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listeningin

Old School Values

Ex-Columbia Prof Michael van Biema's Highly Networked Funds Idea

***Michael van Biema**, the former Columbia University finance professor and founder, managing partner and CIO of fund of funds group **van Biema Value Partners**, was a successful young tech entrepreneur and investor when he had a road to Damascus experience and embraced Graham and Dodd-style value investing. It was something of a case of being in the right place at the right time. Mike was a newbie on the Columbia finance faculty when Mario Gabelli brought one of his legendary value investing teachers back to campus to try to rekindle the faculty's interest in the discipline, whose star had been eclipsed in academia, albeit not in the real world, by the Efficient Market Theory. One lecture and Mike was hooked, going on to become one of the school's leading proponents of value investing.*

That was the 1990s. By 2004, he was ready for something new. Mining the vast mother lode of value investing connections he'd accumulated at Columbia, Mike started van Biema Value Partners with a star-studded advisory board of legendary investors and an ambitious and clever twist on both value investing and the funds business. Value investors with relatively small portfolios, he knew well, tend to generate the biggest excess returns. Yet they're off limits to many institutional investors, who either don't know they exist or simply can't invest enough in them to move their performance needles. Mike's solution: Collect the best small value investors his world-class connections can unearth into funds of funds, and make their pooled talents available to investment behemoths. So far, it's worked just like the textbooks predict. Mike's flagship Van Biema Value Fund essentially tracked the broad market averages – until the credit crisis hit. Since then, it's beaten them handily. And his Asia fund, fortuitously launched at the end of 2008, has taken off like a firecracker gaining better than 50% since inception.

I dropped by Mike's Manhattan office a couple of weeks ago to learn more about what he's up to. Listen in.

KMW

As a first-time visitor to your offices, I can't help myself. I just have to observe that your address, at 57th and 5th, doesn't exactly scream "value investing".

Michael van Biema: You're not the first, by any stretch. But your reaction is quite reasonable – I react that way every day when I walk past the grand piano in the lobby. It doesn't really look like a lair of value investors. Actually, **Chuck Royce**, who runs the **Royce**

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Funds, is one of the august members of my board of advisors and his offices are upstairs. We initially officed with him over on Sixth Avenue, where he was for many, many years, in what was distinctly a B-grade building.

Rather famously so, as I recall.

Right. The offices were very grade-B and the elevators were pretty slow and horrible and so on and so forth. But Chuck finally decided to upgrade his offices and moved over here. We moved over here with him, still as squatters in his offices. Then, fortuitously for both of us, both of our firms expanded and we had to find our own space. This office suite happened to be available at that point, and it had already been built out, so I decided just to move downstairs. It in fact *is* a value proposition because we actually rented it at pretty much the market low.

So you bought – or rather, leased – low?

That's right. When you're a good value investor there are two things you always have to consider, value *and* price. Hopefully, I won't need to do it at any point soon, but I could easily get out of the lease or sublet this space to somebody at a much higher rate than we have to pay. From that perspective, this prime real estate is a value.

What can I say? I'm envious. But before we dive too deeply into your approach to value investing, there's something else I have to ask. How is it than someone who started out as a *technology entrepreneur* ended up becoming one of Columbia University's most prominent preachers of the *value investing* creed?

Well, my background certainly is eclectic. My wife likes to say that as soon as I become competent in any profession, I change fields.

That's what a good spouse does. Keeps you grounded.

Right. Anyway, that's her read on the situation, which is probably not entirely inaccurate. But my involvement in technology was when I was very young. I started a couple of companies. Some of them were what I would characterize as moderately successful. One of them, we sold to **AT&T** (T) and I made what I thought at the time was a huge amount of money. In retrospect, compared to what's going on these days, it was a very modest amount of money. Nevertheless, it was certainly a lot for a young guy.

So you started investing?

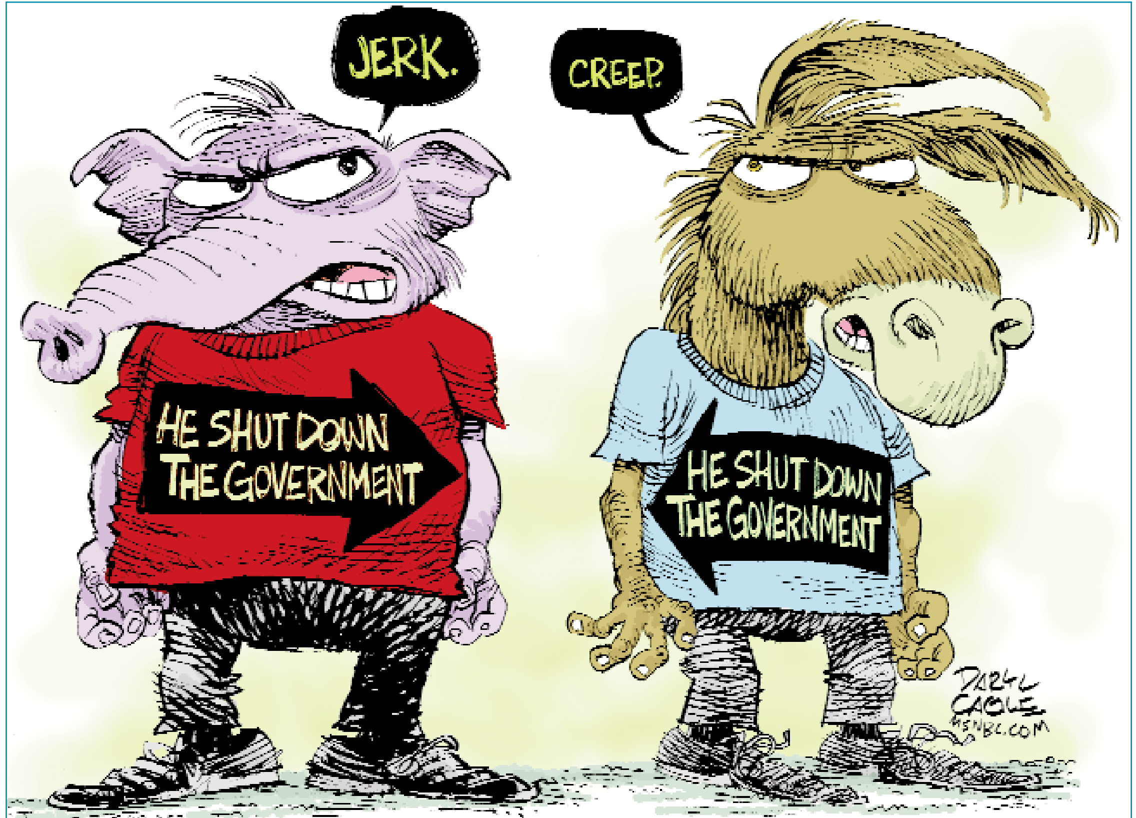
Actually, I had always been interested in finance and the markets. And I always had been an active personal investor – mainly investing in tech stocks, since that was what I knew. I was reasonably successful at it as a young man.

