January 27, 2016 ~ Mr. Richard Oldfield, Chairman, Oldfield Partners LLP

Ben Graham Centre (BG): Your background is in history, how did you make the drastic shift from history into business and investing?

Richard Oldfield (RO): It wasn't really a drastic shift. Particularly, at that time and in the particular firm I went to go work for. I went to go work for a firm called Wahlberg and Sigmund Wahlberg who founded the firm always believed in hiring who had studied humanities. He wanted people with a broad education and not a specialist economics or finance education. When you met him, he was very old by the time I met him, when I was sort of a new boy and I had been in the firm for 6 months or so, I got a quick call and I go to his office and we spent an hour talking about German literature, of which I knew not nearly as much as him and about politicians and politics and not about financial things at all. So in his firm it was more normal than otherwise to have people who had a broad background, a background in anything, even neuroscience.

As for the sort of aptitude for someone who's studied history and goes into investing, I've always been interested in investments but I never wanted particularly to do a vocational degree, I wanted to do a broad degree.

BG: Do you think his belief in hiring more people with more diverse backgrounds was justified?

RO: I do think he was right.

BG: Do you think given your background in history you brought more to the table, something that others could not?

RO: No, I wouldn't say that and I don't think I could say that. It might be that it was true but I think in aggregate in the firm, the firm was very much a pioneering kind of firm and it slightly broke the mold of the British merchant banks and I think that was slightly because people didn't all come from the same social and educational backgrounds, they were all very different, it was more cosmopolitan, their educational backgrounds were different in terms of the subjects they had studied and where they had studied and I think that all made it a more exciting and energetic place and certainly much more hard-working than some of the other merchant banks. As I said just now, his ethos was extremely important and it lasted longer than his death. He was extremely keen on absolute precision and accuracy and details, down to where commas where and assuring that punctuation was correct. It was an unforgiveable sin to misspell someone's name for example. And I think that that eye for detail and hard work was part of the business ethos of the firm, which went alongside the investing ethos, and that combination was very strong.

BG: You mentioned earlier that today value investing is an approach seldom used by fund managers due to the emotional turmoil that may arise, is there anything you've learnt over the years that has helped you mitigate that emotional turmoil?

RO: Well, say seldom used would be an exaggeration. What is surprising is that more people don't use value investing given that it is pretty well established by the single history that we've got that value investing tends to work and improves your odds of good performance. So it is surprising that more people don't do it and the reason is as I said it is so hard to do emotionally.

What can mitigate the difficulty of doing it: I think that distance from the frenzy of the day-to-day market is important. I've always been a great devotee of John Templeton and he used to say that he based his operations in the Bahamas, he established a very successful huge financial operation. That worked so well because the newspapers arrived a day late and he couldn't therefore react to yesterday's news because he didn't know where he was. Now I'm sure that was a wild exaggeration, like a caricature, he was a wildly old man and he knew exactly what was going on but I think the principal is what is important. To be successful in value investing, you have to try to retain your calm and your piece of mind and you can only do that if you stand well back from the frenzy, which otherwise buffets you around and pummels you in every direction.

BG: You have a book called *Simple but Not Easy* published in 2007, and I noticed that it is out of print or not available to order to Canada

RO: I must check that, as it is still being bought, albeit not on a large scale (laughs). I thought it was available.

BG: I was wondering if you can tell us a bit about that and if anything has changed since the 08/09 subprime mortgage crisis and if anything or the core values of that book have changed at all since?

RO: I wanted to get off my chest a whole lot of prejudices. I had a very lucky combination of jobs in that managing a family office, I was both investing directly running global equity portfolios but also looking at other managers and few people are in a position to do both those things at the same time. And that gave me a very good insight on manager's behavior at the same time, particularly through the tech bubble – which was a fascinating period. So that's why I wrote it and I like writing, I enjoy it, in trains and planes and the back of a bus over the period of 3 years or so. So I would describe it as a highly biased and autobiographical book.

I often do think about that. Although the title still is right, investing is simple, you can reduce investing to it's rudiments without it being overly complex. That is not

to say that there aren't investments and types of investments, which aren't very complex, or companies that aren't very complex but the basics of investing are very simple and very straightforward.

