CHAPTER 12

MONEYBALL: A VALUE INVESTORS PERSPECTIVE

BY CHRISTIAN G. KOCH

The first time I met Larry King was during the filming of a documentary on his life called *The Voice of a Generation*. At the iconic Hollywood Roosevelt Hotel, he spoke about the people he had interviewed during his 50-year broadcasting career. Individuals like O.J. Simpson, Jimmy Hoffa, Frank Sinatra, Tom Cruise and many more. During the filming, Larry told a story about growing up poor in Brooklyn, New York and not knowing much about money. Once he became successful in broadcasting, the first decision he made was to hire a trusted advisor because he knew he needed help with managing his finances. He said he is still with the same financial company today. That story left a big impression. More individual investors should follow Larry King's advice and hire a trusted advisor to make wise money decisions.

A PIECE OF THE ACTION:

At the beginning of my career, I used to work for several institutional money management firms. During this process, I discovered that large money was run by investment policy committees where group-think was dominant. It was extremely difficult to be a contrarian investor in that environment. This is when I realized that the individual investor really has a competitive advantage over large money. Now I help my clients realize the value of long-term investing by building portfolios that take advantage of stock mispricing that large investors miss – because of institutional constraints.

Being successful in managing other people's money takes confidence, a steady hand, and the ability to be an independent thinker. My mission is to provide wise financial counsel during different stages in life. I focus on helping individuals between the ages of 50 and 70 who are thinking about retirement. This usually involves a range of decisions from portfolio income construction to retirement tax-planning strategies.

THE MONEY DOCTOR:

Financial advice is a service similar to medicine. Most patients go to the doctor because they have a very limited idea of how to be treated. Doctors guide patients toward treatment and are trusted by patients to have positive outcomes. I think about my practice as giving money advice and providing peace of mind. Most individuals hire a trusted advisor because they do not know much about personal finance and are worried about making risky investments on their own. I want my clients to know that they are "in good hands." Most patients trust their doctors and do not want to be seen by an unknown doctor, thus most investors trust their financial advisor based on their expertise, experience, dependability and confidence.

TEE-BALL TO MONEYBALL:

I started playing tee-ball when I was five years old in Jacksonville, Florida. I remember loving the game of baseball. My passion over the summers was collecting TOPPS baseball cards and playing ball with my friends. In fact, I wanted to become a professional baseball player.

After a move to Atlanta, I started to buy and sell baseball cards for profit. My first major purchase was a Pete Rose rookie card that I purchased for $50.00, which had an estimated value of $75.00. One evening at the dinner table my father bet me $100.00 that I could not sell the card for a profit. A few weeks later, I sold the Pete Rose card for more than original purchase price. That moment was my first exposure to the concepts of ***inefficient markets and value investing***. That was a clear turning point in my life.

The best-selling book, ***Moneyball***, by Michel Lewis tells a story of how the Oakland A's general manager, Billy Beane, was able to identify baseball talent and compete against teams with much greater resources. Billy Beane was able to identity which players were mispriced and undervalued based on newly-developed statistics called sabermetrics. The Oakland A's went on to have a winning season using this strategic approach. Unlike the game of baseball, investing is a game that you do not have to swing at every pitch. One can wait patiently for superior investment opportunities to appear before deploying capital. Furthermore, investing is a game at which one should increase their skill with the passage of time, as experience should improve one's ability to recognize good ideas, companies and patterns, and exercise judgment in different market situations.

The Moneyball story appears to parallel both my equity research analyst's career and my baseball card experience. The ability to identify assets, characteristics of a company and a financial situation that is undervalued to the market is a unique skill. This creates a *competitive advantage*. When I was a student at Harvard Business School, one of my teachers was Michael Porter. In his lectures he provided a framework for how to create a sustainable competitive advantage. This is by either cost or differentiation advantage. Billy Beane was able to use *sabermetrics* to create a competitive advantage and winning strategy.