> ***"The thing that really appeals to true value investors is that rule No. 1 is Don't lose money, and rule No. 2 is Don't forget rule No. 1. If you've made some money in your life, that's very important to you. You don't really need to get that much richer to be a happy human being."***

Yet still you converted from growth to value? How did that happen?

Well, I ended up going back to Columbia – and the reason I went back to Columbia was really that I got married. We were about to have our first child and a very good friend of mine, a guy by the name of **Stanley Klion,** who had been one of the senior guys at **KPMG**, called me up and said, "Listen, the greatest mistake I made in my life was that I was so fixated on my career that I didn't take the opportunity to spend any time with my kids when they were young." He pointed out to me that if I accepted an opportunity I had to go back to Columbia to teach for a while, I'd have a much easier schedule. I was running a consulting company at that point and Stanley had been in charge of KPMG's consulting business. It sounded like good advice, so I followed it and went back to Columbia. They initially offered me a job teaching management, but I wanted to teach finance and managed to convince them to let me teach finance. Right

around that time, **Mario Gabelli**, of the **Gabelli Funds** – and another of our august advisors – was trying to restart the value investing program at Columbia, which had pretty much fallen by the wayside in academia as a result of the popularity of the **Efficient Market Theory**. Interestingly, in the 1980s, value investing was not, as far as I know anyway, taught as a discipline anywhere. It certainly wasn't taught in the United States at that point. Mario actually gave the school some money in the early 1990s to bring back his former professor, **Roger Murray**, to give some lectures *to the faculty* about value investing.



And you attended?

Exactly. That's how I initially learned about value investing. I immediately got interested in it. Sort of had one of those ah-ha moments and said, "This really makes a lot of sense." As **Warren Buffett** says, either you get it in the first five minutes or you never get it. Value investing immediately appealed to me. It made sense that this was a wonderful way to maintain your wealth, first and foremost; it was very downside risk-focused. But then it also had a long history of not only maintaining wealth but growing it at a very attractive rate. But the key thing – and I think the thing that really appeals to true value investors – is that rule No. 1 is Don't lose money, and rule No. 2 is Don't forget rule No. 1. If you've made some money in your life, that's very important to you. You don't really need to get that much richer to be a happy human being.

Wow. Now *there's* a contrary opinion. But you really can't overstate how out-of-fashion value investing was when you arrived at Columbia. Not in Wall Street, necessarily, where there were a lot of highly successful value investors – Mario, Chuck, Buffett, Walter Mintz at Cumberland Partners, John Neff at Vanguard's Windsor Fund, Mike Price at Mutual Shares, Walter Schloss, etc. But in academia, it was anathema.

Yes, well academicians love things that can be described in elegant mathematical formulas. Having grown up as a quasi-mathematician and certainly as a tech-focused guy – my undergraduate degree at **Princeton** was in electrical engineering and applied math – I can certainly think in numbers, although I don't consider myself a great mathematician.

I guarantee you're better than me – and a whole lot of investors, though.

Well, my wife's father was actually chairman of the Columbia math department. He always used to tease me that I was clearly an *engineer* and not a *mathematician*. His idea was that if you failed at becoming a mathematician, you first became a statistician and then if you *really* failed at mathematics, you became an engineer. So I don't have any pretense of being a real mathematician. Nevertheless, I certainly understood the math behind a basic finance theory. It is reasonably elegant stuff, but it's unfortunately based on a bunch of assumptions, which – if you've actually spent any time in the real world – can't possibly be true.

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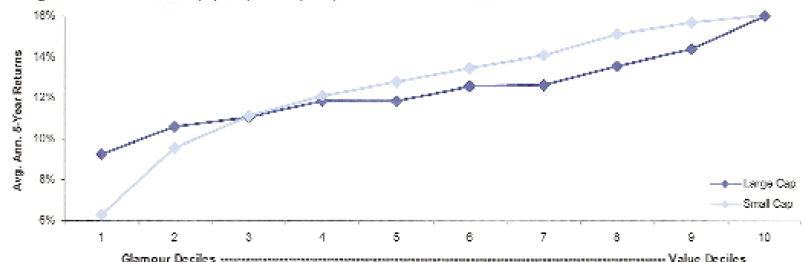
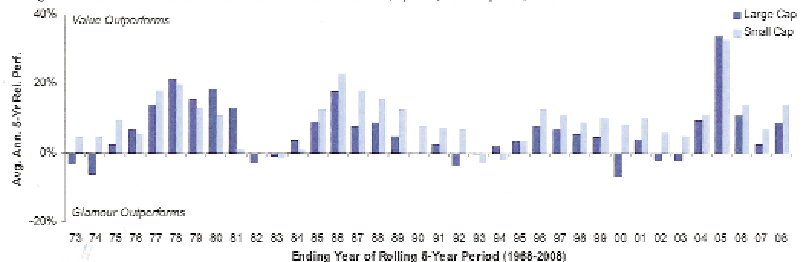
Value Outperforms In The U.S.

- Research has shown that a value investing approach outperforms growth ("glamour") and other investment styles as well as the broader markets over the long term.

Average Annualized 5-Year Returns, April 30, 1968 – April 30, 2008



Average Annualized 5-Year Relative Performance of Value vs. Glamour, April 30, 1968 – April 30, 2008



Source: Compustat, The Brandes Institute, as of 4/30/08.
** Studies above are based on the stocks of all companies domiciled in the US. For more information, please visit http://www.brandes.com/institute.*

Now it's my turn to say, "Exactly".

So the Efficient Market Theory is just that – a theory. And it was always doomed to failure by those assumptions. Not to mention that the existence of all the great value investors was always sort of the great evidence that the Capital Asset Pricing Model (CAPM) doesn't work in reality. People spent significant amounts of their academic careers trying to explain away people like Warren Buffett – and you just can't do it. In any case, it was great that Mario brought value investing back at Columbia. As you probably know, it went from being basically one course with a small following at Columbia to now being a major part of the Business School curriculum and a big part of the program. **Bruce Greenwald**, who was my senior colleague up there, has really turned it into a huge success.

It's now something of an industry.

For the school, yes. There are a lot of great value investors, obviously, working in this general area. The fact that the school can draw on them to teach classes and so on makes it all the more successful. It was very powerful that we could get real practitioners to go up and lecture the students and so forth. In any case, when I went back to Columbia, I decided that value investing was really a very intelligent way to invest my own money. So I started doing that and stuck with it – even though I went through a difficult period because that was in the early '90s and then, of course, we went into the tech bubble. For a while there I felt like an idiot, frankly. But over time I was proven correct. Our value discipline worked ultimately. Of course, even many of the great value investors, like **Jean-Marie Eveillard**, of **First Eagle Funds**, also suffered through that same period. They watched their funds and assets under management dwindle during the tech bubble.

