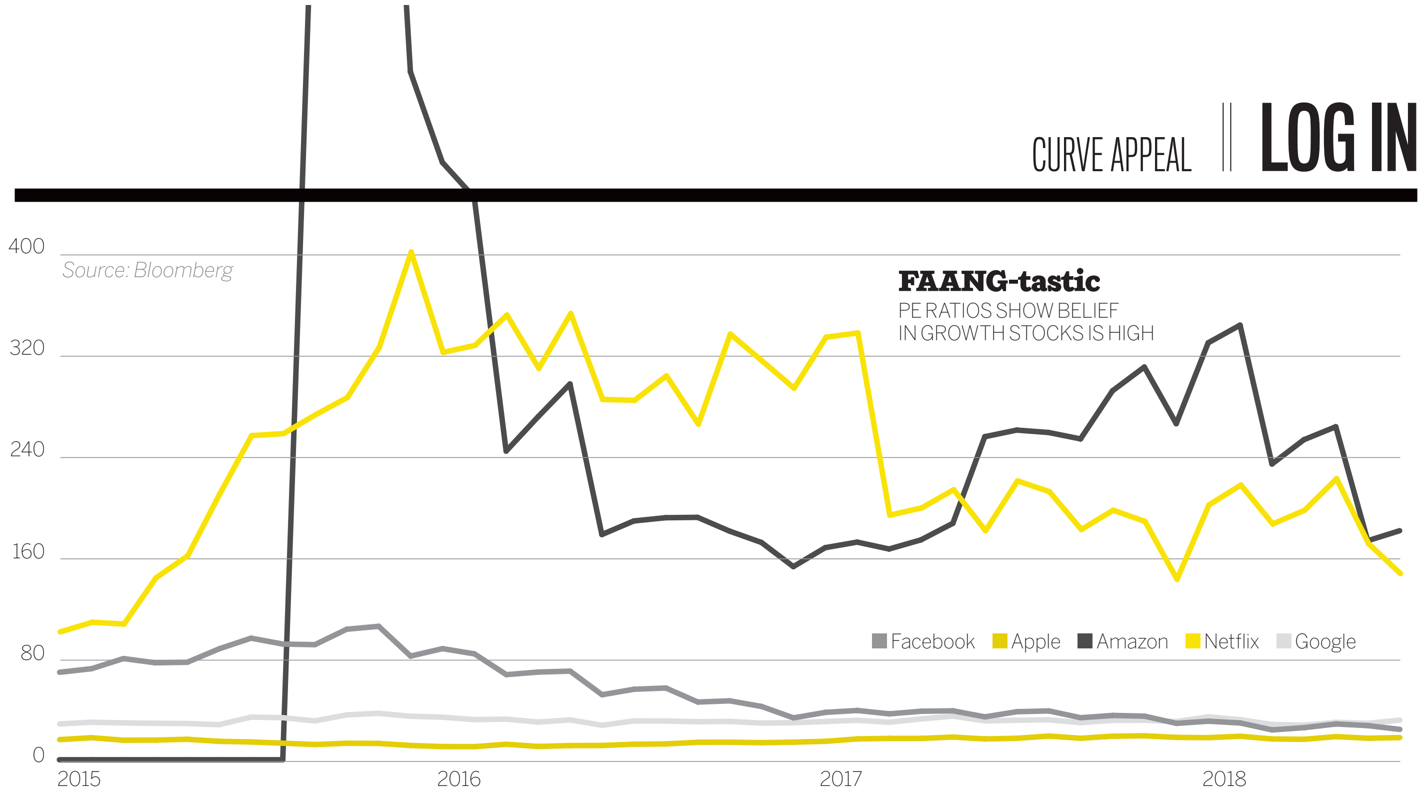

Revisiting the value of value

Buying FAANG stocks makes investing easy, perhaps too easy

›BY ARTHUR SALZER

THE RECENT OUTPERFORMANCE of the Facebook, Apple, Amazon, Netflix and Google stocks affectionately known as the FAANGs has drawn many investors into these five names. Given their market superiority and growth over other stocks and sectors since the Great Financial Crisis 10 years ago, some weary investors might well be asking: Why not reduce my headaches and just own these five?

To best address this, we should first go back to the words of Benjamin Graham, mentor of Warren Buffett. Graham is considered by many to be the creator of modern day value investing, a concept detailed in his two classic investing books, *Security Analysis* and, later, *The Intelligent Investor*. Until these books were written, people bought what was going up and sold what was going down, which is akin to buying high and selling low.

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Graham was one of the first to recognize that the share of a stock represents an ownership interest in an operating business. By studying a company's financial statements, management, dividend policies, etc., it is possible to determine its fair value. All an investor has to do is wait for an opportunity to buy when a company's market price is at a discount in order to achieve a margin of safety over time. However, waiting is like watching paint dry and people often lose interest before an opportunity arises. It is also human nature to become excited when stock prices surge and to get depressed when they collapse. Thus, buying when valuations are reasonable is easier said than done.

Most investors are not value investors, but prefer to operate as growth investors. There are two main reasons for this. First, investing in growth stocks is simple and fun. In general, people like investing in stocks that represent the future and that everyone is talking about. Also, it's much easier to invest when there is no need to read and understand complicated and boring financial statements. It's so much easier to buy a stock that everyone thinks is rapidly growing and the only direction is up. Secondly, to add fuel to the fire, when growth stocks are in favour, they can be in favour for years and turn anyone into an investment genius. Why would an investor hire a money manager or hold a diversified portfolio when it's so easy to make money?

Growth stocks today have outperformed value stocks by more than 130% over the past decade. The last time growth outperformed value by such a large margin was in the 1990s. Even the legendary Warren Buffett could not keep pace with growth stocks back then: for instance, the Nasdaq in 1999 was up 86%, while Berkshire Hathaway Inc. was down 20%. To the investing public, value was dead on arrival — along with prudence and diversification. For those too young to remember, there was a cataclysmic change from growth to value stocks in the early 2000s corresponding with the dotcom crash, which led to declines of 75% in the tech-heavy Nasdaq over a period of 18 months. Offsetting these losses, value stocks, such as Berkshire Hathaway, generated positive returns of more than 30% during this tumultuous time.

Fast forward to today: the PE multiple of Amazon.com Inc. is 150x, Netflix Inc. is 163x, while Apple Inc. is a relative value at only 19x. We are not suggesting an imminent crash in these stocks is in the cards, but we are also well aware that there is better value and, therefore, a margin of safety in other names and sectors of the pubic equity markets. Will the stock run of the FAANGs go on for the foreseeable future? We don't think so. Remember, the market over time always reverts to the mean and, by extension, common sense valuations. With an autumn breeze in the air, it may be time to harvest the gains from the FAANGs and look for better value in other sectors. **FPM**

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