Winter 2024

You've got to learn how to recognize rare opportunities when they come — Charlie Munger.

A decade ago, I embarked on a journey into the world of investing, acknowledging the inherent uncertainty of the path ahead. For many years prior, I had been an avid student of Warren Buffett and other legendary investors, pursuing this knowledge as a passionate pastime. At that time, there were not as many individuals aspiring to emulate Buffett's success.

In the dynamic and swiftly changing landscape of today's social media, the proliferation of Buffett enthusiasts has somewhat diluted the authenticity of emulating the grandmaster. Surprisingly, still today, only a few manage to faithfully replicate the entirety of Buffett's approach. While most investment managers adhere to the traditional management fee structure, some stand out, such as Mohnish Pabrai, who has taken a unique "performance fee only" approach that has been endorsed by both Buffett and Munger.

Also, most Buffett-Munger disciples chase the elusive goal of exceptional outperformance, failing to grasp that consistency in doing so is the name of the game. Those who achieve short-term brilliance often fade into obscurity over the long haul. The scarcity of investors with a 10-year track record of achieving a 20% CAGR starkly underscores the difficulty of sustained outperformance.

François Rochon, is widely regarded as one of the top professionals in the industry. His strategy involves seeking out excellent businesses and acquiring them at a fair price, with a slight preference for cheapness. According to Giverny Capital's website, the Rochon Global Portfolio, which is the model for their client portfolios, has had a compounded annual return of 14.5% since its inception on July 1, 1993. Even among top performers like François Rochon, none can match Berkshire Hathaway's extraordinary 55-year legacy of 20% annual returns, which would not have been achieved without the profound influence and dedication of Charlie Munger—a testament to his unparalleled investment prowess. But his influence extends far beyond investment decisions to the very fabric of Berkshire Hathaway's culture. His emphasis on ethics, integrity, and a commitment to long-term thinking has fostered a work environment that attracts and retains top talent, further enhancing the company's competitive edge. What a legendary life! Rest peacefully, Charlie.

I've observed numerous intelligent, hardworking, and disciplined stock investors struggle to surpass market indices, let alone achieve a consistent 20% compound annual growth rate (CAGR). The reality nowadays is indeed that a surprising small number of "stocks only" asset management firms have demonstrated a track record of 20% 10-year CAGR. This already scarce number is likely to diminish further if we add another decade and look at the 20-year track record, possibly to the point of extinction.

If an amazing long-term CAGR is your goal, I believe you must look outside the box and widen your perspective beyond solely long-term stock investment. A valuable insight in this regard comes from a recent CNBC article in which Charlie Munger suggested that Berkshire Hathaway might have doubled its value had they utilized leverage—borrowing money—when acquiring businesses and common stocks. He stressed that he and Buffett almost never used this common Wall Street practice because they always put their shareholders first.

"Berkshire could easily be worth twice what it is now. And the extra risk you would've taken would've been practically nothing. All we had to do was just use a little more leverage that was easily available. The reason we didn't was the idea of disappointing a lot of people who had trusted us when we were young. If we lost three-quarters of our money, we would still be very rich. That wasn't true of every shareholder. Losing three-quarters of the money would've been a big letdown."

There is an example where Berkshire Hathaway actually used leverage. Not many people are aware of this, but Warren Buffett borrowed 5 billion in Japanese yen at a fixed interest rate of 0.5% per year to purchase equity in five outstanding Japanese trading companies. These firms also had an 8% dividend yield. So, he was going to pay roughly ¥25 million in interest on ¥5 billion, and he was going to get nearly ¥400 million in dividends.

If you don't have any shareholders and my tiny little company is 100% privately owned, it's worth examining the conservative use of leverage and hedge the associated risks with, for instance, long-term PUT options. Furthermore, in addition to adding conservative leverage to long-term stock investments, the search for a long-term panacea beyond the traditional buy-and-hold approach led me to dive into the yet-undiscovered territory of short-term trading.

Short-term trading

Short-term trading, mostly options, is the polar opposite of long-term value investing. But can option trading be profitable?

According to a study published in the Journal of Financial Economics, only about 5% of active traders are consistently profitable. This suggests that the vast majority of attempts to develop a successful short-term trading strategy are unsuccessful. While the odds of success are slim, it is not impossible to develop a profitable short-term trading strategy.