If I only had a dime for every time I was told, "They just don't get it". But that climate made it a real feat for them to hang on to assets under management. So what made you decide to leave your comfy perch at Columbia and dive into the fray?

While I was at Columbia, I seeded, along with Mario Gabelli and Bruce Greenwald, one small manager, a former Columbia MBA student, in starting up a microcap hedge fund that worked out very well – both for the former student and also for us as his seed investors –and that gave me the idea.

Let me guess, that was the Hummingbird Value Fund?

Yes. That experience gave me the idea of creating a business centered around investing with "undiscovered" small, existing and emerging deep value managers. The question was whether we would try to run it as a seed type of fund or as just as a straight fund-of-funds. When I sat down with the members of the board, we decided that there were too many potential conflicts of interest involved in doing the seed business. The seed fund business was potentially attractive, certainly, but only if you wanted to grow your managers to be quite large. One of our basic tenets was that there's a huge advantage to having a collection of really small managers. It would have been counterintuitive, or really a conflict with our own philosophy, if we went into the seeding business. So we decided to just do the straight fund-of-funds.

Your board roster reads like a *Who's Who* of value investors. Talk about a triumph of networking.

It is a real advantage. Our board of advisors, which is comprised of experienced, enormously successful value investors, isn't just window dressing. They act as a "brain trust" and assist us greatly in sourcing and evaluating prospective managers. Each and every one of our managers goes before a panel of our advisors to be vetted before any investments are made. And

believe me, those aren't just pro forma interviews. So my Columbia connection certainly has helped. Then again, value investing is an unusual segment of finance in that it is very network-based. There is a strong sense of community. All of the great value investors know who all the other great value investors are – because periodically they end up in the same stocks with them. They typically do watch the list of a company's shareholders to see if there are a lot of similar minds on the list. It is reassuring, typically, when you're buying something and see that other value investors also think it is interesting.

Probably even more reassuring than seeing that mainstream investors think you're certifiable to buy it.

True. With that said, however, one of the interesting characteristics of value managers – and this is something Buffett pointed out in his article, *"The Superinvestors of Graham-and-Doddsville,"* [published in the fall, 1984 issue of Columbia's *Hermes* magazine] is that value guys actually show very low correlations. So – even though they may look to see if they're co-invested with certain people in a given situation – overall, in terms of their portfolios, they tend *not* to share a lot of positions with one another. It's more that they occasionally will pick up a position in common, rather than that they typically have very similar portfolios, which they don't. Our funds have demonstrated over time very low actual positional overlaps between managers. And that, of course, is what you want because if you hire 15 or 20 small managers and they are all buying pretty much the same stocks, you haven't really accomplished much of anything for your clients.

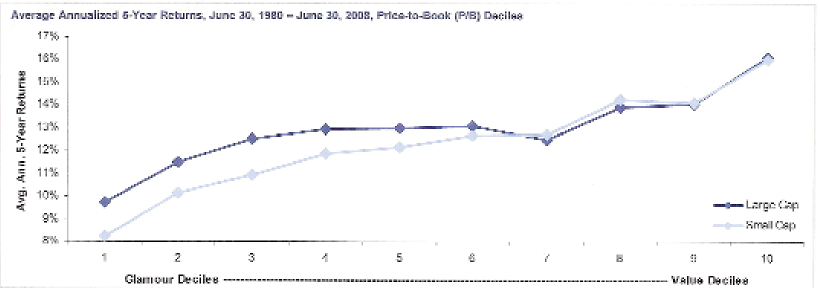
Why *do* you see little overlap, do you figure? They all inhabit the same universe –

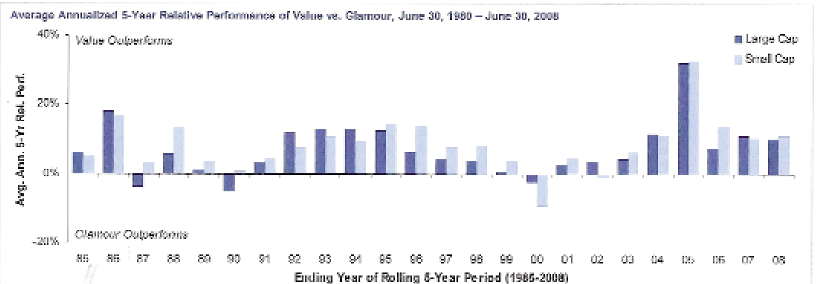
Right. But the fact these guys tend to be very contrary and quite original thinkers means that they're not swimming with any herd, so to speak. Besides, while our managers are all deep value investors, they employ a whole range of investment styles and strategies. Typically, they have strong conviction on their own ideas. Nonetheless they also obviously *do* notice when they're in a particular position in the company of somebody else whom they respect as a good value investor.

So how long ago did you start van Biema Value Partners?

Value Outperforms In Global Markets

- Value outperformance is a global phenomenon and holds true for both small cap and large cap stocks in developed markets around the world.





Source: Worldscope via FactSet, The Brandes Institute; as of 6/30/08
* Studies above are based on the common stocks of all companies domiciled in 23 developed markets around the world. For more information, please visit http://www.brandes.com/institute.

We started the company in 2004. That's when I left Columbia.

No more lecturing for you?

I do occasional lectures but I don't "teach". I really feel that if you're managing people's money in this business, it should be a full-time commitment. The exception would be if you're doing research that is obviously for the benefit of your investors. But value investing is reasonably straightforward and obviously there's not a lot of research that I would say still needs to be done. We understand why value investing works; that's not the problem. The problem is finding people who are actually capable of doing it.

Sticking with the discipline, you mean?

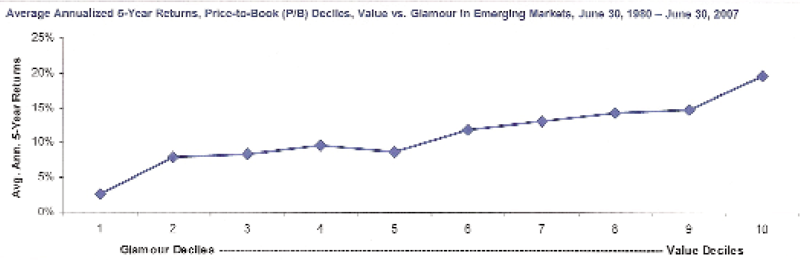
Right. It's very easy to state what value investors – *good* value investors – do. But it's really a profession that requires unusual character elements – and not that many people have the set of characteristics you need to carry it out successfully.

