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Takeaways from Best Ideas Omaha 2018
Value Investing Insights and Ideas in Asia
Interview with Fernando del Pino
Interview with Tito Avila and Mathias Wagner

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Fernando del Pino on Business and Investing in Spain and Beyond

We recently had the privilege of interviewing Fernando del Pino for the second time. Our first exclusive conversation took place in early 2014 (it is reprinted a bit later in this issue).

MOI Global: In our first interview, you stated that you invest in undervalued assets globally. Do you have a specific sector or industry preference?

Fernando del Pino: My investment style is somewhat eclectic: there are no boundaries in terms of geographic location (excluding exotic markets where I don't feel comfortable), market cap (provided a minimum of liquidity), business quality, industry or currency. I look for asymmetric risk-return situations, where potential upside is way bigger than potential downside, and where risk is defined as permanent loss of capital (losing money without hope of recovery), and try to avoid overstretched balance sheets.

Where do investment returns, the upside, come from? Schopenhauer, the German philosopher, differentiated between what a man is (his personality, health, strength, moral character, intelligence, and education), what a man has (his property and possessions of every kind) and what a man is in the eyes of his fellowmen (shown by their opinion of him, manifested by the honor in which he is held, and by his rank and reputation).

By the way, the philosopher arrived to the conclusion that happiness is to be found, to a very large extent, only in what a man really is, and showed some surprise about the fact that "people in the highest positions in life, with all their brilliance, pomp, display, magnificence and general show" thought that the key is "what lies in the heads of others" – call it their beloved image or reputation, a minefield full of hypocrisy, dependency and untruthfulness (so whenever you hear someone placing an undue importance on reputation, beware).

Well, in the case of stocks, we only have two factors instead of three: what they truly are (their assets, economics, competitive position and general prospects, so called quality) and what they are in the eyes of the market (their market price, so called quantity, Graham's market's voting machine, which measures their current popularity). In the case of stocks, "happiness" (high returns) comes from a combination of the two with a preponderance of the valuation factor. Being right on the quality side is more difficult and more subject to uncertainty, and, therefore, a less reliable factor than being right on the valuation part, where human nature, who will never change, projects ad infinitum recent events and go to extremes of excitement and despair.

Therefore, my first point would be that buying cheap remains the key factor for profitable investing. It should be stressed that attractive businesses do not always imply attractive stocks, and sometimes unattractive businesses provide ample returns. Even when growth is negative, a cheap enough stock can become a profitable investment. Remarkably, this is anathema today.

At the same time, one should try his best to make sure quality doesn't go against him with a permanent change in business economics, industry trend or competitive position that might significantly erode its historical profitability; in any case, one should rely heavily on the valuation side to compensate for errors of judgement on the quality side. But again, that's how I invest. Other investors follow different paths and achieve great results. Good for them. It's very important to invest in accordance to your temperament, needs and goals in life.

In a sense, investing is about choosing among pains, because in investing pain is everywhere: the pain of having a temporary paper loss or a permanent loss of capital, the pain of making less than the guy next door, the pain of regret for deciding not to invest in what subsequently proves to be a great investment, the pain of sizing incorrectly (having invested too much if it proves wrong, too little if it proves right), etc. In a word, investing has a lot to do with knowing yourself.

My second point would be to emphasize that we can never talk about valuation without mentioning the expected return to be obtained if we were to invest at such valuation. Therefore, if someone says that a certain business is worth X, he should in all fairness specify which return is to be expected if we bought the stock at X. Valuation without expected IRR is a lame concept. However, nearly all investors forget to state such information.

MOI: Where are you finding investment opportunities?

del Pino: I never talk about my portfolio. I apply here the dictum that you are the slave of your words and the master of your silences. I hasten to add that today's markets remain hugely expensive for historical standards. To a large extent, central banks' unusual interventionism is to blame, as was to blame in the Great Debt Crisis that exploded in 2007-08. Therefore, caution should be paramount these days.

Don't take my word for it, but Philip Carret's: "when stocks are high, money rates rising and business prosperous, at least half a given fund should be placed in short-term bonds". Some small pockets of undervaluation have emerged, probably the first signs of cracks in this ageing bull market, who knows. Also, some exposure to gold is warranted, in my opinion.