However, it is not easy and that is the part that people seem to miss in the title (laughs). If I were to retitle it, I might call it, "Simple but extremely difficult". As for the core things, I feel pretty good about the core points in the book. One of which is the expensiveness of hedge funds and that fees matter. I produced a bit of arithmetic about what the normal return of a hedge fund might be and that is pretty much being borne out by circumstances in the last 10 years. Hedge funds in aggregate have not done the job that people thought they might do. They have been disappointing in aggregate. Of course there are great hedge fund managers as there are great money managers, but in aggregate they have been disappointing. In aggregate they were bound to be disappointing, in fact that is one of the points I've tried to make in the book is that it is unrealistic to think that the average hedge fund manager is going to be better than the market just as the average money manager will be better than the market. And then therefore the average hedge fund manager will be getting a gross return on the long side which is the market return, and on the short side which is the market return and if you do therefore the sums and take off the 2% management fee of the 20% profit, you get to a really low single figure return for the investor and what I've argued is that the pie is simply not big enough to give the owner of the money enough return. Since then, they've been – there's a book by Simon Lack, The Hedge Fund Mirage, in which he did a piece of arithmetic roughly speaking hedge fund managers since the beginning of the hedge fund business have had fees of something like $390 billion dollars – the owners of the money have had profits of $39 billion dollars. A multiple of 10:1. Somebody else did an interesting sum, which was – suppose you have 2 investors: one buys shares in Berkshire Hathaway from the beginning – 1965, and the other puts money in a hedge fund, whose only asset is shares in Berkshire Hathaway. The one who buys shares in Berkshire Hathaway turns $1000 into 3-4-5 million dollars. The one who buys a hedge fund turns $1000 into $390,000 and the hedge fund manager – who reinvests fees in Berkshire Hathaway earns $3.9 million. So as I said, the pie is not proportionately shared. And of course, there are marvelous, brilliant hedge fund managers who thoroughly deserve very large fees but it's extremely difficult to pick managers and the odds of picking a hedge fund manager who justifies those fees are very small. So that was one piece of the book which I was pleased with. I don't think I've got anything to regret about my long-term belief in equities. In 2009, after the crash, people though equities were finished and expected very low returns – they couldn't have been more wrong.

BG: People could also argue that that was the best time to buy

RO: It was the best time. But people also thought that was the best time to be selling. I went to an investment committee meeting in 2009 and in one meeting someone said we should go to 0 in equities. So, of course it was the best time to

buy, but in the nature of things the best time to buy is also when almost no body thinks it's the best time to buy. It's not neuroscience but it is psychology that one of the best short-term indicators of the market is this thing called the Investors Intelligence Survey of Advisory Sentiment, which measures whether newsletters in the States are bullish, bearish or are looking for a correction. It's a terrifically good inverse indicator that when the great majority of people are bullish, the market's likely to go down, when the great majority of people are bearish, the market is likely to go up. And it's obviously so, actually magic, when everyone's bullish, they're already invested and when everyone is bearish they've got loads of cash. It is natural that in March 09 when so many people thought we can't possibly invest in equities, it was the best time to buy. Too much on that, I think on the whole, I'm quite pleased with what I said then but there are some things which I would rewrite.

BG: Should we expect a 2nd edition (of your book)?

RO: No. (laughs) Not on investments. Something completely different.

BG: In your talk, you were talking about the difficulty of macroeconomic forecasting and all of that is definitely true, I guess the fact is that macroeconomic effects sort of trickle into other things such as equities and I was wondering how you factor these into, especially the recent macroeconomic effects, into your analysis? Like say in China and the mysterious things that are happening there right now or oil and I was wondering if you can say a few words?

RO: In general terms, one of the solutions to the problem that it is very difficult to make these macroeconomic forecasts is to make sure you've got a diversified portfolio, so you've got lots of ideas and not a single big economic idea. In specific terms, the answer to your question is not enough. We didn't factor in a slowdown in China, we expected it, but we didn't factor it in enough, or enough of a fall in industrial investment in particular and fixed capital investments. We do of course take into account the macro concept as best we can and that leads us to change assumptions about commodity prices and so on. We don't make specific forecasts and try not to depend on the necessity of an assumption being right in the very short term, we're investing for the very long term and so oil for example, we never, even when it was over $100, we didn't assume it would stay over $100, I think we were using $70 or so at that stage. We didn't expect it to go as low as $30. And we don't expect it to stay as low as $30 because at that $30 there is no incentive to develop. The natural rate of decline of oil wells is about 6% per year so if there is no development and you have a 6% decline in oil production, so for the time being at least, you have oil demand increasing, It wont always be so, and this is becoming more and more of an issue. And this is what I call the squeeze medium-turn. In the short-term, oil is under pressure and it may well spike lower, in the medium-term there will be an increase in oil demand – which is likely to result in the oil price going higher but in the long-term there is