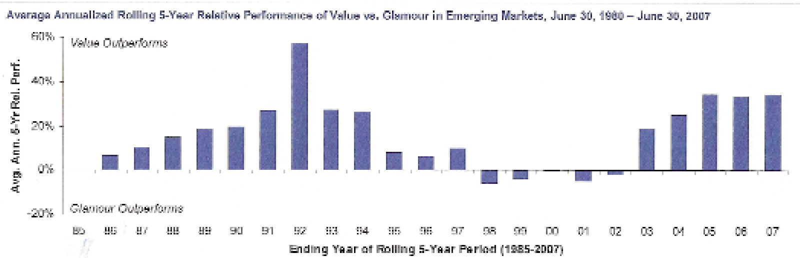
Most of the good value investors I know *are* characters of one kind or another, that's for sure.

I'm sure. One of the reasons that my job is fun to do is that the people that we invest with are very eclectic; some people would call them – somewhat eccentric. But the reason that they

Value Outperforms Even In Emerging Markets

- Even in emerging markets, which tend to be viewed as "high growth" areas, value investing provides superior returns over the long-term.
- Compelling value investments can be more frequently available in emerging markets given greater information inefficiencies than in the US and other developed markets.





Source: Worldscope via FactSet, The Brandes Institute; as of 6/30/07.
** Studies above are based on the common stocks of all companies domiciled in markets defined as emerging by MSCI Barra. For more information, please visit http://www.brandes.com/institute.*

find interesting, niche-y little value investments is because they have slightly different ways of looking at the world. Therefore, they don't end up in the same set of investments that a lot of the rest of the industry frequently herds into. There have been a lot of studies now that show there's very high correlation among the larger hedge funds. They're basically all buying into the same positions – quite frequently.

The quants and mega-funds, you mean?
Right. By contrast, our guys are buying stuff that really is pretty far off the general travel map, so to speak. There are two types of "under the radar" managers we typically invest with, basically. The experienced ones have a passion for investing and solid track records. But they've remained "under the radar" because they don't generally enjoy marketing or want to build an empire, so they have relatively small levels of assets under management. The others, whom we call "apprentices," tend to be younger but very talented money managers. Typically, they have trained under a highly regarded master of value investing and are just beginning to run money on their own.

Let's focus on your funds-of-funds. How did you settle on that structure? Multiple layers of fees don't exactly scream "value investing" to me, either.
That's a good observation, as well.

I concede it has to hold considerable attraction for management, though.
Right. What happened was that we sat down – "we" being myself and the board –

Which must have been some meeting, considering who you've assembled on your board. You've already mentioned Mario Gabelli and Chuck Royce, so you'd better drop the others' names, too –
Our board of advisors now officially consists of **Charles Brandes**, founder of **Brandes Investment Partners**, **Peter Guy**, co-founder, **JANA Consulting and Warakirri Asset Management** (Australia), **Alan Kahn**, former president and CEO, **Kahn Brothers & Co.**, **Teng Ngiek Lian**, founder, **Target Asset Management** (Singapore), and **V-Nee Yeh**, co-founder, **Value Partners Ltd.** (Hong Kong), as well as Chuck. Unfortunately, another long-time board member, **Peter Cundill**, the founder of Canada's **The Cundill Group**, recently passed away. But we frequently benefit, too, from informal counsel from a number of the other great value investors I befriended while teaching at Columbia. Anyway, when we got together, I basically said that I wanted to leave Columbia – because I wanted to go back to work for a living again. I told them I saw two things that I could do: One was to start my own fund and the other was to implement this small-manager deep-value fund-of-funds idea I had come up with. The board pretty much unanimously was against me doing my own fund.

Really? Why was that?
Well, it was really that the board was very much in favor of me pursuing the small-manager deep

Representative van Biema Managers

Manager	Strategy	Industry Experience	Fund Inception	Date of Initial Investment	Current Fund AUM
Manager A	Long/Short Equity	19	Feb-03	Nov-04	$209,100,000
Manager B	Long/Short Equity	23	Nov-98	Oct-04	$171,800,000
Manager C	Long/Short Equity	25	Mar-06	Aug-06	$210,162,000
Manager D	Long/Short Equity	13	Dec-09	Jan-10	$11,178,831
Manager E	Long/Short Equity	42	Jan-93	Jan-05	$301,200,000
Manager F	Long/Short Equity	26	Nov-91	Aug-06	$83,846,138
Manager G	Long/Short Equity	24	Dec-99	Oct-04	$880,000,000
Manager H	Long/Short Equity	26	Jan-94	Jan-05	$54,500,000
Manager I	Long/Short Equity	6	Apr-06	Oct-07	$400,000,000
Manager J	Long/Short Equity	26	Jan-98	Oct-05	$122,000,000
Manager K	Long/Short Equity	18	Mar-03	Aug-06	$170,000,000
Manager L	Long/Short Equity	19	Jun-03	Oct-05	$140,000,000
Manager M	Long/Short Equity	30	Oct-80	Jan-05	$393,000,000
Manager N	Long/Short Equity	25	Jun-97	Jan-05	$97,762,005
Manager O	Long/Short Equity	25	Jun-97	Jan-05	$97,762,005
Manager P	Long/Short Equity	14	Feb-03	Dec-04	$14,800,000
Manager Q	Long/Short Equity	18	Jun-00	Jan-05	$157,000,000
		Average Experience	Average Inception		Average Fund AUM
		22 years	Feb-99		$206,000,000

Data as of 9/30/2010

value fund of funds idea. And you can attribute many possible reasons to it. I actually think most of them thought the small manager fund-of-funds idea was interesting and different, whereas there already were lots of good value funds out there.

I can't see that group exactly shrinking from the prospect of more competition —
No. That would be an extraordinarily flattering interpretation of why they didn't want me to do my own fund. The guys who were sitting around that table are some of the great value investors of all time. I don't think they were overly concerned about the prospect of me competing with them. But they *did* think this idea – that you could manage a bigger pool of assets by distributing that pool to a bunch of small deep value managers – was interesting and different. They've all been through the process whereby they've grown successful investment management businesses. And, as I always say, the biggest problem in our profession is that success begets size – and size begets mediocrity.

That seems to be a law of nature.
And that's what makes this idea so compelling. Which is that you could actually have great performance and – hopefully, as long as you didn't get too carried away – you could continue to keep the size of each individual manager quite small. Therefore, you weren't going to run into the problem of shrinking your investable universe quite so quickly – or even, hopefully, you wouldn't shrink it very significantly at all. Anyway, since we all thought it was a fun, interesting idea, we started our first fund of funds more or less as a little social experiment among ourselves. We pooled about $35 million of our own money and just went out and hired a bunch of managers.