Also, Mark Schwager, the author of several books on short-term trading, emphasizes that finding a successful trading strategy is a journey filled with challenges and learning experiences. Successful traders are not born with their strategies; they develop them through extensive research, experimentation, and adaptation.

If you consider embarking on the journey of short-term trading, please be advised to start with caution and small sums of money. In the words of Jack Schwager, the traders featured in one of his books had "diverse beginnings"—some achieved immediate success, while others faced initial failures. Mark Cook, for instance, not only experienced multiple complete losses of his trading capital but also found himself in staggering debt, teetering on the brink of personal bankruptcy at one point. Stuart Walton, who once depleted funds borrowed from his father, later faced the risk of losing not only his trading capital but also money acquired through a home equity loan. Mark Minervini's story includes losing both his personal funds and borrowed capital in the markets. Therefore, such a journey is undeniably a risky one.
Many have ventured into the realm of short-term trading, hoping to find a trading strategy that can consistently generate profits regardless of market conditions—the holy grail of investing. It's a mythical beast, but many traders believe it exists. Some traders spend their entire careers searching for it, while others have given up hope.

My experience thus far has led me to believe that iron condors are not only one of the most profitable option trading strategies in the long run, but also less risky than other option trading strategies. An iron condor is an options trading strategy that is designed to profit from low volatility in the underlying asset. It is a combination of four-option contracts where all four options have the same expiration date.

- One long-put option with a strike price that is out-of-the-money (OTM)
- One short-put option with a strike price that is closer to the money (CTM)
- One long-call option with a strike price that is OTM
- One short-call option with a strike price is CTM.

By consistently experimenting with strike prices and expiration dates and employing the ability to minimize losses during periods of increased volatility in the underlying asset, you can discover a strategy that proves to be effective. Many iron condor traders use technical analysis to help them identify potential trading opportunities and manage their risk. Perhaps surprising, but I don't use technical indicators at all.

What I am willing to disclose further is that it's not a specific formula or a singular approach that does the job. It's a decision-making framework, and its effectiveness hinges on your alertness during the trading day, the discipline applied in its execution, the daily balance between risk and reward, and the likelihood of whether an option position will be assigned or not.

Furthermore, the use of cutting-edge trading technology and algorithms has been demonstrated to be an important building block for obtaining outstanding results. There are, for instance, so-called adaptive algorithms out there that harness a blend of intelligent routing features and user-configured priority settings to enhance cost efficiency during execution. Consequently, it can result in superior fills compared to conventional limit and market orders.

The 2023 trading pilot was one on a small scale, with just small amounts of money to reduce possible losses if things didn't go well. The scalability of this approach is yet to be determined, and the optimal way to assess it is by incrementally raising the invested capital. As of today, I am confident that the current trading strategy is efficient in fostering a consistent double digit CAGR within the $100,000 to $10 million range. However, its adaptability beyond this threshold is uncertain, necessitating further research to ascertain its suitability for larger capital bases.

Attaining a consistently high compound annual growth rate (CAGR) through short-term trading indeed relies heavily on upholding rigorous discipline, particularly during the few very-high volatility days that arise annually. The approach has to be solid enough to survive, for instance, a 2010 look-alike flash crash. Flawless execution on these days is crucial for achieving the desired returns; any deviation from the strategy could jeopardize the overall goal. The most fitting analogy I can come up with is that of an airplane pilot. When the weather is fine and the aircraft is confidently progressing towards its destination, all seems well. However, it is during takeoff and descent, as well as when turbulence sets in, that mistakes can lead to misfortune.

One of the important lessons in this regard I learned from a recent video with Jack Schwager was "Knowing how and when to get out before you get in." It emphasizes the importance of planning your exit strategy before even thinking about entering a trade. In essence, knowing how and when to get out before you get in is about taking control of your trading and prioritizing risk management.

Thinking about the future of short-term trading, imagine the possibilities if we could accurately forecast the daily price fluctuations of, say, the SPY ETF. According to Google Bard, artificial intelligence (AI) can be used to predict daily SPY ETF prices. Several studies have shown that AI models can outperform traditional statistical methods in this task. For example, one study found that a deep learning model was able to predict SPY prices with an accuracy of 80%, while a traditional autoregressive model could only achieve an accuracy of 60%.

Here are a few examples of companies using artificial intelligence (AI) to predict daily SPY ETF price movements.