the prospect of electric cars, there is the prospect of solar panels displacing others means and sources of electricity and that long-term seems to be getting closer and closer, so that medium-term prospect of oil returning to 60-70 is squeezing into a shorter period. In fact, tomorrow I'm going to a conference in New York on stranded assets which is to do with the likelihood that a lot of the reserves of fossil fuels companies will never be used. Therefore, you have to discount them in valuations. So that is very much on our minds, so we take into account all those things. For example, we don't attribute any value to coal in attributing value to companies because coal may well be finished in 15-20 years time even though in India and in China an awful lot of electricity is still going to be generated by coal. In the Western world, it is oil. It is very interesting to see, on my way over here today, I saw an advertisement of stat-oil, Commodity Company, Energy Company, in which they attacked coal – you want natural gas not coal. So it is quite interesting to see the beginning and the ends fighting.

BG: You touched upon in the beginning of your speech about how you focus on equities because that is your background and expertise. Is there any other reason you chose to, would you do anything differently, like in the beginning.

RO: No, I wouldn't because I'm fascinated by equities and I'm not fascinated by bonds. I'm fascinated by the market so I'm more interested in quoted markets than in private equity for example. I would, early on in my career, I went to of course investment courses by a man called George Hockley and he used to say "Bonds are death, equities are life" and of course it's not really true, and the bond market since I started in the very late 70's/early 80's, the bond market's been as strong as the equities market. The US treasury has given higher returns than US equities. So it's not true, there's plenty of life in the bond market. I do find bonds pretty boring.

BG: So it's mainly due to personal preference?

RO: Yes. Personal preference and also the very strong belief that over the long-run, what will give you the best real return after inflation is equities.

BG: Do you find there is different personalities that are suited more to equities than bonds or do you think everyone is inclined to play in both?

RO: I suppose that, taking it back to your first question, that it's probably true that humanities people are more interested in equities and mathematicians are more interested in bonds. In personality as opposed to education, I don't know.

BG: Going more into equities, does your due diligence process vary across different portfolios? (I.e. your global equities vs. your small cap equities) and how so?

RO: Yes it does. In a small cap, we have to know the management. Because management's are so important for a small cap company. In a big company, the direction of a company changes like a ship changing direction – it changes pretty slowly. There are just so many moving parts for new management to take control of. But, nonetheless, they have an impact. They can have an impact on the culture of the company really quickly. But in terms of direction and results it can take a long time. In a small company you can have very dramatic changes, with single product companies, you can have changes very quickly. So knowing the management very well is important.

I talked about management a bit in the talk. There have been occasions when for the biggest companies in the world, making a judgment about the management has been very vital.

For example, in the case of BSkyB, the son of the chairman had just been appointed chief executive or was in the process of being appointed chief executive and the market viewed this really badly. There were 3 headhunters and lots of psychometric tests and there were 30 candidates, but in the end the person that was appointed was James Murdoch. We knew James Murdoch's record in Hong Kong and thought he was exactly the right person to be chief executive of Sky. So we took advantage of the markets skepticism about the Chief Executive. That played out very well. We are very weary of what we call the premature ratification of chief executives. Carlos Scorne of Reno was regarded as incapable of being wrong, he would announce that there would be 8 new luxury models and 30 new modeled all together, and the market would say "isn't this great, when the industry as a whole is consolidated". One day in about 2006/2007 when we were really struck by the fact that Reno had just made an announcement, the stock went up. On the same day, Steve Ballmer made an announcement at Microsoft and as usual, whenever Steve Ballmer said anything – the stock went down. Ballmer in fact, in his 12 or 13 years, I think that revenues went up by 11% a year and net income went up by 9% a year and earnings per share went up by 11% a year with share buybacks. Not bad for somebody who was regarded with such sadism by the market. So that really struck us on that day, that Carlos can do no wrong and we should be hesitant, we held a stake in Reno and it played a part in influencing us to sell and Ballmer could do no right – and the stock was, we felt, undervalued at the time. So managements are important, but we don't have a policy requirement to know every manager of every big company as we do for the smaller companies.