You found good managers just like that?
Well, I got our first list of prospective managers from the members of the advisory board, so it was very easy to "discover" good managers in the U.S., initially.

Not surprisingly. They all must have known somebody who had worked for them or who they had invested in, whom they could recommend.
Right. That initial list included probably 100 names or maybe a little more. But a lot of those names – actually, more than half – ran funds that already had been hard closed. I actually was enthused by that fact, because it demonstrated that the sort of managers we look for are disciplined and that they do close their funds at relatively low asset levels – which is one of the things that we think is so attractive about this idea.

You mean you *want* managers focused on performance, not asset-gathering?
Exactly. One of the things we ask our managers is what do you want to be remembered for; what do you want to accomplish in your business? The only acceptable answer, as far as we're concerned, is something that says that they want to have a great long-term performance record. Collecting assets and becoming large is obviously a negative from that perspective. When you look at some of the guys who have spun out of some of the great value shops, it's actually quite consistent that they typically close their funds at what most people would consider very modest asset levels. That's because they want to be able to grow for 20 – 30 years, and compound that growth at good rates of return.

What else do you and your board ask prospective managers?
Well, our four key questions are: What do you own?; Why is it cheap?; What is the market missing? and What is the catalyst? More broadly, we're looking for a passion and commitment to value investing, strong risk-adjusted returns, a strong buy/sell discipline and a sturdy operational infrastructure, the ability to exploit value opportunities in a wide range of market environments, and a manager with meaningful personal "skin in the game," plus, of course, unquestioned integrity. My thought, essentially, was that finding those kinds of managers and combining them in this fund of funds would be an interesting and a fun thing to do – and that it would offer nice, excess returns to our investors.

Even after your two layers of fees?
That gets us back to the first part of your ques-

Small Is Beautiful

- Studies have demonstrated that smaller managers tend to outperform their larger peers.
- Small managers are typically more nimble and are able to exploit compelling opportunities without size constraints.

Annualized Risk Table	Small Funds	Mid-Sized Funds	Large Funds
Compound ROR	13.52%	10.69%	9.81%
Standard Deviation	6.93%	5.88%	5.94%
Semi Deviation	7.59%	6.06%	5.98%
Gain Deviation	4.47%	4.03%	4.21%
Loss Deviation	4.98%	4.20%	4.09%
Down Deviation (10%)	4.69%	4.17%	4.25%
Down Deviation (5%)	4.09%	3.64%	3.59%
Down Deviation (0%)	3.54%	2.98%	3.01%
Sharpe (5%)	1.17	0.93	0.75
Sortino (10%)	0.68	0.15	-0.04

Source: PerTrac Financial Solutions. Small funs are defined as those with assets of up to $100 million, mid-sized $100 million-$500 million, large over $500 million. Study period ranged from January 1996 through December 2009.

tion – and it's actually a question I asked the board at that first meeting, when we decided to do this. "All this sounds great," I said, "but how am I going to make a living doing it? As a value investor, I don't really approve of the concept of having two layers of fees." The board basically said – and it was really Mario who was the most vocal and proactive on this – "Listen, Mike, you're doing something for people that they can't do for themselves. It's going to generate really good returns if it works the way we think it's going to work. Institutions really can't access these managers. These managers are too small, individually, for institutions to try to invest with them. So you're providing them with access, diversification, and good returns. And you deserve to get paid for that." Perhaps self-servingly, that argument resonated with me.

It sounds like vintage Mario.

And the rest of the board agreed. Fortunately for us, we have found at least a few large institutions out there who seem to agree as well. We invest in a very, very attractive niche and it is impossible for larger institutions to really play in this niche. They can't be running around the world, the way we are, finding and vetting managers that can put only $10 or $20 million to work in a shot.

As their consultants would be quick to tell them, that wouldn't move their performance needles.

Right. Exactly. I can take $100 or $200 million from a large pension fund and I can distribute it across my manager set and it makes for a nice – as one would say these days – "high alpha diversifying investment" for them. The other things that clearly have been important in the firm's history are the prominence of the board and the fact that we've done a pretty good job in terms of running the fund, doing the operational due diligence and so on. We've developed a good reputation in the industry. Still, people invariably ask me, "What have you changed post-Madoff, in the way you're running your fund-of-funds?" I can truthfully answer, "Nothing," because we have always done it the right way. We do our homework. We look at each manager's positions; we know what they are doing. Internally, we are experts in this particular investment niche.

You do regular portfolio-level analysis of all of your managers' funds?

Yes. We have pretty much full transparency into all of our managers' portfolios. We review those portfolios, at a minimum, quarterly. More typically, on a monthly basis – and if something looks funny, we call up the manager and ask what's going on.

What? You *don't* rely on annual reports from storefront no-name accounting firms located in tiny upstate hamlets?

No, my operational due diligence team is two guys whose offices are right next door to mine. One of them, our CFO, **Sam Klier**, was the corporate controller of the hedge fund and fund-of-funds business at **Bear Stearns** Asset Management. He's seen a lot of "stuff".

He's seen everything, I'd venture.

Yes. Sam was one of the last employees at Bear, because they wanted him to help clean up the mess that was left over. Here, he functions very much as a forensic accountant and I'm very pleased with that. It's not infrequent that a fund manager will call me up and complain that Sam is literally crawling up an orifice and he is tired of it! To me, that's the best news I can have, because that's what I want Sam to be doing. The other guy is **Steve Bondi**, our chief operating officer, who came to us after nearly 10 years with **Asset Alliance Corp.**, and before that, he actually spent 18 years with Gabelli. He was Mario's second CFO; started when Mario had $400 million under management and left when Mario went public at $20-some-odd billion. Steve was also, during his tenure there, the president of Gabelli Securities, the parent company of Mario's alternatives business. So, we have two guys who are *very experienced* in fund management. It's my philosophy – which is something else I learned from Chuck Royce – that you never want to hire people who don't have a lot of experience, particularly if you are a small firm. You're much better off paying up for guys who have been there, done it many times. First of all, as a small firm, one mistake can put you out of business. In addition, we want everybody who touches our fund managers in any way shape or form to be a very experienced person. I think a lot of other funds of funds have gotten themselves into trouble because they've relied some of my former students – freshly minted MBAs – to go out and do some of their initial selection and vetting of managers. Now let me be clear: There's nothing wrong with the intelligence of those young MBAs. But they just haven't seen the things that the guys who work for me have seen. What is interesting, in my

experience, is that the inexperienced folks in this business invariably bond with sort of the worst possible investment risks. This happens remarkably consistently, and I think it's because they're drawn to the younger, hotshot sexy managers out there.