The starting point to identifying a competitive advantage is hard data and numbers. Have you ever thought of what information is on the back of a baseball card? It's the player's annual statistics like Home Runs, Runs Batted In, Batting Average, etc. These statistics are similar to a company's annual report. Each year publically traded companies provide an annual report document which gives historical figures that can be used to estimate future earnings and intrinsic value. From my perspective, the balance sheet and income statement of a company is like the back of a baseball card full of detailed information for the individual investor.

VALUE INVESTING:

I have been studying the principles, constructs and ideas of value investing for 25 years. At the core of value investing is the belief that equity markets often offer opportunities to buy stock in companies at discounts to their intrinsic value. As further context, Ben Graham, the godfather of value investing, had a simple framework for investing. He believed there were two values for every stock:

1) the intrinsic value based on a fundamental judgement of the company's consolidated financial statements.
2) the quoted market price, which is the current price at which buyers and sellers are willing to purchase the stock.

From experience, I have found these two values often diverge and have wide gaps based on the perceptions of market participants.

The idea that the market is inefficient is an anomaly in academic finance. What I studied in my MBA class was a theory called *Efficient Market Hypothesis*. EMH was created by Eugene Fama and states it is impossible to "beat the market" because prices reflect all relevant information and stocks always trade at their fair value. There are several other academic investment theories like Modern Portfolio Theory and Random Walk Theory that simply do not hold up in practice. Also, I have found in practice that portfolio concentration versus diversification actually reduces risk, as unsystematic risk is eliminated with only 15-17 individual companies in a portfolio. Value investors eliminate risk because of how they buy a stock. The goal is to create a margin of safety which is the difference between the current stock price and the intrinsic value per share.

One of the biggest disconnects I have found in practice is the central tenet of measuring risk. In academic theory, risk is defined by volatility and standard deviation versus the risk of a permanent loss to investor capital. Clients do not care what the standard deviation is for their portfolio. They care about the risk of a permanent loss of capital. To use an airplane analogy, standard deviation measures the turbulence or bumpiness of the ride. Permanent loss of capital determines if you arrive at your destination safely.

In fact, I learned this important lesson as a technology analyst during the tech bubble in the late 1990's. I watched asset prices spike to extreme levels with valuations based on new Internet-age earnings. However, that trend was short lived, and investors lost money during that market correction. In October 2017, we celebrated the 30-year anniversary of the

1987 Black Monday crash. The DJIA fell over 500 points or 22.6% in one day. Today, investors who hold large positions in the hottest stocks – "go-go" companies like Facebook, Amazon, Netflix and Google – are likely to lose their shirt again as the market will follow the normal business cycle correction. Going forward, we may be going into a period where return of capital is more important than return on capital.

WHAT DO I BELIEVE?

One of my favorite baseball quotes is from the movie ***Bull Durham*** with Kevin Costner, Susan Sarandon and Tim Robbins. The Costner quote goes something like this:

> *Well, I believe in the soul, the hanging curve ball, I believe there ought to be a constitutional amendment outlawing the designated hitter. I believe in opening your presents Christmas morning rather than Christmas Eve.*

~ Bull Durham. Directed by Ron Shelton, performances by Kevin Costner, Susan Sarandon and Time Robbins, Orion Pictures, 1988.

What I like about the Bull Durham quote is that you walk away with a clear understanding of his beliefs. Using this as context, let me identify my core principles for life and investing:

- A trusted advisor is a co-partner to help make wise money decisions.
- Trust is a simple five-letter word and is the substance of a solid relationship between two individuals (the client and the trusted advisor).
- Academic finance (Efficient Market Hypothesis) does not work in practice and breaks down in periods of market extremes.
- Risk should be defined as a loss of permanent capital, not standard deviation.
- My starting point is always to try and buy $1.00 worth of assets for 0.50 cents.
- Rule #1: Don't lose money.
- Rule #2: Don't forget Rule #1.
- Valuation matters: Beginning price determines your rate of return.
- Value investing provides a Margin of Safety versus glamor investing.
- My personal hero is Warren Buffett.
- Chipper Jones should be in the Baseball Hall of Fame.