MOI: How do you think about portfolio concentration and what is your take on cash?

del Pino: The difficult task of outperforming the market in the long term (I could call it alpha, but I increasingly detest these pedant Greek words that pretend to make complex what is so simple) is related to concentration (sizing) as compared to the index, or to having the right asset allocation in the shorter term (say five years). Leverage (through debt or through insurance float) is the other important factor of outperformance, although I would not recommend leverage to anyone (in fact, I am quite allergic to debt).

I don't specifically mention pure stock picking as an usual factor of "alpha", as I am of the opinion that only a very tiny number of investors have such ability in the sense of being able to choose one stock of each and every industry, weigh it exactly like the index weighs the industry (when constructing the portfolio) and expect to outperform the index.

Let's take Buffett, the richest investor ever, and three of his most well-known long-term holdings: Coca-Cola, Gillette/P&G and American Express. Well, Pepsi would have been proven a slightly better investment than Coca-Cola (since 1988), Colgate would have been a better choice than Gillette/P&G (since 1991), and Visa or Mastercard, of course, have had several times the return of American Express (since the formers' respective IPOs). These data shows us that one can achieve great results choosing the right idea or industry and not necessarily the best stock, and secondly, that buy-and-hold forever (forever is a mighty long time, as Prince used to sing), practiced in reality by no investor I know of, makes little sense, as change happens and nobody has super powers.

Low turnover is clearly the right beacon for all investors, so a five-year average holding period is usually better than three and much better than one. However the holding period not only depends on the investor's willingness to hold but on how fast Mr. Market loses his marbles, so clinging to a stock when it has reached a nose-bleeding price for the sake of long term fanaticism is absurd, in my view.

Now, regarding the always important question on concentration and diversification, if we hold thirty stocks of the same industry and country we might have eliminated individual risk, but that's not what I'd call a diversified portfolio. Sizing remains one of the unexplained success factors in the investment field (the other being the sell strategy). I would say that in general asset managers exaggerate diversification because of the perverse incentive system put in place by clients' real desires. On the other side of the spectrum, those investors who pretend to imitate Buffett or the outstanding Lou Simpson are way too concentrated to my taste. A few of these suffered greatly in 2008, promised themselves to avoid excessive concentration in the future but, human nature being what it is, soon forgot the lesson.

Following Ben Graham, I would say that for most investors a portfolio of thirty securities belonging to different industries and, preferably, markets, might provide enough diversification and not too much diversification. In this sense, the asset management industry should be more honest: if you brag with your clients that you dig extremely deep into businesses, you can't have 150+ stocks in your portfolio. Also, if you boast that you place a great importance on competitive advantages, "moats" and stuff, that's incompatible with having two or three years' average holding period, in which the effect of supposed competitive advantages is insignificant.

If we are talking about the shorter term (say five years), asset allocation is key, with all its dangers and shortcomings. In this sense, except for some two-tier markets such as in 2000, in panics all stocks tend to nosedive together. The cheapest will bounce back much sooner, but I think it's unrealistic to expect your portfolio to hold when the market tanks 50%. In this case, and provided you don't hedge, only uncorrelated assets can provide diversification, psychological relief and the courage to act at the right moment (meaning pricing, not timing).

Cash (and sometimes bonds and gold) is one example: always wrong from a strategically point of view, cash is sometimes very right from a tactical point of view. I think that today is one of those cases. However, the stupid, illogical and extremely dangerous negative interest rates we still see in some parts of the world make it very difficult to hold cash in such currencies (in fact I would say it is morally unacceptable to hold cash and pay for the privilege of it).

MOI: To what extent is the concept of "circle of competence" important to you?

del Pino: Look, investing is hard enough as to impose to yourself additional burdens limiting your activities to certain areas. Even Buffett has invested in many, many types of sectors and industries: banking and financial services, insurance, telecom and media, prefabricated homes, all types of industrials, rail freight, airlines, materials, utilities, energy, retailing, consumer staples, consumer discretionary, automobiles, pharma, technology, etc.

There's research that shows that Berkshire held 230 different stocks from 1980 to 2006. It goes without saying that 230 stocks will probably cover a large part of the market. By the way, according to this study, which doesn't appear to be market-cap weighted, only seven of those stocks were held for longer than twelve years (the core holdings), while the average median holding period was one year, a number that honestly surprised me. I would say that my only circle of competence is valuation-based: I won't touch what appears expensive by any rational standards regardless of perceived "quality" or future prospects.