BG: Just how you have different approaches to different portfolios, you must have a different approach for your diverse client base. So how do you find that, do you vary your strategy by whether your client is a charity or a family office, etc?

RO: No. Same strategy. All of our global portfolios are essentially identical. There may be cash flow which affects so that if we get some cash flow, we don't

necessarily buy the whole portfolio, we'll buy the companies that we think are undervalued at the time not buy a company that is close to it's valuation target. But, they're essentially identical.

BG: So to you every client is the same?

RO: Yes, so the clients have made the decision that that's the strategy and philosophy we want. We don't bend the philosophy for different clients.

BG: Do you not vary your relationship management styles either then?

RO: I wouldn't say that we do really, but that we do in practical terms. We have a total of about 250 investors, something like that. The great majority of them are invested in funds. Then we have separate portfolios for some large institutional clients. Most of the people invested in funds come to the twice a year meetings which we have in a hotel in London, which are usually 40-50 people. That is the best way to report to them, and the way in which they quite like being reported to. Because we don't have very many meetings, we always say to all investors – whether very small or very big – that we're very happy to meet, but in practice, the smaller investors tend to come to the big hotel meeting. So in reporting style there is a variation, but in actual written report, pretty much identical. Where consultants are involved or an in house investment team, then there may be more detail about performance attribution, views on particular companies and that type of thing.

BG: So on a broad level, the client chooses your firm and the strategy is standardized across.

RO: Yes. If they didn't want the strategy, they wouldn't come to the firm.

BG: You touched upon a little about pursuing global opportunities versus focusing on a particular market. I know you mentioned that fundamentally the behavior is the same in each country, but do you think there are tradeoffs in pursuing opportunities in different countries versus in one market?

RO: Yes, I do think there are advantages in being global, because you can make these international comparisons. Therefore you can find that, and particularly so in Japan recently, that there are companies in the same field with very high quality of product and high quality balance sheet and so on, that just have a very low valuation for no reason relative to an American company that is similar.

BG: But do you feel that with the attention spread out in so many markets, that you are missing so many opportunities you could've found while focusing in one market?

RO: Yes, I have no doubt that is so. Same as my comment on research. A small firm spreading itself globally is naturally spreading itself more thinly than a big firm, particularly a firm that is very specialist. There is no doubt that there is a tradeoff, we don't have the same knowledge in depth as many companies and big firms. But there is a tradeoff there, the decision-making is very much better in a small firm versus a big firm. This is for 2 reasons. For one, you have a smaller number of people making the decisions. Large number of people making a decision tends to be non-optimal. 2, you are forced to concentrate on key issues by the size of the firm. Occasionally, that will mean you miss something, but in general, it means that you have a better more expeditious decision-making process. You don't get stuck in analysis-paralysis.

BG: So is would be fair to say that for Oldfield partners, you try to limit the size and the growth?

RO: Yes. It won't get any bigger than that.

BG: I'm very interested in one particular aspect of managing a fund, and that's growing your assets under management. I know for a lot of hedge funds, they typically use bull markets as an opportunity to grow their AUM but I realized for funds that have a longer term commitment, such as Oldfield partners, you're okay with going through bear markets just to look at the opportunities and to capitalize on those opportunities. Do you have any specific policies that are reflected in the way you raise capital that you might be able to expand on?

RO: We do. We have caps on how much we will have in different strategies, so for emerging markets we won't go more than a billion dollars. We got to a billion, we closed. It almost immediately went into reverse, because the markets fell and one pension fund client in the UK immunized their portfolio, went out of equities. We got a 6 billion dollar cap in global. We very nearly got there, we're just short of that point. So we do have caps and the reason we have those caps is that we want to be very liquid. For global, we want 20 stocks in the portfolio. Most companies have a market cap of more than 20 billion dollars. We don't like owning more than 1.5% of a company, so multiplying those 3 things we get to 6 billion dollars. Liquidity is very important because we don't like to be stuck in a stock, we like to be able to move quite abruptly. As for the strategy of raising money in a bear market, I can't say that we do have a strategy exactly. I mean we keep on talking people. We like to be able to persuade people to buy, I mean that's making sort of a right egotistical assumption that we will think it's the bottom and nobody else does. When we see a lot of value, which we did in March 09 for example, and in 2000 and as we do now, when we see a lot of value, we would love to be able to persuade people to come in but it's often after a period of bad absolute performance and sometimes after bad relative performance. So life just isn't like that and you have to settle on that fact. But some clients are themselves very inclined to operate in that way and that is great. I think there are clients who after the 2008 crash, were adding money in