They are seduced by the fast track?
Exactly. They don't realize that driving a speeding *Ferrari* down Route 1 is not cool; it's potentially life-threatening. I remember when I was a technology guy; one of the companies that I didn't invest in, fortunately, was a company that was called **Apollo Computer**.

I remember Apollo Computer.
Actually no, Apollo is a different story. I should have said **Eagle Computer**, that's the one whose IPO I was lucky I didn't invest in. Apollo was founded by a guy by the name of **William Poduska**, a very, very smart guy. But Eagle Computer was founded by this poor guy, **Dennis Barnhart**, who on the day of his IPO back in 1983 was killed when his *Ferrari* literally drove off of a highway in California. Left a wife and three children and the underwriters actually had to cancel the IPO. It was a real disaster; a *very* sad story.

Quite a cautionary tale, even if it didn't take much wind out of that first tech bubble. In any event, you said a lot of the funds your board initially recommended to you, weren't interested in taking in any new money from you?
Right. Maybe out of the first 100, only 40 or so were still open and available to us, and we made no effort to pursue the others. It's always been my philosophy in life – not that you necessarily want to follow the path of least resistance – but that you don't want to bang your head against a wall too hard, particularly when you're starting a new business. So, to the managers who were hard closed, we just said, "Fine, if you decide to open, let us know." We had plenty of talent available to us elsewhere. And, as we've been in business longer now, we actually have seen some managers who weren't interested initially, come back to us. There was one guy, for example, in Hong Kong, who I wanted to give money to because I thought he was a *terrific* manager – and we did quite a lot of due diligence on him and his fund. But he was closed to new investors for three years. Nonetheless, every time I went to Hong Kong, I'd go see him. We would have lunch and talk about the market in Hong Kong and so on. And every time, at the end of the conversation, I'd say, "Are you sure you don't want to take a little money from me?" He always said, "No," and after a while, he said, "Don't even ask, Mike. I'm never going to open; you're never going to give me any money. I enjoy having lunch with you, so we can continue to have lunch – particularly since you are paying and I'm a value guy – but we're just not open." I would reply, "That's okay. At some point, somebody will pull some money from you, you'll have a hole and you'll think of me." So what happened? 2008 came along and one of his family office investors pulled $15 million out of his fund, which was *really tiny*, because he had closed it at under $100 million.

That *is* awfully small –
Yes, but we do have some other managers like that. They're very disciplined. In Asia, you don't need that much money to live. If you're running an office with two or three people and you've got $100 million under management and you've got 20% compounded annual returns, you're not doing badly. In any case, that manager called me up in the middle of the credit crisis and said "Listen, I remember you told me at our multiple lunches that an opportunity would come for you to put some money in my fund – and I'm calling you now. But I perfectly understand if you pass on the opportunity because I really doubt that you're going to step up to the plate, given the current situation and uncertainty." I said, "Wrong again! I do have funds to allocate." We quickly brought him before our board to be vetted, completed our due diligence and wired him the $15 million. He is one of our best managers and has been compounding at an outrageous rate of return since we gave him the money. As a matter of fact, we have so much money with him now – because of his compounding and because we've given him more money – that I actually had to stop giving him new money because we have a limit of 15% of assets in any single fund. I'm actually a little frustrated that our fund of funds has not grown fast enough, in terms of assets under management, to match his compound growth. It's always annoying when you've got a great manager and you can't invest as much with him as you would like.

But remember what you said about size breeding mediocrity?
Exactly. That's why we have the 15% limit, to keep me from getting carried away with myself.

One complaint I hear over and over from smaller managers is that institutional — and particularly fund of fund — money is hot money that evaporates when they need it most. Behaves exactly the opposite of the way you did with your friend in Hong Kong. Value types, in particular, tend to be very wary of it.

Right, well, that's one of the ways we've managed, over time now, to differentiate ourselves. Our managers view us as good long-term real value investors. Certainly, the ones in the U.S. didn't take much convincing. They took one look at our board and said, "Okay, these guys must know what they're doing because they wouldn't get these people to join the board if they didn't." But in Asia, initially, the great U.S. value investors on our board were just much less well-known. Many of the money managers we wanted to invest with had never heard of them. So we had to actually establish proof of concept, or whatever you want to call it, that we were going to give these people money and let them run it. And now we've added three prominent value investors based in the Far East to our board.

Just how patient are you prepared to be with your managers?

I always tell my fund managers, "Listen, if I give you money I'm not going to pull it for poor performance for *at least* three years. I may pull the money if it turns out that you have bad morals, or regulatory issues, or if I see significant personnel or strategy changes or style drift. But, from a performance perspective, we are committed to you for three years because good value managers can easily have severe underperformance for an extended period of time." In other words, we've demonstrated to these guys that we *do* stick around and that we *are* patient. They appreciate that from an investor. Because of that and also because we have gotten larger over time, we've been able to, in many cases, get better deals from some of our managers in terms of fees. That makes me feel better in terms of the double layers of fees inherent in the fund of funds structure; we're basically now wholesale buyers of these smaller managers' services. Not only are we wholesale buyers, we're high-quality buyers, so they're effectively selling to the Wal-Mart of this business, and have to give us something of a discount.

Sweet. Does that help on the other side of your business, enticing institutions to invest through your funds of funds?

The fund-of-funds sale to institutions is certainly not an easy sale, post 2008. It was much easier pre-2008, pre-Madoff, and so on. That said, given the fact that we have survived, that we've grown the firm continuously over time, and that we do have a good quality image, it's certainly been less of a challenge for us than it has been for some of our competitors. I am very pleased that we have never really shrunk as a business despite going through what was probably – or hopefully was – one of the most difficult periods in investment history. I think what we're offering people has some real merit to it and has real appeal. But clearly, people still have to get over the stigma that Madoff attached to funds of funds. In particular, niche, specific area, funds of funds, such as ours, which are very different than what people typically think of when they hear "fund of funds", actually have a very valid purpose, even for sophisticated institutional investors.

Which is?

We have a high level of expertise in our one particular niche, value investing. It would be very hard for even a major institution to put together a staff as expert as ours in this one niche. They just can't afford to do it. It doesn't make sense from a business model point of view. As I try to point out to people, if you have a high level of expertise in an otherwise inaccessible investment niche and you can offer an institution a good – reasonable – return that also diversifies their portfolio, a fund of funds like ours makes a lot of basic sense. But you have to think about the fund of funds concept in an objective way, as opposed to in the more subjective or emotional the way that many people have been thinking, post-'08.

Is the fact that trading these days is dominated by short-term and black box quant strategies making it more difficult for you to sell institutions on something as long-term and patient as value investing?