MOI: On your personal blog, you write about political issues, including economic policy. Should investors take into account such policies in the countries in which they invest?

del Pino: Unfortunately, there seem to be few oases out there in terms of governmental common sense. Economic policies of any government in any democracy seek just two goals: the first is election; the second is reelection. There's no number three. We are witnessing the decay of democratic systems everywhere, a disturbing development of which the Welfare State is a clear symptom. As a matter of fact, most economic policies belong to the kick-the-can-down-the-road category, avoiding pain for the voter and creating the figure of the voter-tyrant, a spoiled child that believes the whole world is there to serve him, someone who severs the link between effort and reward (in that chronological order), and considers it is his right to demand ever increasing largesse from other people's pockets.

Almost no government takes the bull by the horns because almost no voter really wants that to happen, and therefore, the system has been abused by nearly all politicians in nearly all democracies, which have slowly decayed into demagoguery and the adulation of the masses, as Aristotle warned nearly 2,500 years ago, a process in which many more promises are made than money is available to fund them. For those promises that have not been fulfilled, the outcome is enormous frustration. For those promises that have indeed been fulfilled, the outcome is a gigantic amount of debt. We now have both, and this is a clear and present threat to liberty. If we are to remain free, we'd better keep our capacity for critical thinking alive, look at the leaders' deeds, not at their beautiful words, and think for ourselves instead of swallowing full the message conveyed by the media. Finally we can turn to the man in the mirror and wonder whether the problem is not in our leaders but in our selves: maybe we lost our values chasing happiness where it can't reside and forgetting that only the truth can set us free.

For the sake of being more specific, in my view the greatest danger are central banks' policies, which risk destroying the whole system by destroying the confidence on our currencies and financial system, encouraging reckless behavior and allowing the advent of dangerous leaders. Such policies are sowing the seed of social unrest and financial chaos. Central bankers, with no crystal balls (usually with no balls at all to bite the bullet, if I may), average intelligence and below average contact with reality have received too much power, and that doesn't bode well. Also, they have no skin in the game and are subject to no accountability. With such a perverse incentive system, we should worry. Finally, I think the close relationship between central banks and financial institutions is dangerous and paves the way for inside information, as too much money is involved. Surprisingly enough, the light and controls that governments are subject to are not felt by central banks. Why they remain considered like pristine high priests endowed with superhuman clairvoyance is a mystery to me.

MOI: What do you think about the "boom" of value managers in Spain?

del Pino: I am glad that Spain has broken the historical monopoly that the banking sector had on asset management. This is great news, since that monopoly usually resulted in high fees and mediocre performance and left clients at the bottom of the list of priorities, so the emergence of independent value investors bring some healthy competition and incentive systems more aligned with investors. I feel comfortable talking about two firms whose managers I know and who are true asset managers, not asset gatherers (this cannot be considered an endorsement and investors should perform their due diligence as adults). Of course, there are other independent value managers that might excel, but I don't feel familiar with them.

The first would be Magallanes Value Investors, where CEO Blanca Hernandez and CIO Ivan Martin have created a great environment with the right ideas and investor-centered incentive systems (full disclosure: I belong to their Advisory Board). Blanca has one of the broadest experiences I know of dealing with risk-conscious, performance-oriented, independent investment managers from around the world and separating the wheat from the chaff. Grounded on such experience she partnered with Ivan, who though young had the right mental framework and a nice track record, and created their firm. Ivan has good old-fashioned horse sense, is humble and serious, talks little, observes a lot, takes notes and learns continuously, and is able to evolve independently from the value investing industry fads.

The second firm is azValor Asset Management, founded by my friend Alvaro Guzman and other two partners. They are incredibly deep, self-confident and serious analysts with a proven, long and outstanding track record, people who also put their client's interests first and do not pretend to become stars. I like their values. They also keep an eye on what happens around them in terms of overall market valuation or other external significant trends. Anyhow I would say that as a whole most independent value managers will fare better than the vast majority of banks, which still cling to the tradition of intimidating and dumbfounding their clients with the usual macro blah, blah, blah that promotes turnover and less-than-smart decisions that often end up in frustrating long term returns.

MOI: Since our last interview, what new books have you found insightful?

del Pino: I love reading! I would mention the rereading of the 17th-century classic Robinson Crusoe, which on top of the well-known adventure part, is mainly a reflection on solitude, life's important priorities and God's providence.

