Katsenelson, Vitaliy – Active Value Investing

Wiley & Sons, 2007, [Equity Investing] Grade ★★★★★

Reading this book in 2007, it had an immense impact on my thinking. The gravitating pull from valuations in a range-bound market – one of the book's core ideas – nicely interlinked with the identification of great franchises. *Active Value Investing* also hit home in a few other ways; it dealt with the "dirty" topic of general market valuations and it was written by someone (then) outside the normal investing guru entourage. It also introduced an attempt to put the selling decisions on par with buying, both equally deserving of an articulated strategy. On top of that, the book goes into considerable detail explaining the "QVG-process" (Quality Valuation Growth) of evaluating potential investments, distancing the book from other more theoretical tombs. Finally, it is written by someone who cares about his reader, carefully nurturing every word like he is afraid the reader might otherwise lose interest, put the book down and thus miss all the goodies presented in the next chapter. In short, it is a book which most certainly will be seen in bookshelves of investing die-hards 50 years from now.

Re-reading the book cover to cover again, the first impression has lasted. Part I is an impressive tour-de-force into why we are in the age of a range-bound market, broadly estimated to last between the years 2000-2020. Written in 2007 with the markets at around ATH it took considerable cojones to make his argument as forcefully as the author does (as can be said today again). The importance of the range-bound market concept is needed to set the stage for the practical application of bottoms-up value investing techniques. Katsenelson is clearly concerned the pure value investor might cringe seeing this focus on the broader market. But he shouldn't be. A core commandment of the valuation minded investor is arguably the belief around the equity markets being a market of stocks rather than a lump-sum stock market. Hence, this part is crucial to all active investors except the buy-and-forget-to-sell crowd that tend to grow in times of pro-longed bull markets. It is hard not to nod in approval while the author builds up the reader's knowledge and appreciation for market cycles. And range-bound markets occur more frequently than you might think; about half the time in the last 200 years. They are characterized by falling PEs but rising profits, resulting in flattish total returns for investors (average is 0,6% real p.a.). They can be seen as a sort of "payback markets" as investors need to pay back in declining PEs for the excess returns of the preceding bull-market. An important caveat is exactly that; the author separates what he terms cyclical markets within the longer pull-and-tug between secular markets, whose average tenure is 17 years. The question is if it will remain so, with the rules of central banking being re-written as we speak, ushering in a new cast of intervention-prone actors in the monetary play, funnily enough correlating with more boom-bust cycles than ever before.

But, equity market cycles have been brilliantly illuminated before. It is in Part II – the practical applications section – being introduced to the QVG framework, that my scribbles, notes and references occupy almost every page. It is truly shared knowledge and very transparent – a practical guide more than anything. First and foremost, QVG treats investing as stock picking one company at a time, rather than pushing stocks into themes or styles, like sheep into their designated hemming. Fastenal was not a great investment because it ex-post fits into 2-3 quality criteria; it was a great investment because of corporate execution, a thriving market and a juicy starting valuation. Mr Katsenelson's tools help separate the two. The sheer work of gathering numbers, painting a 20/20 vision and doing so in a language far from the typical dry finance-lingo deserves no less than top accolades. Add to that a suggested framework to incorporate into company research, and the only question remains: Do we have to wait until the year 2020 for Active Value Investing, 2nd edition?

Henrik Andersson, June 29, 2014