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Value Investing

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Origin of Value investing can be traced back to the times of Benjamin Graham and David Dodd when they began teaching at Columbia Business School in 1928. The investment philosophy has been successfully captured in the Benjamin Graham and David Dodd's book "Security Analysis" published in 1934 often referred as The Bible of value investing. Since then there have been number of value investors who guided by the Bible have successfully created wealth for investors as well as for themselves. Some of the well-known proponents of value investing include names such as Warren Buffett – Founder of Berkshire Hathway, John Templeton –Founder of Franklin Templeton, Peter Lynch – Fund Manager at Fidelity.

Value-investing involves buying assets, which are priced substantially below their intrinsic value. So when the asset recovers to its fair valuation or above fair valuation value investors exit with a good return. The discount to the intrinsic value called as "margin of safety" often serves as a buffer and provides protection against non-achievement of intrinsic value. Basic tenets of value- investing are as follows:

1. **Detailed analysis**- It involves very thorough analysis of the fundamentals of investment based on its historical performance, both today's conditions as well as future prospects.
2. **Intrinsic value/ economic value**- This means the real value of an investment taking into account current conditions as well as future prospects. Over a long-period of time, asset prices are anchored around their economic values. Prices, which are very high or very low are not sustainable and revert to their economic values sooner or later.
3. **Adequate return**- In its simplest form, it is defined as any return, which exceeds the long-term bond yield and annual inflation. However, for an individual investor, it means a reasonable return that he is willing to accept provided he acts rationally.
4. **Protection of capital**- Value investing postulates that in no circumstance should an investor lose his principal. This is achieved through identification and reasonable mitigation of all the risks embedded in an investment. Very risky investments might yield very high returns but there is a great probability of erosion of capital, so, value investing focuses on ruling out such investments.

There have been number of evidence on value investing which proves that it works not just in academic but in real world as well. Value investors take business owner's perspective in every investment they make. They spend bulk of their time and energy on trying to understanding the underlying asset and various moving part involved. They often follow configural analysis which is rigorous as it demands a holistic understanding of a situation taking into account multitude of factors. Post these analysis value investors will make a decision on quality and prospects of the asset which would require a study of past and projection for future cash flows. Based on the perceived risk the value investor will try to come up with an estimate of intrinsic value. Based on this estimate, value investors wait for an opportunity to buy the asset below its intrinsic value with a margin-of-safety". For a value investor margin of safety is often in the range of 30%-50%. Once the asset is acquired, value investors update their estimate of intrinsic value every time there is any relevant event. Value investors also keep themselves abreast of current market valuation of the asset and as soon as the asset reaches it fair value or above fair value the value investor exits the asset with profit. Such methodical approach often leads to value investors earning good returns over their investment. The margin of safety acts as a buffer to the investment. Buying below intrinsic value with a margin of safety limits the downside for the investor even if the intrinsic valuation goes wrong.