I read a lot about World War II, one of the least understood wars in history, and I have recently enjoyed Europe at War, by Norman Davies, and *Hitler's Charisma: Leading Millions to the Abyss*, by L. Rees, a remainder that desperate people may elect wrong leaders (mirrors of the people's fears and desires at the time) and how democracies can suddenly change and destroy liberty. Richard Maybury's outstanding little book on WWII is also worth mentioning.

On psychology I would recommend any of Elizabeth Lukas books on Viktor Frankl's logotherapy.

On spirituality, *How to Live Nobly and Well*, by E. Garesché and *An Introduction to the Devout Life*, by St. Francis de Sales.

On business, Henry Ford's autobiography is fantastic, and is François Michelin's *Et pourquois pas*?

On investing I have reread *The Intelligent Investor* and read Sam Zell's *Am I Being too Subtle*?

MOI: What advice would you give to young people in the investment world?

del Pino: That's an interesting question, although I consider myself pretty young and don't have any remarkably long experience. It's always a responsibility to give recommendations provided how many mistakes one has made through the years. Also, investing styles differ, and what works for me, biased as I am by my character, my hopes and fears, my background, my circumstances, my beliefs and goals in life, might not work for others. Furthermore, investing is always work in progress, failing and learning continuously and sometimes even starting anew every now and then.

However, if I had to give some suggestions (rather than advice) here to nascent investors, I would focus on three things. The first is a piece of advice which they won't find anywhere else, contrarian as it is: they should de-Buffettize, if I may put it this way. Why do I say this? In the 2017 Daily Journal AGM, Charles Munger chose some strong words: "you come here as a cult to talk to the cult leader", and then went on explaining in a funny way why such leader (himself) wasn't that admirable. Although he was referring to Daily Journal and not to Berkshire, his choice of the word "cult" was a clear wake-up call to me.

If you step back to attain perspective, it's fairly easy to see that Buffett's weird worshipping phenomenon has gone a bit too far and I don't feel comfortable nor consider it healthy to idolize anyone (in general I prefer to march to the beat of my own drum). Extremes are never good.

De-Buffettizing doesn't mean not learning at all from such a successful investor. That would be absurd. It means to limit the admiration to his "circle of competence" (financial prowess) and not to other areas of life where he does not necessarily have any special track record and, in general, to take it easy and relax. Relax regarding buy-and-hold forever, relax regarding competitive advantages and stuff, relax and stop repeating like parrots expressions like circle of competence, moats, or being "agnostic" about something. Relax because Buffett's style reflects his own experience, his temperament, his genius and, most importantly, the peculiar Berkshire's system as investment vehicle, biased by its huge size, its leverage (through the insurance float), and the control over FCF from closely held businesses. His style, that has worked extremely well for him but has evolved to adapt to Berkshire's peculiarities, might not be suitable for the vast majority of investors.

In general, as free individuals we should try to always think for ourselves and resist being intimidated by wealth, fame or high IQs by any persona in the public eye, be it a politician, a corporate leader, a journalist, a writer or a thinker. Again: take it easy.

Also, I would encourage digging into Berkshire's numbers to learn the two distinct periods it has gone through, with vastly different returns. In this sense, Munger's letter to Berkshire's shareholders in 2014 is indispensable reading: "In the early decades of the Buffett era, common stocks within Berkshire's insurance subsidiaries greatly outperformed the index, exactly as Buffett expected. And, later, when both the large size of Berkshire's stockholdings and income tax considerations caused the index-beating part of returns to fade to insignificance (perhaps not forever), other and better advantage came. Ajit Jain…"

From 1978 to 1997, Berkshire's book value and market value per share increased by roughly 27% and 34% per annum, respectively, versus ca. 16% for the overall market. However, since 1998 (the last 20 years, a mighty long time) book value has increased around 11% p.a. and its market value has increased 10% p.a., vs approximately 9% for the overall market (S&P 500 equal weighted, my favorite US benchmark). But what really matters for investors (not for Berkshire's shareholders) is Berkshire's public portfolio of securities (a truer measure of pure, unleveraged investment results, unaffected by underwriting results and float leverage).

