

Shearn, Michael – The Investment Checklist: The Art of In-Depth Research

John Wiley & Sons, 2012, [Equity Investing] Grade ★★★★★

The mind constantly plays tricks with investors. In a stressful - potentially loss-making - situation the negative pressure risks short-circuiting our analytical ability and when looking at new investments greed makes the investor susceptible to buying into management's song and dance when showcasing the benefits of the company. No matter how experienced you are as an investor you will always benefit from having a checklist that breaks the spell of the moment and ensures that positive and negative aspects of the situation are covered. It will - if well crafted - also make you focus on the few important key issues of the investment. Further, realizing that there are issues that you don't have answers to can also be of huge value as warning signs. In *The Investment Checklist* Texas investor Michael Shearn shares the checklists he has been using for the last decade when researching new investments. The author's purpose is to teach the reader what he needs to know about the companies he thinks of investing in and help him to evaluate if the company is worth the investors money or not. While not explicitly stated as a target group I think the book will help the franchise type of value investor the most.

The book kicks off with a chapter on how to generate new investments; basically describing a search for bombed out, low multiple, deep value stocks where investor pessimism rules but the problems at hand might be temporary. Then the rest of the text covers a list of topics to be analyzed. They could be; the strategic and operational strength and weaknesses of the company, the financial strength of the business, the growth opportunities, the track record in M&A etc. Most chapters consist of a number of checklist questions with a subsequent paragraph discussing the topic. One of the impressive features of the book is the focus placed on corporate management. More than a third of the book discusses how to analyze the executives in charge. To me this is one of the trickiest areas in investing

so even if the text in itself isn't revolutionary the focus is well deserved and it is relatively rare in investment literature. Overall, he who reads through the chapters will be rewarded with plenty of wise thoughts on how to evaluate a company.

Even so, the book isn't a jackpot in my mind. The analytical methodology an investor uses should be tailored to the type of investment opportunities he is looking at and the investment style he uses. This checklist to me feels a bit too generic with the inherent risk that it will not be perfect for anyone. For example, take the bombed out type of stock from the opening chapter, if I researched this the task would be to understand what will change to the better and my focus would be: a) What is the risk of the stock being a value trap? i.e. is the sector or the company in structural decline and is the current shareholders equity or earnings therefore not representative of the future? b) Are the finances strong enough to sustain a prolonged period of weak cash flows before an improvement occurs? c) What could be the triggers to the turn around? i.e. what will change to make things better? d) And what will the normalized financials look like? An analysis should zero in on the key issues for the type of investment at hand. A lengthy analysis of the quality of current management might not be as important. Getting rid of them might even be the trigger needed. Another thought is if there couldn't be a way to quantify the results of the analysis. A checklist is never an exact yardstick to go by. Even so, I think a numeric rating of the issues can help an investor in his thought process. At least it has helped me.

For the long term investor a deep fundamental understanding of the business of the companies he owns is crucial. Without it he will lack conviction and will risk selling due to market volatility, potentially missing the structural improvements underway. This checklist will take you a long way in gaining understanding but the last touch on how to build your own checklist must be up to you.

Mats Larsson, September 14, 2014