W1: Page

As you know, this course is based on the book *Good Stocks Cheap: Value Investing with Confidence for a Lifetime of Stock Market Outperformance*. The book was just released this month, and may be hard to get in some parts of the world for a few weeks. So for the benefit of those still waiting for their copy, the first three modules of this course will include a summary of the required chapters for those modules.

The required book reading for this first module is the introduction, chapter 1, and chapter 5.

The optional reading for this first module is the preface, plus chapters 2-4.

The section below is the summary of the required reading. Whether or not you read it, please be sure to scroll down to the bottom of this page for the case assignment for this first module.

Thank you.

Value investing is an investment *strategy*. It's a way that wealth is deployed in pursuit of a return. An example of a different kind of investment strategy is *growth investing*.

Value investing has, at its core, the fundamental belief that price and value are different. **Price** is what something can be purchased or sold for at a given point in time. Price *fluctuates*. **Value**, by contrast, is what something is worth. It tends to *fluctuate less*.

Personally, I would define value investing as *acting on the observation of a clear difference between price and value*. Others—some of whom have investment records better than mine—might use different words. But we would all tend to have the same gist.

This course shares with you a model. It’s a model used to vet stock investment ideas from a value investing perspective. This is useful because it's the perspective that delivers the highest returns over time.

The model does three things. First, it makes it *likely* that you will make investments that deliver *above market rates* of return over time. Secondly, it makes it *unlikely* that you will make investments that deliver *below market rates* of return. So far, so good. Unfortunately, the model also introduces the *possibility* that you *will not make investments that would have delivered above-market rates* of return. In other words, we’ll sometimes say no when we could have said yes. But, as will be made clear, we happily accept this pitfall in exchange for the first two benefits.

The model begins with three steps. Each step is a question that we ask of the proposed investment.

1. Do I understand it?
2. Is it good?
3. Is it inexpensive?

These three steps are sequential; they’re to be answered in order. And each must be answered with a “yes” in order to move on to the next. If an investment isn’t understood, there’s no point in seeing if it’s good. If it’s not good, there’s no point in seeing if it’s inexpensive. The moment you answer with a “no,” you can reject the idea. So the model sets a high standard for your investments. They must be understandable, good, and inexpensive.

Should you need convincing that value strategies outperform other investment strategies, I would direct you to the seminal work on the subject. It's a distillation of major academic studies. It's a bit technical and may be hard to understand for those new to capital management. So I'll summarize: *Value beats everything.*

Here it is: **What Has Worked in Investing: Studies of Investment Approaches and Characteristics Associated with Exceptional Returns by Tweedy, Browne Company LLC (2009) (http://www.tweedy.com/resources/library_docs/papers/WhatHasWorkedFundOct14Web.pdf)**

Most value investors focus on stocks. **Stocks** are also commonly called *shares* or *equity*. Of course, stocks are not the only kind of securities available to investors. There's plenty of other asset classes. For example, there are bonds. **Bonds** are debt. They can be issued by countries, cities, and corporations of all sizes. And then there are **currencies**, like the euro and the Australian dollar.

So why do value investors tend to prefer stocks? In short, because stocks tend to return better than anything else *over time*. Owning stocks versus other asset classes simply tilts probability in your favor.

Value investors tend to look at stocks differently than other sorts of investors. They see them as *ownership stakes in a business*. With this perspective, investing becomes a quite deliberate activity. It's not about buying paper certificates that may pop up or down in price over the next hour or week; it's about buying a business.

Our primary tool for researching these businesses is **annual reports**. These are the magazine-like documents that listed companies make available to shareholders every year. They can generally be downloaded for free from company websites.

With United States companies, we'll have an even easier time. American companies file a delightfully stripped-down version of their annual report known as a **10-K**. These are black-and-white affairs, appealingly devoid of product shots and pie charts. This will be our document of choice, as you will soon see.

Six Parameters for Defining a Business

- **Products:** When thinking about products, first, determine whether the main products are goods or services. That's easy. Goods are physical and services are not. Then, try to narrow down your definition as best you can. The narrower your definition of the products, the better your understanding of the business.
- **Customers:** As specifically as possible, state who buys the business products. As a first pass, simply determine whether the customers are consumers or organizations. **Consumers** are people buying for themselves or their families. **Organizations** are governments, associations, and companies of all sizes. Then, try to narrow down your definition as best you can. The narrower your definition of the customer, the better your understanding of the business.
- **Industry:** Industry is generally straightforward, but nuances may appear.
- **Form:** Form refers to the way a business is structured, either legally or operationally. Often, the **legal form** of a company is unremarkable. It may simply be a normal incorporated entity like a corporation in the United States, a public limited company in the United Kingdom, or an Aktiengesellschaft in Germany. But sometimes there's something about a company's form that must be understood in order for what it does to make sense. **Operational form**, as the title implies, refers to how a business is operationally structured. For example, a company could be a franchisor or a franchisee. It could be a multi-level marketer or vertically integrated.
- **Geography:** Geography has two parts. One is where the company, itself, is located. The other is where the business' customers are located.
- **Status:** A company's status defines its place in the hierarchy of its industry. Is it the clear market leader? One of several leaders? A one-time leader that is losing market share? A startup?

In trying to understand a business, there are four things that we should take care not to be overly influenced by. One is **product familiarity**. While knowledge of a company's products is a key part of understanding a business, it's just part of the total picture.

Second is **marketing messages***,* which are positive slogans designed to motivate customers. They often appear in ads. They're essential parts of corporate communication plans, but they do nothing for us.

Third is **mission statements.** They might be thought of as a marketing message pointed inward. They speak to a company's goals and strengths and are often written to inspire employees, partners, and investors less savvy than us.

Finally is **aspirations**. Sometimes a company aspires to have a characteristic that it presently does not have. Should you take these aspirations into account when defining the business? Generally not. Plans change, expansions falter, and the future generally turns out somewhat differently than forecast. It's not that a company articulating its hopes for tomorrow is being deceptive, silly, or wrong. It's just that at this stage we should focus on what a business *is* and not what it *could be*.

ManpowerGroup

Please review the 2016 10-K of **ManpowerGroup Inc** **(http://investor.manpowergroup.com/common/download/sec.cfm?companyid=MAN&fid=871763-17-71&cik=871763)** .

In the discussion section that follows, I would be interested in your answer to the following question:

- Using the six-parameters approach, how would you describe what ManpowerGroup does?

Thank you