In this sense, according to an interesting AQR piece of research, from 1976 to 1985 Berkshire's stocks outperformed the market by a mind-blowing 20% p.a. However, from 1986 to 2011 (26 years) Berkshire's public U.S stocks achieved an annualized return that was just ca. 3.5% higher than that of the overall market (indistinguishable from the historical value premium); from 1996 to 2011 (16 years), the outperformance was just 1% p.a.

We don't have data for the period from 2012 to 2017 (in contrast to the more transparent Prem Watsa's Fairfax, Berkshire's Letter never discloses the IRR of Berkshire's investments, just the cost and its current market value, omitting the date of purchase), but Berkshire's book value growth in these recent years has underperformed the market.

Are there additional factors beyond size (a constraint, by the way, that most investors do not have and should not care about) that explain the "index-beating part of returns fading into insignificance"? I boldly venture two.

One might be the trap of consistency: fame (and the subsequent, inevitable dependency on the applause of the crowd) exacerbates being a slave of one's words and reduces the degree of freedom of action because of public exposure and image worries. Other might be putting too much emphasis on quality to the point of sacrificing valuation. This might be a useful warning for younger investors: a very dangerous notion has been ingrained in many people and that is that Buffett's long-term extraordinary performance can be achieved by investing in economically profitable large cap companies (mainly consumer staples with brands and competitive advantages) more or less regardless of price (the famous "great business, fair prices" phrase). Such approach would probably lead to high single digit returns at best, half or less than half Berkshire's long term record. Young investors should resist these siren songs.

I know an investor who held nearly one third of his portfolio in a single stock, which was undoubtedly a very high quality business. The market had recognized this in the usual exaggerated way and valued it at ridiculous multiples, but the investor wouldn't sell. Twenty years later, he still holds the stock, which has returned roughly 0% (without dividends) since the previous parabolic peak. 0% in 20 years! Of course, the investor is Buffett and the stock is Coca-Cola. My point here is that, as Buffett recognized in 2014, his best results in absolute and relative terms came from applying more of a buy cheap approach in times past, and that's the Buffett, investor extraordinaire, from whom most investors should find it easier to learn and to profit from. Interestingly enough, human nature being what it is, Buffett's popularity as measured by the attendance to Berkshire's AGM (from 250 people in 1984 to 2,700 in 1994 and a record of 44,000 in 2015) seems to be inversely correlated with his trailing 10 year performance – but directly correlated with his spot in Forbes wealth rankings. This also tells us a lot about today's society's values.

The second piece of advice to young investors would be to take into account that they are probably going to live in an era different than the period lived by any living investor today. Indeed, we come from the tremendous tailwind provided by the disinflationary period since 1980 and central banks' easy money policies and debt-happy mentality. With the eccentric and system-damaging negative interest rates' distortion in place, a hugely indebted world and hostile demographic trends within Welfare States in many developed countries, we are really sailing in uncharted waters where frustration of the masses loom in the horizon. Such a fragile social, political, economic and, especially, financial system points towards a period where boom and bust cycles will probably alternate more often, and headwinds will arguably be strong.

Importantly, we also start from an overstretched stock market which is already fertile ground for another big scare (when and how nobody knows, for sure), but initial valuation being the key to long term market performance means there's trouble ahead. I would say that as of today we should lower our expectations in terms of future long term average annual returns.

My third and final piece of advice to young investors would be to take the money industry, themselves and successful investors and financial stars less seriously. The value added to society of the whole industry of managing money, gathering assets or collecting businesses (like Berkshire) is not too high, and we should be humble enough to recognize this. It does not produce anything nor create too many jobs. It doesn't invent anything to make the lives of our fellowmen easier or more comfortable. That doesn't mean it doesn't play a necessary role in society, but that role is not that important, so (again) take it easy. On the broader scheme of things, I would advise them to remember that money is great in order to achieve financial independence, but beyond that, its real value quickly follows the logarithmic law of diminishing returns.

Let me finish with an anecdote. Benjamin Graham, Buffett's mentor and author of the best book on investment ever written (*The Intelligent Investor*), retired when he was 60 after a very successful career as an investor in which he achieved sort of 20% annual returns, and spent the remaining 20 years of his life doing different things apart from merely making money, alternating between his homes in California and in the south of France, writing, reading and savoring, in his own words, "the world of the mind, from things of beauty and culture in literature and in art". In these final years, a journalist asked him why he had quit investing in the stock market. I leave you with his response in the hope that it might teach you something you won't learn listening to today's society. Graham smiled warmly and said: "why should I try to get any richer?" That's what I'd call wisdom.

