

Bill Miller Commentary



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A group of us were standing around a few weeks ago when Warren Buffett wandered over. Chris Davis had dubbed us the Value Support Group, as we all adhered to that approach to investing. We were commiserating over how badly we had done in this market, how valuation appeared not to matter and had not for the past couple of years, how it was all about momentum and trend, and how we were all losing clients and assets over and above our losses in the market. It seemed like we needed a 12-step program to cure us of our addiction to buying beaten-up stocks trading at large discounts to our assessment of their intrinsic value.

Mason Hawkins said, “Warren, I’m an optimist. I think this whole thing can turn quickly, and surprise people. Are you an optimist?” “I’m a realist, Mason,” the sage replied. Warren went on to say he was optimistic long term, and backed that up in a talk the next morning on the remarkable history of growth, innovation, and wealth creation the U.S. had produced over the past 200-plus years. He also offered a sober assessment of the current challenges we face, and said it would take some time to work through them.

He then made the perfectly sensible point that as we are all net savers, we should be happy if stock prices declined a lot more, so we could buy even better bargains. That is a point Charlie Ellis elaborated on in his fine book, Investment Policy, a few years back. As a

matter of logic, it is irrefragable. As a matter of psychology, I think most of us value investors think we have plenty enough bargains already, and may not be able to handle that many more. Or more accurately, our clients may not be able to. We are value investors because we are persuaded of the logic of buying shares of businesses when others want to sell them, and we understand that lower prices today mean higher future rates of return, and high prices today mean lower future rates of return.

The best time to open an account with us has always been when we’ve had dismal performance, and the worst time has always been after a long run of excess returns. Yet we (and everyone else) get the most inflows and the most interest AFTER we’ve done well, and the most client terminations AFTER we’ve done poorly. It will always be so, because that is the way people behave.

John Rogers, the founder of Ariel Investments, came in to see us last week. John has been an outstanding investor for 25 years or so, but like almost all value types, is going through one of his toughest periods now. His assets are down, similar to the experience we’ve had. He said it was the most difficult market he’d seen, a judgment I would have given to the 1989-1990 market, up until the frenzy erupted over Fannie Mae and Freddie Mac, which sent financials to what looks like a capitulation low on July 15. I am now in John’s camp.

A point he made that I have likewise noted to our team is that this is the only market I have seen where you could just read the headlines in the papers, react to them, and make an excess return. I have used the mantra to our analysts that if it’s in the papers, it’s in the price—which used to be correct. Indeed, it

borders on cliché in the business that by the time something makes the cover of the major news or business publications, you can make money by doing the opposite. There is solid academic research to back this up. But in the past two years, you didn't need to know anything except to sell what the headlines were negative about (anything related to real estate, the consumer, or finance) and buy anything that was going up and that everybody liked (energy, materials, industrials).

I am reminded of what John Maynard Keynes, himself a great investor, said once about investing, "It is the one sphere of life and activity where victory, security, and success is always to the minority and never to the majority. When you find anyone agreeing with you, change your mind. When I can persuade the Board of my Insurance Company to buy a share, that, I am learning from experience, is when I should sell it."

It has been explained to me that it was obvious we should not have owned homebuilders, or retailers or banks, and that I should have known better than to invest in such things. It was also obvious that growth in China and India and other developing countries would drive oil and other commodities to record levels and that related equities were the thing to own. "Don't you even read the papers?" was a common comment.

While I am quite aware of our mistakes, both of commission and omission, when I ask what is obvious NOW, there is little consensus. If there is something obvious to do that will earn excess returns, then we certainly want to do it.

Is it obvious financials should be bought now, having reached the most oversold levels since the 1987 Crash, and the lowest valuations since the last great buying opportunity in 1990 and 1991? Or is it obvious they should be avoided, since the credit problems are in the papers every day and write-offs and provisioning will likely continue into 2009?

Is it obvious energy stocks should be bought on this

correction in oil prices from \$147 to \$123, a correction that has wiped 25 points off the prices of companies like XTO Energy and Chesapeake Energy in just a few weeks? Or is it obvious that oil had reached bubble levels at \$147, and that buying the stocks here, down 30% from their highs, is akin to buying homebuilders down 30% from their highs in 2005? If you had bought Tesoro Petroleum or Valero Petroleum when their prices broke late last fall—remember the Golden Age of Refining story that took Tesoro from under \$4 to over \$60?—you would be looking at losses in this year greater than if you had bought Citibank or Merrill Lynch.

I do think some things are obvious: it is obvious the credit crisis will end, and it is obvious the housing crisis will end, and that credit markets will function satisfactorily and house prices will stop going down and then start moving higher. It is obvious that the American consumer will spend sufficiently to keep the economy moving forward long term. It is obvious that the U.S. economy, already the most productive in the world, will get even more productive and will adapt and grow. It is obvious stock prices will be higher in the future than they are now.

Sir John Templeton died a few weeks ago, full of riches and honors, as he so deserved to be. The legendary value investor got his grubstake by famously buying shares of companies selling for \$1 a share or less when war began in 1939. He didn't know then that the war in Europe would spread to engulf the world, nor how long it would last, nor how low prices would ultimately go. He always said he tried to buy at the point of maximum pessimism, but he never knew when that was. He was, though, a long-term optimist, as is Mr. Buffett, as am I.

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