ROGER MONTGOMERY: INTERVIEW

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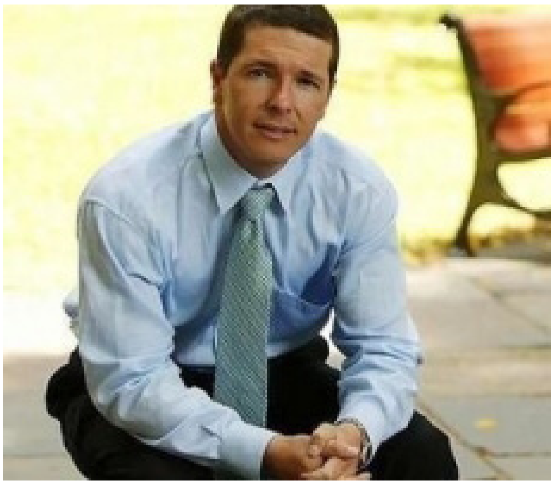

Way back in September 2010, we identified Roger Montgomery as one of our top five financial bloggers, along with others like The Unconventional Economist and The Barefoot Investor.

Over the subsequent months, Roger has been kind enough to share his valuable investment insights across dozens of blog posts for the benefit of the We Be community, discussing everything from Woolworths shares and Apple's iPad, to valuing speculative mining stocks and how to read a prospectus. Today, I am pleased to share the following interview with Roger...

Roger Montgomery established the boutique office of Montgomery Investment Management in December 2010. He is the author of best-selling stock market guide book Value.able and has over 20 years experience in equity analysis, trading and funds management. Ross Greenwood has described Value.able as a "hidden gem". Ross wrote:

"For people who want to understand how to genuinely value a business before investing, rather than "hitting and hoping", this is a book you simply must read."

Roger writes his weekly ValueLine column for Alan Kohler's Eureka Report and monthly for Money magazine. Roger frequently joins Peter Switzer on Switzer TV and appears on the ABC for Lateline Business, Business Today, The 7.30 Report and the Midday News. Roger holds a B.Comm and is a Senior Fellow of the Financial Services Institute of Australia.

Q: Roger, you're a value investor. Can you explain your Value.able investment philosophy?

It's the purchase of an asset for a price that is less than its intrinsic value. In that sense Charlie Munger was right - all investing is value investing. The alternative, buying because you think the price will go up is speculating, like betting on black or red at the casino.

Q: Would you say you're a fundamental analyst of stocks?

Not quite. I am a fundamental analyst of businesses. Trading stocks leads to punting on their direction. I have learned that it is almost futile to try and predict where a stock is going to go in the short term. The idea of trading based on cause and effect is also futile because the relationships are tenuous and inconsistent. Analysing businesses leads to investing in such a way that you would be happy to own the business outright even if it were unlisted.

Q: What's your take on technical analysis vs. fundamental analysis?

Not many people who follow my Value.able investing philosophy on my blog, for example, realise I once developed algorithmic trading systems. My hat goes off to those who have succeeded using charts. My experience with them however now has me agreeing with Buffett and Mandelbrot, although I concede there does seem to be a few people who are successful at charts.

Q: Why is it you've stuck with your chosen market philosophy?

The Value.able method of valuing the best stocks and buying them for less than they're worth works. Just look at the record of the world's best investors - they tend to be value investors. Even Jim Chanos, manager of the world's biggest short fund, is perhaps unwittingly a value investor, he just bets against excessive over valuation.

Q: How has your philosophy developed over time?

The way I analyse and select stocks today bears no resemblance to how I have done it before. It has changed completely.

Q: Can you provide us a specific example of an analysis you were successful on?

I was on the ABC TV towards Christmas 2009 saying that Myer was overpriced before its float, and saying that its value was closer to $2.90 than the $3.90 (the lower end of the pricing range). Indeed I still can't get a value above $2.86 out to 2012. The share price fell from $4.10 to about $2.88 I believe.

On the up side, I have picked Matrix, Forge, Oroton, JB Hi-Fi, just to name a few.

Q: Can you provide us a specific example of an analysis that went wrong and lost money?

No. When I have lost money, it is because I haven't applied any analysis. Taking short cuts doesn't work.

Q: In the instance of a bad analysis, how do you manage your risks?

Risk is managed at the portfolio construction level by ensuring some diversification and watching covariances (but not tracking error). Risk is also mitigated at the investment selection stage. I only buy shares in companies I regard as the highest quality; they have to rank as one of my A1s to A3s and occasionally a B1 or B2.

There are no C5s for example in my portfolio. It gives me the confidence that I would be content, even if the market were closed for a couple of years.

Q: Is buying shares that are undervalued by your analysis possible in the modern market or are most shares trading at fair value, or a premium?

Good value will always be available because Ben Graham's observation, that in the short run the market is a popularity contest, is that investors drive prices to extremes in both directions. On the stock market you get these wonderful opportunities to buy and sell companies at prices that would never present themselves in the calm environment of a trade sale.

Q: What's your strategy for finding stocks?

I track, rank and calculate the intrinsic value of every single listed company – about 2000 securities, by their quality, from A1 down to C5. I have found this to be extraordinarily powerful because it allows me to spend time on those stocks worthy of attention while simultaneously avoiding the companies that will ultimately produce pain and suffering.

And no, I won't be disclosing my exact formula for how the Montgomery Quality Ratings (MQRs) are derived.

The highest-quality, A1-rated companies have the lowest risk of catastrophe and the companies with the lowest quality, C5, rating have the highest risk of catastrophe.

More than 35 different metrics are used to rank stocks between A1 and C5. It's done automatically – none of that manual data entry at Montgomery Inc – and the calculations are done every single day and to every single stock. Every time there is a capital raising, a buyback, a merger, a downgrade or any other event, for any single company, you can bet the quality and the value will be affected and it will be picked up.

Q: What's the best way a student can enter into the world of value investing and build a successful career?

Start out as an analyst and love reading and asking questions. There are no short cuts except perhaps choosing to learn only from those with a demonstrated track record of success. Everyone wants the fast track. That's why margin lending is so popular. The faster you drive, the more likely you will crash. The tortoise won, remember?

Read every book you can find about value investing. Read the works of Graham, Munger and Buffett. And read all the work on Valuation theory available in the Journal of Finance.

The only possible short cut is to learn from those who have a demonstrated track record of success.

Q: You've written a book called Value.able, can you tell our readers more about it?

There are some terrific books on investing that I have read that date back to the 1950s but none did it all - correctly laid out the steps to successful value investing. They were either too technical or too simplistic. I decided to write a book that explained in very clear and plain language a method for valuing the best stocks and for buying them for less than they are worth that was consistent with the work of Graham, Munger, Walter, Simmons and Buffett but was easy enough for my Aunt to read.

Q: You also run a blog at www.blog.rogermontgomery.com, can you tell us more about it?

In April the blog reached 10,000 comments. Its a great place to see what I am currently thinking about the market and I occasionally lay out A1 companies (and C5s) - those that my models suggest justify further examination. A warning though, it's not advice and I am under no obligation to keep any thread updated so you should not rely on it for anything other than a source of suggestions about what to go and research further or seek and take personal professional advice on.

You don't need to borrow to become wealthy. Don't be in a rush.