- Quantopian: Quantopian is a platform for quantitative finance that allows users to create and test algorithmic trading strategies. The platform includes a suite of AI tools that can be used to analyze market data and identify patterns. Quantopian's AI models are used by a number of institutional investors and hedge funds.
- IBM: IBM has a number of AI products and services that can be used for stock market prediction. One of these products is Watson Financial Risk Analytics, which uses AI to analyze financial data and identify risk factors. IBM's AI models are also used by a number of investment banks and asset managers.
- Google: Google's AI division, DeepMind, has been working on AI models for stock market prediction for several years. The company has published a number of research papers on the topic, and its models have been used by a number of investment firms.

I believe Google's AI division, DeepMind, has favorable chances of outperforming others. However, it's intriguing that I haven't come across any compelling AI-driven long-term compound annual growth rate (CAGR) results from DeepMind so far. Have you?

This year's short-term trading pilot has been quite profitable. Keep in mind, though, that it is still an experiment, but definitely one I'd like to continue in 2024.

The Free Lunch Portfolio

In 2021, Mohnish made quite a shift in his approach to picking the constituents of his portfolio. He decided to ignore the algorithm's buy-and-sell decisions and only make portfolio tweaks if they were no-brainers. This bias towards inaction will avoid disrupting the compounding engine and should help the Free Lunch Portfolio perform well over time.

It will be fun to observe how this approach develops and which businesses, under real-world circumstances, are identified as "no-brainers" and why. Although I had quite an argument with my investment robots on this matter, and I referred several times to the newly gained insight that the Berkshire Hathaway empire was built on holding on to just 4% of the successful investment decisions, my robots kept nodding and refused to make the change; they insist on replacing its constituents annually. So that's the way it is. These are stubborn robots, indeed!

In the attachment, you will find the 2023 results of the USD and EUR robots. Q3 has been expanded with two new conditional sales orders. So now we have Q3x (that's the original Q3), the conservative MP FLP with a conditional selling order at 40%, Q3y, the conservative MP FLP with a conditional selling order at 50%, and Q3z, the conservative MP FLP with a conditional selling order at 60%.

As of today, four exceptional investment robots with an outstanding 6-year CAGR have been identified.

Robot	6-year CAGR	5-year CAGR
Q3x	19.1%	18.7%
Q3y	20.6%	23.5%
Q9	18.0%	12.4%
Q10	20.5%	13.9%

Q3y, the conservative version of the Mohnish Pabrai Free Lunch Portfolio, with a conditional selling order at +50%, is the best performing one. Mention to me a few "human investment managers" with similar results. There aren't many of those. Well done, Q3y!

Assessing the future potential of the USD robots, I believe the CAGR over the last 5 years is a much more representative indicator than the 6-year one. The probability that we will see the exceptional 2018 results once more is very, very small. If you ask me today, I would bet on Q3x and/or Q3y.

Anyhow. Wingardium Leviosa! Here are the 2024 USD and EUR constituents, to be bought on the first trading day in January 2024 and sold on the last trading day of December 2024.

Robot	Constituents
Q1	TAV Airports, Alphabet, Reysas Logistics, Microsoft, Brookfield Corp., Brookfield Asset Management, Alpha Metallurgical Resources, Lithia Motors, Chipotle Mexican Grill, Asbury Automotive Group, Consol Energy, Assured Guaranty, Primerica, Jack in the Box, eBay, Toll Brothers.
Q2, Q3	XPEL, Asbury Automotive Group, Alpha Metallurgical Resources, Lithia Motors, CONSOL Energy, Reysas Logistics.
Q4	TAV Airports, Alphabet, Reysas Logistics, Microsoft, Brookfield Corp., Brookfield Asset Management.
Q5 – Q11	eXp World Holdings, Asbury Automotive Group, Extreme Networks.
Q12 – Q18	Quilter, NTG Nordic Transport Group, Mobilezone Holding.

This year, I added XPEL to the Q2 and Q3 robots, which happens to be a favorite of yours truly.

So here we are

While long-term investing remains a cornerstone of my investment approach, short-term trading is a new and compelling endeavor in my search for consistent long-term compounding results. In 2024, I will most certainly continue the newly developed short-term trading approach. The reason is simple. If this approach is as effective as I believe it is, it has the potential to fund my company for many decades to come. The advantages of operating such a "perpetual money-printing machine" are undeniable: freedom from bank loans, interest rate payments, and debt obligations.

