and give back some share of what they are earning. Not only has this approach worked very well for us in the accounts we've been using this strategy with over the past 20 years, there are numerous studies in academia and in the investment world that associates above-average dividends with terrific long-term rates of return. We put together a little paper called [The High Dividend Yield Return Advantage](#) reporting the direct correlation between yield and performance.

One other thing that is comforting is that in difficult markets the dividend strategies tended to hold up better than some of the value strategies. It makes sense, if you have a stock with a 4% dividend, the yield begins to attract people into the stock. Of course it assumes the dividend stays in place, which is one of the reasons we look for above-average yields and not maximum yields.



The Tweedy, Browne Value Fund recently reopened after being closed for a two-year period. The Tweedy, Browne High Dividend Yield Value Fund opened on September 5th. Management is considering reopening the Tweedy, Browne Global Value Fund possibly some time in early 2008. For more information on these funds, please visit www.tweedy.com

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