A Peek into the PRIME QUADRANT

We are pleased to announce a new speaker for our 2017 Prime Quadrant Conference:

Sheelah Kolhatkar
Best-Selling Author of *Black Edge*, Writer at *The New Yorker*

11.1.2017

Contact conference@primequadrant.com to reserve your spot!

pqconference.com

Sheelah Kolhatkar

Sheelah Kolhatkar is a *New Yorker* staff writer and former hedge fund analyst who writes and speaks about Wall Street, Silicon Valley, national politics, and women's issues. Her new book *Black Edge* takes readers into the high-testosterone hedge fund world and the largest insider trading investigation in history. Her writing has appeared in Bloomberg Businessweek, The Atlantic, The New York Times, New York Magazine, Time, and other publications. Kolhaktar holds an undergraduate degree from New York University and a M.A. from Stanford University.

Upcoming Investor IQ Workshops

June 21, 2017:
Performance Measurement

July 19, 2017:
Gold & Commodities

August 23, 2017:
Real Estate

What is the PQ?

In financial terms, the Prime Quadrant is the optimal zone in which you achieve the highest return per unit of risk.

STORIES OF INTEREST

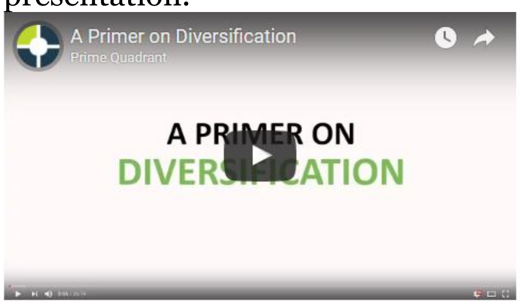
Via Negativa: Wisdom Through Subtraction
Removing information can actually add to knowledge by eliminating mental pollution.

How to Play the Game to Win
What Rick Barry and the Atlanta Falcons can teach us about risk management and our egos getting in the way of investing.

The Truth about Investing
As told by Howard Marks...

When Holding is the Hardest Part
How do you ensure you're holding on in the bull market and surviving when it inevitably turns?

A Primer on Diversification
In case you missed this past week's Investor IQ Series on Diversification, here are some of the highlights of the presentation.



THE WAY WE SEE IT

The following was provided by Jeremy Rosmarin, CFA.

The Five-Point Path to Generational Wealth Protection - Part II

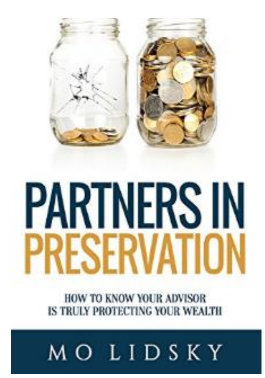
In a previous newsletter, we introduced five different aspects of an intelligent approach to multi-generational wealth preservation, which we define as protecting the value of a family's net worth, after inflation, while covering all annual expenses. We dubbed this series the Five-Point Path to Generational Wealth Protection:

1. Follow a Value Philosophy
2. Maintain a Healthy Cash Buffer
3. Invest Broadly Across Asset Classes and Geographies

Being in the Prime Quadrant requires seeing the big picture and making intelligent choices, from among all investment options and strategies, to best meet your goals.

Prime Quadrant is an investment research and consulting firm that helps high-net-worth Canadians make better investment decisions.

Mo Lidsky's most recent book Partners in Preservation: How to Know your Advisor is Truly Protecting your Wealth is now available on Amazon!