It's possible that my company might be among the rare few that survive and thrive without needing any external capital to sustain itself. And that's great, because not every outside investor is a blessing. An intriguing and frequently underestimated aspect to highlight in this context is that 58% of startup failures can be attributed to "relationship issues" between founders and investors, as reported by CB Insights.

Had I not embarked on the journey of long-term value investing a decade ago, I likely wouldn't have stumbled upon this short-term trading approach. Gaining more real-world experience during the critical high-volatility days remains important, not only to refine my ability to navigate them effectively but also to fully comprehend the potential consequences of any missteps on the overall outcome.

In my current assessment, considering the scarcity of investment managers boasting a decade-long 20% CAGR exclusively in stocks, if you were to inquire about the strategy most likely to accomplish a 10-year 20% CAGR within the $100,000 to $10 million range, I would give short-term trading the benefit of the doubt. If my short-term trading strategy remains as profitable as it has been and indeed is expandable as I believe it is, there's a chance that I may opt not to oversee external capital and instead allow my company to evolve into a full-swing private short-term trading business. I can't wait!

Happy new year!

Peter

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28 December 2023
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Post scriptum. Veritiv Corporation, one of my favorite companies in the Intelligent Cloning portfolio, was acquired for $170 per share in cash by a subsidiary of Clayton, Dubilier & Rice, LLC (CD&R). I added the stock to the portfolio in 2018 for $24. That's the equivalent of a 5-year CAGR of almost 48%. And remember, this stock went down to $7 before starting its stellar journey.

The Value Firm®

QUANTS, ROBOTS & CYBORGS

In search of an investing quant, robot or cyborg that consistently outperforms the market with a greater than 15% CAGR.

	The USD Robots	2018	2019	2020	2021	2022	2023	2024	2025	CAGR
Q1	The Mohnish Pabrai Free Lunch Portfolio (MP FLP).	-17.0%	21.7%	3.0%	25.0%	-17.7%	30.3%			5.8%
Q2	The conservative version of the MP FLP.	-10.5%	25.2%	15.9%	25.6%	-10.0%	33.4%			11.9%
Q3x	The conservative version of the MP FLP. Sell at +40%.	21.3%	34.0%	20.6%	26.7%	-10.0%	27.8%			19.1%
Q3y	The conservative version of the MP FLP. Sell at +50%.	11.6%	41.6%	28.6%	25.1%	-10.0%	34.5%			20.6%
Q3z	The conservative version of the MP FLP. Sell at +60%.	-13.3%	45.6%	25.0%	21.1%	-10.0%	40,2%			15.8%
Q4	The MP FLP. Spawners only.	-	-	-	28.0%	-15.2%	26.4%			11.1%
Q5	The USD new year robot. Sell at –20% or +40%.	40.0%	27.7%	-20.0%	36.3%	-20.0%	-2.6%			7.2%
Q6	The USD new year robot. Sell at –20% or +50%	50.0%	34.4%	-20.0%	43.0%	-20.0%	-2,6%			10.3%
Q7	The USD new year robot. Sell at –20% or +60%.	60.0%	33.4%	-20.0%	49.6%	-20.0%	-2,6%			12.2%
Q8	The USD new year robot. Sell at +40%.	40.0%	27.7%	-6.1%	36.3%	-17.4%	12.3%			13.4%
Q9	The USD new year robot. Sell at +50%.	50.0%	34.4%	-6.1%	43.0%	-14.0%	15.7%			18.0%
Q10	The USD new year robot. Sell at +60%.	60.0%	33.4%	-6.1%	49.6%	-14.2%	19.0%			20.5%
Q11	The USD new year robot. No conditional selling.	17.9%	25.4%	-6.1%	95.1%	-14.2%	-12.6%			12.5%
BM1	Benchmark: iShares S&P SmallCap 600 UCITS ETF	-9.1%	22.3%	11.2%	28.1%	-16.5%	12.5%			6.8%
BM2	Benchmark: iShares Core S&P 500 ETF	-5.2%	31.2%	17.4%	30.6%	-18.3%	25.2%			11.8%