For your reading enjoyment, we reprint below our interview with Fernando del Pino from early 2014.

MOI: Please tell us about your background. How did your multi-year involvement with Ferrovial influence your approach to investing?

del Pino: I studied business administration and economics in Madrid and then worked for an American bank for a few years. During my stay there I was asked to start the equity research department in its Madrid branch; a friend lent me The Intelligent Investor and as I closed the book after reading it (or rather devouring it) I decided that was what I wanted to do professionally. Since that providential read, realizing university hadn't taught me anything too useful as far as successful investing was concerned, I have read maybe a hundred other books on investment and a few on behavioral finance, family businesses and strategy. I left the bank as soon as I understood that my realm of analysis would be constrained to only certain sectors within the Spanish stock market. Wanting to invest globally, I then went to work at my father's family office to help invest the proceeds of Ferrovial's IPO, which was soon to take place. After a few months, in early 1999, my father offered me the chance to join Ferrovial's Board, which I happily did; I also joined the Executive and the Audit Committees. My father was the most anti-nepotistic guy you'll ever find and even though the family held 58% of the company's stock immediately after the IPO, at the beginning only three out of the eleven Board members belonged to the family (my father, Founder & Executive Chairman, my eldest sibling, CEO, and I).

After six years, even though I was working with a terrific small team in the family office, had a great relationship with its CIO (my direct boss and a great investor) and had a very pleasant working environment, I couldn't resist the call of the wild and decided to go independent, much to my father's surprise (though he fully backed my decision). Two years later, in 2006-07, I sold my shares in Ferrovial and left the Board, after belonging to it more than eight intense years. I have been managing my net worth as a global value investor since then.

Sitting on the Board and Committees of Ferrovial taught me a lot about how businesses are really managed and how Boards work in the real world, and also about the big challenges they face, such as the immense power of what Buffett calls the institutional imperative, and the permanent threat of group-thinking. I also witnessed the deep, lasting cultural effect of a private business going public, the huge importance of the reward systems and the risks of debt-financed, fast M&A-based growth. I feel very grateful to my father for having given me that fantastic opportunity at such a young age.

MOI: Let's stay with Ferrovial for just a moment: What are the main business lessons you have gleaned from the tremendous growth of the company since the founding in 1952? Ferrovial now has more than 50,000 employees and generated roughly $1 billion in operating income in 2012…

del Pino: Before sharing my personal experience with you, a bit of history is required, because the business lessons I learned are influenced by the very peculiar period of time I lived while at Ferrovial's Board. My father, who sadly passed away in 2008, started Ferrovial from scratch in 1952 when he was 32 years old. He was a very brave man and had a hard youth. A very intelligent and highly cultured civil engineer (he spoke Spanish, French, English and even Latin quite well), he possessed an inquisitive spirit and his was a relentless quest for knowledge. Working extremely hard, he built a large business in a small, poor country, placing a lot of importance on integrity, on two-way loyalty with his employees and on work being well done, running a very tight ship. For the most part of his career, he was debt-averse and fond of always having a sound financial position in order to avoid dependency from banks. Growth was organic until the mid-nineties, based on projects finished on budget and on schedule. In 1999 Ferrovial took a big risk and bought the 407 ETR, a 99-year highway concession in Canada, which turned out to be a huge step forward and a great investment. In 2000, my father retired, being succeeded by my eldest sibling, who had spent his whole career in the business. From 2000 to 2007, Ferrovial engaged in a buying spree with the goal of diversifying away from both the civil construction sector and the Spanish geographical market. Some investments worked well, others didn't. In 2006 Ferrovial bought out BAA, back then the owner of Heathrow, Gatwick and most British airports, in a deal valued at 15 billion euros. I had strong convictions on this deal. I liked the quality of BAA's assets, but I was worried about the credit orgy we were witnessing worldwide, thought that the asking price was far too rich and that the immense amount of debt needed to fund the deal would weigh so much on our balance sheet that it would unnecessarily put the business at risk. I vehemently advocated the opposite strategy: taking a contrarian course, selling assets, raising cash when everyone else was getting ever deeper into debt and taking advantage of the impending, inevitable disaster by buying on the cheap at the right time and price. I was convinced the opportunity cost would be so high. The proposal went through many Board meetings and lots of discussion, and in the end it was approved with only one vote against – mine. This intense debate coincided with a growing, even burning desire to fully follow my own path in life, with total freedom, pursuing my investor vocation. With all this in mind, added to other personal reasons, I sold my shares in the following months and left the Board in June 2007. Thankfully, my father fully understood my reasons and generously backed my decision to leave. It was a tough decision, as Ferrovial is a fine business and I had felt it as a privilege to sit there, but it's been the best decision I've taken so far. Unfortunately, when the bubble burst in 2008-09, Ferrovial suffered great financial strain due to its over leveraged balance sheet, like many other businesses. Four years later, after many asset sales (its stake in BAA having been reduced from 60% to 25%), operating improvement in BAA and other affiliates and debt reduction, Ferrovial is now clearly out of the woods and doing very well in the stock market. The lesson is that, in any business, good, even brilliant managerial capabilities do not suffice when you buy expensive assets with tons of debt: wrong capital allocation decisions are a heavy burden. I still hold a small stake in Ferrovial and continue to have personal contact with a few ex fellow Board members, but have no involvement in the company otherwise whatsoever.