In Search of the Prime Quadrant: The

4. Avoid Unnecessary Costs and Fees
5. Educate the Next Generation of Investors

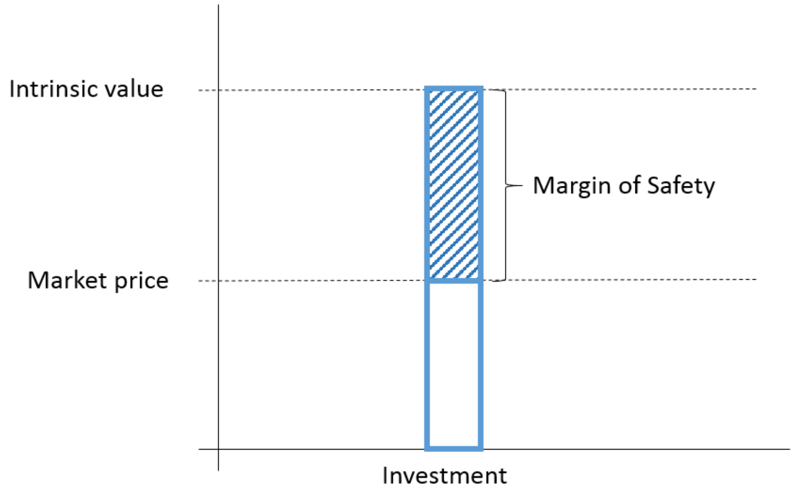
In this newsletter, we will elaborate on the first item and the importance of following a value investing philosophy.

More than enough ink has been spilled – and blog posts posted – on the subject of value investing. But the fundamental principle of value investing can be summarized in just one sentence: *Invest on the basis that you are buying something for less than its intrinsic value.*

One way to think about value investing is as follows. Imagine that you make an investment, and in the very next moment all potential buyers and sellers in the market for that investment disappear forever. In such a case, any hopes of quickly selling your investment at a tidy profit would evaporate. The value of the investment would be the value of the cash that you could receive from its underlying economics (i.e. interest in the case of bonds, earnings in the case of stocks, rental income in the case of property, etc.). This is the meaning of 'intrinsic value'. As the term suggests, it is the inherent value of an investment independent of things like market sentiment, public perception, fads and trends.

Determining an investment's intrinsic value - and therefore the amount of cash that it will produce in the future - is far from simple. Whether it is in stocks, bonds, real estate, distressed credit, private equity, or any other type of investment, there are countless analysts armed with spreadsheets and high IQs trying to determine how much cash an investment will produce. For most of us, trying to beat these people at their own game is impossible.

This is where the concept of 'Margin of Safety' - first raised by the philosophical father of value investing, Benjamin Graham - comes into play. Margin of Safety is the amount by which an investment's intrinsic value exceeds its market price. In value investing, Margin of Safety is supposed to be as large as possible. In Graham's words, the Margin of Safety "is available for absorbing the effect of miscalculations or worse-than-average luck." Those who are familiar with Prime Quadrant often hear us say that "the only thing we know for sure is that we don't know what the future will be." Rather than calculating the precise amount of cash an investment will produce, most of us are better off focusing on areas where there is clear opportunity. It is better to be approximately right than precisely wrong.



For most of us, the most straightforward approach to value investing is to simply avoid areas of the market where everyone else is acting with reckless abandon. To quote the most famous value investor, Warren Buffett, "be fearful when others are greedy and greedy when others are fearful." Very often there are areas of the market in which pricing has become disconnected from all fundamental analysis. Prices are so high that there is no longer even an effort to justify them based on expectations of future cash flow. Investors should avoid these areas. From this perspective, value investing is much more about self-restraint than deep analysis. After all, the most high-flying investments are, by definition, the ones in which others are making the most money…until they don't.

Two common misperceptions about value investing are (i) it involves avoiding high-growth areas of the market and (ii) it consists of buying investments that look inexpensive based on historical statistics such as price-to-earnings (in the case of stocks) or capitalization rates (in the case of real estate). In reality, participating in investments with high growth prospects is consistent with value investing so long as the expectations for future growth are not overly-optimistic and a reasonable price is paid. And simply focusing on investments that seem inexpensive on the surface will not yield good results and should not be confused with value investing.

Of course, value investing is not the only way to make money. Take the market for rare artwork, for example, where people have made considerable riches despite paintings producing no cash flow. And in some cases – such as when hedging or investing in strategies that reduce portfolio volatility – it is sensible to participate in investments that are not value-driven. That being said, value investing is a strong foundation for investors looking to protect wealth over multiple generations. One question we often get from investors is: What should I do if there are not enough good value opportunities available? The answer to this question is the subject of Part III of this series.

> **" All I want to know is where I'm going to die...so I'll never go there.**
>
> ***- Anonymous Man, often quoted by Charles Munger***

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