	The EUR Robots	2018	2019	2020	2021	2022	2023	2024	2025	CAGR
Q12	The EUR new year robot. Sell at –20% or +40%.	-	-	-	-	-20.0%	24.1%			-0.4%
Q13	The EUR new year robot. Sell at –20% or +50%.	-	-	-	-	-20.0%	27.5%			1.0%
Q14	The EUR new year robot. Sell at –20% or +60%.	-	-	-	-	-20.0%	30.8%			2.3%
Q15	The EUR new year robot. Sell at +40%.	-	-	-	-	-45.0%	24.1%			-17.4%
Q16	The EUR new year robot. Sell at +50%.	-	-	-	-	-45.0%	27.1%			-16.4%
Q17	The EUR new year robot. Sell at +60%.	-	-	-	-	-45.0%	30.8%			-15.2%
Q18	The EUR new year robot. No conditional selling.	-	-	-	-	-45.0%	25.3%			-17.0%
BM	Benchmark: iShares MSCI Europe Small-Cap ETF	-	-	-	-	-27.3%	16.1%			-8.1%

	The China Robots	2018	2019	2020	2021	2022	2023	2024	2025	CAGR
Q19	The China midyear robot. Sell at –20% or +40%.	-	-	-19.3%	23.8%	-20.0%	0.4%			-5.4%
Q20	The China midyear robot. Sell at –20% or +50%.	-	-	-19.3%	30.5%	-20.0%	3.7%			-3.3%
Q21	The China midyear robot. Sell at –20% or +60%.	-	-	-19.3%	37.2%	-20.0%	-19.6%			-8.1%
Q22	The China midyear robot. Sell at +40%.	-	-	6.1%	13.4%	-49.3%	-0.2%			-11.7%
Q23	The China midyear robot. Sell at +50%.	-	-	9.4%	20.1%	-49.3%	3.1%			-9.0%
Q24	The China midyear robot. Sell at +60%.	-	-	12.8%	26.7%	-49.3%	-28.2%			-15.0%
Q25	The China midyear robot. No conditional selling.	-	-	56.4%	135.8%	-49.3%	-28.1%			7.7%
BM	Benchmark: iShares MSCI China Small-Cap ETF	-	-	11.3%	22.6%	-28.6%	-10.1%			-3.3%

	The India Robots	2018	2019	2020	2021	2022	2023	2024	2025	CAGR
Q26	The India midyear robot. Sell at –20% or +40%.	-	-	23.0%	41.2%	19.3%	14.4%			24.1%
Q27	The India midyear robot. Sell at –20% or +50%.	-	-	29.7%	51.2%	7.0%	17.8%			25.4%
Q28	The India midyear robot. Sell at –20% or +60%.	-	-	36.3%	54.5%	10.4%	19.2%			29.0%
Q29	The India midyear robot. Sell at +40%.	-	-	24.2%	41.2%	19.3%	18.3%			25.4%
Q30	The India midyear robot. Sell at +50%.	-	-	30.9%	51.2%	7.0%	21.6%			26.7%
Q31	The India midyear robot. Sell at +60%.	-	-	37.6%	54.5%	10.4%	23.0%			30.3%
Q32	The India midyear robot. No conditional selling.	-	-	44.3%	243.7%	-1.2%	23.0%			56.7%
BM	Benchmark: iShares MSCI India Small-Cap ETF	-	-	-7.2%	81.3%	-6.1%	11.9%			15.3%

- *The above numbers are the gross results. A "red year," like 2020, is a year in which the stock market experiences a significant decline. This is typically defined as a decline of 20% or more from the market's high to its low during the year.*
- *The remarkable 2021 results of the India robots feel "inflated" or not representative if you will. We will gain a clearer idea of these robots' future potential, for example, by ignoring the 2021 results and focusing on the 3-year CAGR of the remaining years. The adjusted results for Q26 to Q32 are as follows: 18.8%, 17.8%, 21.5%, 20.6%, 19.4%, 23.2%, and 20.6%.*
- *I do not account for currency movements in robots when the constituents trade in separate currencies, such as the EUR robots. The sole factor I evaluate is the total shareholder return (TSR) in the currency of the constituent under review, which I believe is the best sign of such robots' future potential.*
- *What I'm aiming for is an investment robot with an exceptional 10-year track record on paper. And only then would I consider putting some money to work with such an approach.*
- *If you find a mistake, it's unintentional, and I want to know. Thank you.*