Summarizing the business lessons I learned in a short answer is a difficult task. I might mention just a few points that marked my personal experience, though: pay a lot of attention to reward systems, because they might lead you where you don't want to be; beware of empire building and excessive debt (to me, "excessive" starts pretty soon); promote independent voices in the Board; do not make bet-the-farm investments and be disciplined to only buy assets at a good price, walking away when they are not; stick to what you know; and try to bring strong capital allocation capabilities into the Board, because CEOs in general are not known for being good capital allocators – rather the opposite is true. I would also emphasize that resisting the institutional imperative is extremely important: being contrarian works in business as well as in the stock market. Keep the concepts of fragility and robustness always in sight, and do not obsess about growth and size. Finally, beware of hubris, particularly when you have had a good, long lasting streak. We are all just simple human beings subject to the very same weaknesses. This last lesson is 100% applicable to the world of investment as well, of course.

MOI: What are the key principles underlying your investment philosophy?

del Pino: First of all, there are many ways of making money in the investment world (and many more of losing it!). The more I learn, the more humble I become, as I understand that my approach is just that: one particular approach. And my circumstances are my individual circumstances, which affect my way of doing things (in fact, my company is called Myway Investments). Therefore I must first talk about my circumstances.

Once I became independent, my first big decision was whether I was going to accept third parties' monies or not. I finally decided against it, which turned out to be the right decision. Therefore I don't have to put up with that ambivalent creature called the client: on the one hand, third-party money management allows the asset manager to make a living and to turn what is probably not a high calling (as compared to that of a priest, a doctor, a teacher or a thinker, for example) into a worthwhile service to others. On the other, the client, having always sworn that he is there for the long term, will invariably call in with every single media-amplified mini panic, run to the exit at precisely the wrong time and require lots of admin and compliance work. The only thing I miss from not having clients is the concept of serving others through my work. I do miss that, although there are indirect ways of rendering that service. I also think of my monthly columns in Spain's leading business journal as a service (you may read them in English at www.fpcs.es).

My investment philosophy (maybe this word is a bit too pretentious for a field like investing) is mainly based on Ben Graham, and probably even more so, the Ben Graham in his seventies (already retired and ever wiser) than the one who wrote The Intelligent Investor, although I consider it to be the best book available on investing – by far. My investment style is disappointingly simple: I only buy cheap assets when I find them on a global basis, that's all. I understand this is too short a statement to impress clients and increase AUM – but that's not my case. If I had clients, perhaps I would feel impelled to add some bells and whistles to this description, such as saying that I only buy great businesses with durable competitive advantage, high ROIC, recurrent cash streams and management teams resembling Mother Theresa of Calcutta. But being as skeptical as I am about the ability of the average investor – even the average good pro – to spot this kind of businesses a priori, and skeptical as well of the usefulness of doing so, I am glad to stick to the shorter version. You know, outstanding companies do not always make outstanding investments – more often than not, they don't, because of one single irritating factor: expensive prices. Very few investors can follow this path consistently and successfully – in a more Phil Fisher way, so to speak, but Buffett has, wrongly in my view, made this approach appear easier than it is and independent from his individual circumstances as an investor (the Berkshire business model). Now the wide-moat idea has become a fad.

