From: Steve Zali Fepeussi

Re: Cheap, Ugly, Undesirable - The Route to Performance

We all seek investment performance which is above average, **but we need to understand that the average returns from all investors must be the average returns of the market**, so how to achieve superior returns remains a major question. My views on the subject have come increasingly into focus as the years have gone by, and 2020 made it even clearer how (and how not) to best pursue those superior results.

In his book about Value Investing *Bruce Greenwald* emphasises that if you buy randomly the 10% cheapest stocks in every exchange, you will most likely beat the market in the long term. He explains that **looking for small, non-glamour, cheap, with a low P/E or low M/B stocks gives us the answer to consistently outperform the market.** This approach is rooted in behavioral finance. In investing, you want to ask yourself: "Why are you on the right side of the trade". *Greenwald* see three main bias:

- Patience: experience shows that these stocks don't tend to have instant gratification, you won't strike it rich overnight. **And people love instant gratification; this is human nature.** How long are you willing to wait until your stock reaches its fair value, 1 month, 6 months, 2 years, 5 years...10 years? Only fortune tellers can give you a timeframe on when your investment

- Loss averse: experiments have proven that humans are loss averse. A loss is more painful than a gain is pleasurable. **These stocks usually have the potential of immediate loss**, of course people usually dump these stocks because they maintain a depressing and ugly story.

- Overconfidence: people tend to believe that past behavior will remain in the future, applying both the upside and downside. **We think when a stock goes up, it will continue to go up (overbought), when it goes down it will continue to go down (oversold).**

- Index tracking: managers are not allowed to diverge too much from the index in order to avoid redemption, they will then have a **tendency to buy stock they believe can do well in the short term.**

This is not exactly a secret. **So why isn't everyone a value investor?** The stock market is not exactly designed for value investing, people need action, they need liquidity.

What if everyone was a value investor, the stock market would become pretty boring which would not be great for the main stakeholders (brokers, investment bankers, media, hedge funds, etc).

For sure we will get killed during severe market downturns, but the long term success of value investing is no doubt looking at the track record of famous value investors.

Also, remember **investing isn't buying stock that merely looks bad, it always means using some sort of formalized evaluation process to determine if the stock is undervalued.**

NB: Please don't hesitate to share any obscure and out of favor stocks that could be attractive.

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