Well, most of the investors interested in what we do have a bias against black box types of investing. And there are plenty of those investors out there,still. A lot of people, correctly I think, view quant strategies as very difficult to monitor, to control, to assess the risk of. So there's a big group of institutions that really stays away from quant investing. Those institutions certainly are potential clients for us. As I see it, that there are two segments of the investing world out there. There's one seg-

ment that believes, in order to make excess returns, the investment process has to be really, *really* complicated. And hard to understand. We don't tend to deal with those guys. The other segment of the world realizes that actually you can do some very, *very* simple stuff and outperform – just because you're an original thinker and not doing what everybody else is doing. That's really our home niche. I've been in both camps in terms of my investing history and what I always tell people is that quant investing is intellectually challenging and fun, if you have that sort of mind. The problem is that it's a gerbil-on-a-wheel type of approach. You always have to be running faster than the next guy, if you're going to earn excess returns – and there are lots of gerbils out there that you can hire.

I can imagine quite a few quants taking umbrage at being compared to gerbils.

I don't know, I've always had a soft spot for gerbils. My first business was raising gerbils, which is actually a terrific business because they definitely procreate quickly! Unfortunately, I was put out of business by my pet cat who decided one day to open all the gerbil cages. My mother didn't think it amusing to come home and discover a couple of hundred gerbils running around the apartment! But it was very profitable. The economics of that business were probably the best I've ever run into. I remember buying my first gerbil couple for $14, which I thought was an outrageous amount of money, at **Lampston's** and then breeding them away.

I'd say you had a very indulgent mother!

Well, I was an only child. But my point was that it's very difficult to maintain your edge over time, if you're a quant. Remarkably, a few firms have managed to do it, but it's really very hard work. In a sense, it is much easier to do what we do and what our managers are doing. You just have to have the right outlook on the world. If you have that, making money is still work, but you don't have to continuously reinvent yourself, which is what you have to do if you're on the quant side. A good value investor basically has one skill set, which is being a contrarian thinker and then he just has to find examples of where the world has gotten the story wrong.

And have the fortitude to wait for it to wake up! Do you find it at all ironic that for all their complexity and sophistication, most quant models seem to hinge in some way on the Efficient Market Theory, which as you said is deeply flawed?

The way I would prefer to say it is that markets are definitely inefficient part of the time and there's no question about it. No matter how efficient a given market is, there still are significant inefficiencies. If you're talking about U.S. and European markets, which are the most well-developed and most efficient markets, a lot of people would contend that their inefficiencies are very rare. But as 2008 yet again demonstrated, there actually are plenty of inefficiencies, and sometimes there are *huge* inefficiencies, even in comparatively very efficient well-developed markets. Those inefficiencies create huge opportunities for people who think about inefficiencies. The reality is, if you *really* believe in CAPM, then you are saying that a vast percentage of the money management industry should go away.

Absolutely. But that's no way to win friends and influence people in Wall Street.

Because if that's true, people are being paid outrageous amounts of money to create what effectively are indexed funds for their clients, right? We believe, on the contrary, that there really are some great inefficiencies out there. If you are clever, you can take advantage of them and you can produce significantly increased returns as a result.

Of course, events like 2008's don't happen very often, thankfully.

Which is why, on the one hand, having managers of small funds is important in the more developed markets. It *is* true that over time, the inefficiencies in well-developed markets do tend to get – *in the typical case* – smaller and smaller. But if you're only putting small amounts of money to work with each manager, there are always going to be some niches of inefficiency for your managers to exploit. On the other hand, if you're trying to put large amounts of money to work in a value strategy you need a 2008 – and 2008's don't come along all the time. Then again, in the less-developed markets like those in Asia, you again need to put small amounts of money to work – simply because the markets are small. You just can't put huge amounts of money to work in a market like Indonesia or Malaysia because otherwise you'll end up with an index fund. You're not doing your clients any favors if you're trying to put billions of dollars to work in a market where the total market cap is a few billion dollars.

And where the locals specialize in taking advantage of the –

– naive foreigners. We always try to be ahead of the curve, so it's a big warning sign for us when a market starts to get "attractive".

You started your domestic fund of funds in 2004, but your international ones are of newer vintage, aren't they?

Yes, we added the van Biema Global Value Fund in 2006 and then we enjoyed a bit of propitious timing in adding the Asia fund, van Biema Asia Value Fund, in August of 2008.

***Propitious*, in August of '08?**

Well, that was actually when one of our large existing clients seeded our Asia fund. But the deal that we make with our clients is that we get the discretion to draw down the money that they give us over a period of time, as appropriate. So even though the fund was seeded in August of 2008, which potentially would have been a terrible time to put money into the markets, we actually didn't put most of the money into the Asian markets until January of 2009. We let it sit there for a while.

Was that luck, or good timing?

Our timing was a combination of two things. I always used to tell my students that you need three things to really be successful in life: You need good timing, good luck and good looks. We had two out of the three. I'll let you guess which two. But things worked out nicely for our Asia fund of funds. We don't claim to be macro investors because we are value investors and macro strategies are sort of contrary to our discipline. But we do claim to try to be reasonably intelligent about when we put money into markets and we try not to put it in at the absolute highs – we try to put it in at the absolute lows, if we can do that. Not that we think we're going to get our timing absolutely right, obviously.

How are your assets under management allocated across your funds now?

The majority of the money is in the U.S. and Asia funds; they are our two big funds of funds, at roughly $350 million, each. Our global fund is quite a bit smaller.

Where are you most anxious to add managers so that you can invest more assets? In other words, where do you see the best opportunities now?

In Asia. We think that our model has worked *really* well in Asia because there are many fewer value managers in Asia – value investing, as a strategy is not as well-known in Asia as it is here. Asia is very much a growth-focused market, for all the obvious reasons.

It's also focused on gambling – speculation. And developing markets are, by definition, less-than-efficient, as you said.

Right, right. That creates huge opportunities for us because there are goodly numbers of Asian companies that are good companies, strong-franchise businesses, well-managed businesses – but that just happen to be growing somewhat more slowly than the target levels of growth that most people are looking for in Asia, for one reason or another. I mean, how many times have you interviewed an Asian investor and heard the first few words out of his mouth be something like, "And the great thing about my portfolio is that everything is growing at 20% per year, at least"?

I've lost count.

I'll bet. There are some *great* companies in Asia that are growing at 8% to 15% annual rates. But because they have these sub-par growth rates – or, rather, what are *considered* sub-par growth rates – the markets really punish them. They are generally neglected and disdained by investors. I frequently say that value investors do what I call "Statue of Liberty investing". In other words, give us your poor, your forgotten, your unloved. That's what we're looking for – and in Asia there are a lot of great companies that fit that description. We can buy companies in Asia at three to six times free cash flow that have dividend yields of 6% or more. So we're getting paid to wait around for the companies to revalue. And, eventually these companies *do* revalue.

Why, in markets so fixated on growth? You're not banking on that changing anytime soon, are you?