MISSION DRIVEN:

MY MISSION is to help individuals grow their nest egg and to provide wise, trusted financial counsel. I help my clients realize the value of long-term investing by building portfolios that take advantage of stock mispricing that large investors miss because of institutional constraints. The parallels between baseball and investing are very similar. As a value investor I search for the misunderstood and underfollowed companies and avoid the popular growth stocks of today's market. Just like Billy Beane in *Moneyball*, searching for the most unwanted prospects and players to fill the roster, the search and quest for value stocks is never ending. As a lover of baseball and stock market investing, I have found my mission in life.

It's only fitting that we close with a few quotes from Warren Buffett, Chairman of Berkshire Hathaway and my personal hero. He has several memorable quotes about the art of investing. Enclosed are three of my favorites:

> *The most important quality for an investor is temperament, not intellect. You need a temperament that neither derives great pleasure from being with the crowd or against the crowd.*

> *Price is what you pay, value is what you get. Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down.*

Finally, Warren Buffett compares investing to the game of baseball. However, in his world of Moneyball, there are no strikes and wise investors can wait for the perfect pitch to hit.

> *I call investing the greatest business in the world … because you never have to swing. You stand at the plate; the pitcher throws you General Motors at 47! U.S. Steel at 39! and nobody calls a strike on you. There's no penalty except opportunity lost. All day you wait for the pitch you like; then when the fielders are asleep, you step up and hit it.*

About Christian

Best-Selling Author® Christian Koch, is recognized as one of the top ThoughtLeaders® and private wealth experts in the money management industry. He is a veteran investment manager and equity research leader known for providing customized retirement investment strategies to his clients. Christian is President and Owner of KAM South, an Atlanta-based, fast-growing firm that provides advice for investment management, retirement, financial planning and tax strategies. He also holds various prestigious certifications including Certified Financial Planner (CFP®), Certified Private Wealth Advisor (CPWA®), Certified Divorce Financial Analyst (CDFA™) and a Retirement Income Certified Professional (RICP®), and has been honored with the coveted Five Star Wealth Manager Award in 2013, 2014, 2015, 2016 and 2017.

Christian launched KAM South in 2011 to fill a need he saw in the financial world. Using the extensive experience he acquired from his previous positions in large companies – such as Lindner Funds (a four-billion-dollar mutual fund company), Fifth Third Bank, and Trusco Capital Management – Christian has grown KAM South from a firm that started with just a couple million to over $80 million in asset management all in the past six years. KAM South brings to life its brand motto of “We Build Wealth.” One of the ways Christian is able to help his clients is through the unique process system he developed in which clients use customized portfolios to attain predictable and sustainable income. While the firms unique Retirement Income Planning Process makes sure to protect their client’s finances for years to come, it’s Christian’s southern hospitality and ability to make his clients feel happy and “at home” that makes KAM South truly a success.

Christian has shared his expertise throughout several media outlets. He has been quoted multiple times in *The Wall Street Journal*, and has been seen on ABC, NBC, CBS and Fox affiliates after appearing as a guest in the show *Times Square Today®* and *The Brian Tracy Show*. Christian is also a Best-Selling Author® of the titles *The Soul of Success* and *Get In The Game*, which he co-authored with Jack Canfield and Kevin Harrington respectively. He is also an author of *Performance 360* and is currently collaborating with Larry King to co-author the forthcoming book, *The Big Question.*

Christian completed his Bachelor of Business Administration at Stetson University, where he was also a Division I Baseball player. He continued his education with an MBA from Jacksonville University. He is also a Harvard Business School Advance Management Program graduate and is currently working on his Doctor of Business Administration degree from the University of South Florida, which he anticipates completing in 2020. Christian is also on the Board of Directors of Rotary Club of

Buckhead, and is involved in the Harvard Business School Club of Atlanta.

Christian has mastered the art of work/life balance. On top of running a successful company and continuing his education, he is also a loving husband and father to five children between the ages of 8 and 16 (three girls and two boys). An avid baseball fan, he can often be found at SunTrust Stadium with his family cheering on the Atlanta Braves.