Value Investing Risks and Pitfalls

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- Nothing in the world of investment is risk free
- In fact RISK has been at the centre of valuation
- Value Investing is a relatively low risk investment strategy but it is still possible to trip up and make mistakes

Value Investing Risks and Pitfalls

- Firstly make sure that you do your own analysis and use the most up to date financial information
- If you are inexperienced, then you will need to improve your understanding of financial statements and their analysis
- Hold off making investments until you have improved your own level of financial expertise

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- The next step is to make sure that you read the notes to the accounts
- This is always where the interesting detail is buried
- If you find something unusual or out of the ordinary, consider this a potential red flag!

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- Don’t be blindsided by “Extraordinary” items (positive or negative) in the financial results
- These should be stripped out of your analysis
- Often they are one off events and can distort the true picture
  - A sale of a property
  - Litigation

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- Even if you are doing your financial analysis, keep an objective eye on your Ratios
- They do not always tell you what you need to know

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- Make sure that you know whether you are using pre-tax or post-tax numbers
- Understand exactly how Earnings Per Share is calculated - look at the shares outstanding and how it has changed over time
  - Share buybacks
  - New Issues
  - Options and Warrants increasing the fully diluted number of shares

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- Making comparisons of companies using ratios can have its complexities as we have already seen in comparable companies valuation
- Bear in mind often companies have different accounting policies and accounting rules vary from country to country
- This can distort the results of your analysis

Value Investing Risks and Pitfalls

- Your biggest risk is simply paying too much
- Over valued or fair valued companies may look attractive but without your margin of safety your chances of losing money are greater

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- “It is far better to buy a wonderful company at a fair price that a fair company at a wonderful price” Warren Buffett
- Its not the cheapness of the stock, it the quality of the business

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- The next risk applies to all investors
- Don't have all your eggs in one "sector" basket
- Modern Portfolio theory helps you to improve returns by diversifying your risk - having a range of assets and different companies in your investment portfolio
- This probably means having between 10 and 30 stocks in your portfolio
- Of course this is why investment funds work - they do this for you. You just invest in the fund.

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- The opposite side to this coin, is the more you diversify and reduce risk, the less your investments are likely to out perform
- Lower risk = lower returns
- Your challenge is to over come this by doing your initial intrinsic valuation work properly

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- Finally remain detached and trust your judgement
- Don’t follow the herd and buy into rising markets and sell into falling markets because they are moving
- Value investing is a long term strategy not a short term approach

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