No, but these are good companies operating in such a high-growth environment that the growth catches up to them in some way or other. They'll come out with a new product that will be exciting or they'll move into a new market. I'll give one example. We invested in a company that maintains the conveyor belts at airports. The only problem was that the company is located in Singapore. At the time we invested in it, it maintained the conveyor system in the Singapore Airport. That was not a

high-growth market because there's only going to be one airport in Singapore for the rest of time, as far as I know. But it was an attractive company. It did a great job maintaining its one little conveyor belt system there and it threw off a lot of free cash flow. It was very profitable because it was basically a monopoly business in Singapore. Still, nobody paid much attention to it because it was not a high-growth, sexy Asian type of business.

So what changed?
Finally, they ended up getting one little contract to maintain another airport conveyor belt – in Western China – and all of a sudden, investors decided they were going to be *the* maintenance company for the next 25 or 50 new airports that were going to be built in China. **Goldman Sachs** picked up coverage of the company; the company's P/E went from 5 to 15 to 25 to 30. We, of course, were long gone by the time it hit 30, but my point is that this is *not* an atypical story for our fund managers. These little gems are out there, if you have the patience to buy them and then just sit around and wait. But you're getting paid to wait, so it's not so bad to wait. The opportunities in the area are great.

Are the fund managers you depend on to sniff out those kinds of stocks locals, who can navigate Asian markets much more easily than someone operating from here?
Yes, all of our Asian managers are in fact people who have either grown up in Asia – are Asian – or they are U.S. or (mainly) British ex-pats who moved over there years ago and worked for some of the big ex-pat brokerage houses before setting up their own little funds. They are very plugged in. We don't invest with the people who invest in Asia from London or New York or L.A. We don't think that is an attractive way to do it. Besides, those firms – because they have to have infrastructures both here and in Asia, typically tend to have much larger amounts of capital under management. Therefore, it's harder for them to invest in the types of smaller cap companies we find really attractive.

A lot of Asian markets are notable for their volatility. Doesn't that make it more difficult for your managers to hold for the long term, as value investors are supposed to do?
It's interesting that people develop these investment phobias – and any list of current market phobias certainly has to include volatility. People *hate* volatility. But the reality is –

You need it to make a buck.
Exactly. The reality of the situation – in the Asian markets in particular – is that volatility is your *friend*. There are some great companies over there and without the volatility you would never be able to buy them at a cheap price. The volatility actually creates the opportunities in many of these countries. Take India, which frequently can be highly valued for long periods of time, but then hits a bump in the road. That's when you get the opportunity to buy some of India's great larger companies at attractive valuations. Let me be clear. We don't buy *only* small cap companies. We will also buy some of the larger cap Asian companies when volatility creates great opportunities. You're usually not going to get those things really *cheap,* but occasionally they will come down in price enough to become a good value investment.

How has your fund of fund arrangement worked for your managers? Have you had much turnover?
We have had relatively low turnover. At the fund of funds level, we basically practice value investing with people, as opposed to with equities. We try to pick portfolio managers who we think are really good and, hopefully, we're right at least a decent percentage of the time. For us, typical turnover is one manager per year per fund, which is not a lot.

Is that mostly because of good news — as in stellar performance makes them too big, or bad news — as in lagging performance?
A combination, really. Our most frequent reason for turning over a manager is that we find somebody who we think is even better. We are always looking at what our current portfolio is and asking, does anyone else do something that's similar to a manager we already have – and do we think that they're even better at it? But we also do occasionally turn over a manager if he gets too big, in our view, to deliver the type of returns that we're looking for. Size is always a consideration.

I know this is a question value investors hate, but what's your take on the market outlook? How do you see the rest of the year playing out?
The reason we hate this question is because no real value investor believes that he has a good answer to it.

I *know*, you can't forecast the market—
My answer is that is one of our fundamental beliefs and we try to stick to it . What I think

makes many of the guys who are on my board so successful is that, in spite of the fact that they've had highly successful long-term careers in this profession, they maintain strong levels of modesty. We tend to believe that as soon as you *think* that you have the market figured out, it will prove you wrong.

It's often a very humbling business.

Plus, these days the other thing I'll say is that governments – ours and others – have their hands so involved in the overall economies of the world that if macro was nearly impossible to do before, if anything, it's even more impossible to do now. Not only do you have to sort through the macro fundamentals going on in the world, but on top of that you have to figure out this overlay, where governments are playing lots of games with us. If you think you can predict what politicians are going to decide to do, more power to you. I don't really have a clue.

You mentioned that your value managers' portfolios don't tend to contain overlapping positions. But in looking across them, can you detect any themes?

Yes, they're being extremely cautious. In terms of valuations, they are trying only to buy things that are really, *really* cheap because there is so much flux out there in the system as a whole. In the past, when they might have felt that they had something of a handle on the status of the economy – that the economy was good or the economy was improving or even that the economy was bad or getting worse – they might have made different sets of investments. Now, they're really just trying to buy things that they feel are fundamentally so mispriced that – no matter what happens on the macro basis – they're still going to do pretty well. But that does reduce the opportunities they are finding. So we have higher levels of cash in the portfolio than we typically have had at many times in the past – with the exception of the end of 2007. That's clearly an indication the managers are having trouble finding stuff that they feel comfortable buying.

Your fund managers are holding more cash than they have at any time, except at the peak of the credit bubble? How close to that peak are they?

I'd rather not get into specific numbers. But they are moving in that direction.

I'm guessing that as good value managers, they held *a lot* of cash back in late '07.

Yes, they had high levels of cash at the end of 2007. And in moving in that direction now, they are being very, very cautious, which is not at all unreasonable. One thing I will say is that, in general, corporate America is in pretty good shape. If the economy were to turn up significantly – or turn positive, period – American corporations would be very well-positioned to take advantage of that. They have done a very good job in terms of cost cutting and improving their productivity and so on. The big question is *if and when* the American economy will *really* turn around. When we continue to have these little exogenous shocks, as we've been having recently, it makes it even more impossible than usual to predict anything.

Isn't that always the story of the market?

Right, the future is only clear to weathermen.

And their batting average isn't acceptable even to investors! Yet there are lots of folks arguing here that stocks are cheap.

There certainly are, as always, *some* stocks that are cheap. But is the market generally cheap? We look at the Graham and Dodd P/E Index or what now has come to be called the Shiller Cyclically Adjusted Price Earnings ratio, or CAPE, and according to that, stocks are not in general cheap.

Nor are they cheap based on Tobin's q-ratio, as Andrew Smithers likes to point out—

Well, I prefer to measure valuation in terms of average historical P/Es over the cycle, rather than the replacement cost of assets. But either way, stocks in general are not cheap here.

Thanks, Michael.

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