early 2009. Most people will not operate in that way, so it's unfortunately not the way human beings behave. We have two large institutional clients who were doing that.

BG: People generally have different outlooks or considerations in terms of time commitment. Have you ever felt you had difficulty retaining clients given your long-term commitment?

RO: Only when there's been a change in the people, and that does happen. You get a new chief investment officer or a new chief of investments or whatever, and they have not necessarily a different term – it's not that they're not long-term, but it's that they may not be particularly sympathetic to value investing, they may have a different philosophy of investing. And that's a danger because if you've got a mismatch in the ways of thinking between client and manager, that is a danger. On the whole I would say our clients are remarkably long-term. They too have patience, patience, patience.

BG: I noticed that Oldfield partners has a unique practice of investing in other managers. I'm really curious to know that what it is you look for when looking for a new manager?

RO: I think managers ought to have courage. They got to have common sense to. They've got to have the capability to have convictions but they must have sufficient common sense to know that their convictions will not always be right. Some of the most dangerous managers are some of the cleverest people with the strongest convictions. Who therefore, because they know they're right, go 100% into something and of course they're not always right and when they're wrong they are completely blown to bits. So those combinations of courage and common sense and convictions. We look for managers with a process that we understand and that usually means an extremely simple process, we think that a complicated process is absolutely the killer of good investments. If you have whole rows of boxes and arrows between them, then that makes us very weary. Then we look for the right environment, and that encompasses a whole lot of things. It points usually to smallish firms, boutique firms, owner managed firms, people whose interest are aligned with the investors because they're invested themselves in the funds. Of course people with investment philosophy which we can relate to, meaning on the whole they are value investors. But not very big firms with enormous AUM, which make rather immobile, cumbersome decision-making processes with a huge cacophony of noise and peer pressure about all decisions, which pushes people to do things and make people feel they've got to do something everyday rather than sitting back and doing nothing. So the environment matters a lot, and you can have individuals who appear to be exactly the right individuals in our kind of terms, who are driven of course by being in the wrong place. So the environment matters a lot and the client base matters a lot. One aspect of the environment, if you have a client base who doesn't really have a sympathy with what you're doing, you've got a problem.

Very early in our firm we had a very major name who was thinking of asking us to run some money. He was saying can he have performance figures every 2 weeks, or weekly I think it was. And I said I have a file, which is the performance of every month naturally, and I usually ask once intermonth but not more than twice a month. I find it doesn't help at all to know what it is, it's a burden in fact. If it's good it makes you complacent, if it is bad it makes your neurotic. And so, it is not a necessary thing to know and I said no in fact you can't have weekly performances because I don't know what weekly performances is and you can't know more than I do. And he went away, and it was probably a very good thing that he went away because it was before 2008 and I think he would've said stuff like "how can you be holding RBS" and things like that and that would've been counter-productive because it would have pushed us, and it would have made us nervous and pushed us from doing things we wouldn't have done. So, the type of client is very important.

BG: I bet it didn't feel like that when he walked away though?

RO: No, it felt right in fact.

BG: Final words, any piece of advice you would might give to a young investor who is starting out today?

RO: Do it, it's a wonderful life. If you're interested in it, if you're fascinated by investments, do it. If you're not fascinated by investments, don't do it because it is also a frustrating life, it has all sorts of odd aspects to it. You know a postman delivers letters with 99.9% accuracy and an accountant adds up things with 100% accuracy a neuroscientist operates with a very high success rate but an investor is doing well if right 55% of the time and that is a very odd profession to be in. And it is a profession that in aggregate doesn't do any good that is a very surprising profession to be in. And so it is not for everybody but if you are fascinated by it, then do it, because it is very fascinating.