

Value Investing: Finding Diamonds in the Rough

By Simon Hamilton

It takes patience, persistence and know-how to find a good deal, and the larger the potential investment, the more careful you should be. That is the essence of how we practice value investing: seeking out high-quality investments that we believe the market has put on sale, companies with earning potential that the market may have underestimated.

Determining whether a company is both high-quality and a good value requires extensive analysis and good judgment. Value investors believe they are becoming part owners in companies they purchase, not just buying stocks to be traded many times.

Practicing Discipline and Patience

It's easy for investors to get caught up in the moment, fearful of missing out on the latest market shift or investment trend. Value investors need a great deal of discipline, keeping to an investment strategy of finding and purchasing high-quality, undervalued companies and holding them for the long-term. Value investors can't make rash decisions. They need the patience to maintain an emphasis on fundamental investment research, both quantitative and qualitative, to help identify opportunities in the market. Sometimes that means just sitting tight until conditions are right to either buy or sell.

Things to Consider

Value stocks have attractive valuations with characteristics of relatively low price-to-book, price-to-earnings, price-to-sales, and price-to-cash flow ratios; however, this investment approach requires examining factors beyond the stock's price, such as: the company's management team, its business operations, assets, cash flow, growth potential, and how the economy and the market may affect the company. Some of the areas our analysts focus on include:

- Does the company have first-class management and business plan?
- Does management have a significant ownership stake in the company?
- Does the company generate high returns on invested capital?
- Does the company have low-cost operations relative to its competitors?
- Does the company have a dominant or growing market share in a growing industry?
- Could the company's product or service become obsolete?
- Does the company have high-quality earnings with no accounting irregularities?
- Does this company generate real earnings, called "free cash flow?"
- If the company pays dividends, what sort of payout ratio does it have?

Benefits of Value Investing

Value investing is a time-tested strategy for creating and preserving wealth. Because value investments focus on undervalued companies with great potential, investors may minimize short-term market risk while outperforming the market long-term. Value investors also typically benefit from fewer trade commissions and reduced short-term capital gains taxes.

If you would like to learn more about value investing, or how value investing may be the right solution for your financial future, please contact me or another professional at the Wise Investor Group.



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Simon has been a registered financial advisor since 1991, joining the Wise Investor Group in 2003. His areas of expertise include portfolio management, asset allocation and fixed-income analysis.