I also find it difficult to understand why an investor should worry that much about sustainable competitive advantage if the average stock sits in his portfolio for just two or three years (often much less). But again, there are different approaches to successful investing. Although I am not sure that I understand this one, that doesn't mean that some (few) investors cannot be consistently successful using it, of course. Good for them!

I've also been extremely influenced by David Dreman (thanks to whom I came to understand that we are not rational but emotional, an extremely powerful idea), Nassim Taleb (Fooled by Randomness simply changed my way of thinking, as I started to take cause-effect relationships with a grain of salt), Phil Rosenzweig (The Halo Effect is probably the most realistic book on management I know of) and Peter Lynch (with his great approach of different types of stocks with different features and performance expectations, backed by a 30% IRR during 13 years). I could also mention many other great investors and thinkers that I have learned from, dead and alive, and to whom I feel extremely grateful, but the list would be long.

Of course, an investor's investment style evolves with him through the years, but the main tenet of "buy cheap or otherwise do nothing" stands. Low valuation entry points are the key to nice (and easier) returns.

MOI: How do you generate investment ideas?

del Pino: I run value screens mainly focused on valuation rather than on business quality-oriented measures. For instance, high ROE is nice, but statistically high ROE stocks have not proved to perform better than the market. I also avoid extremely indebted businesses, except when the market is pricing a bankruptcy that I see improbable, making the risk-reward ratio extremely asymmetric and, therefore, attractive.

I try to read as few newspapers as possible. Maybe 80% of what you read is just entertainment, 10% is pure propaganda and 10% is information, some true, some false. Therefore, I think that reading daily news is a terrible waste of time and a dangerous source of noise and distraction. I follow a few outstanding investors (partly through MOI) and a few selected newsletter writers from around the world whom I've followed for many, many years. I also keep reading a lot of books on anything from religion (I'm Roman Catholic), psychology or history to investment, economics or medicine. Apart from enjoying reading from the point of view of culture, I hope (and believe) that it builds the right mental model overtime. Information is the lowest use of man's intellectual capabilities; then higher up you find knowledge; and at the summit, there is wisdom. You have to aim at the latter. Too much information hinders knowledge, and very often, too much knowledge hinders wisdom – because of hubris. Today we live in a world with overwhelming loads of stupid information and very little wisdom, I'm afraid.

MOI: Help us understand the process you go through from idea generation to the investment decision — what do you consider to be of critical importance?

del Pino: I always bear in mind some sort of 80/20 principle (a sort of Koch's application of the Pareto rule), that is, that 20% of effort brings 80% of outcome. I try to make things as simple as possible. In fact, simplicity is one of my most beloved guiding lights. I try to focus on what is truly important and forget about the rest. Many times asset managers engage in extremely detailed analyses, ending up in 80-page presentations and unending spreadsheets for a single stock. In general, I doubt the usefulness of that approach in terms of substantially improving performance. I think that has more to do with feeling psychologically in control of a situation than with exceeding performance. Also, there seems to be a human need to appear busy (aimed at oneself for a feeling of self-worth, at colleagues for career advancement and at clients for complexity selling). "There are so many ways of keeping busy," Ben Graham wrote. Unfortunately, complexity sells better than simplicity, and trying to feel in complete control of our life is a very understandable (though chimerical) human desire. The only positive aspect I can think of when taking such a detailed view of an investment is that it might provide psychological support if in the short term the investment appears to work against the investor's expectations and the evil of self-doubt (always there) rears its ugly head. Take the importance placed on management. If the average Fortune 500 CEO tenure is around four years and the horse is more important than the jockey, why bother? CEO turnover is similar to that of politicians. This fact notwithstanding, I even know an asset manager, smart and with a decent track record, who told me he went through the divorce statements of a CEO's ex-wife to get a "true" grip on his character. There are so many ways of keeping busy!

In equity investing, performance comes from just four sources: sales growth, margin improvement, dividend yield and multiple expansion. Let me simplify it a lot: if you intend to hold stocks for 2 or 3 years, for instance, multiple expansion is by far the most important factor to consider; if your holding period is 20 years, sales growth and dividend yield are the most important factors to take into account (this is a mathematical explanation – not a financial one). My investment horizon is maybe three years and I try to act accordingly. I try to focus on low valuations and try to make sure that sales growth and margins will not work against me. Very importantly, I try to invest in extremely asymmetrical risk-reward situations, where upside potential is way, way higher than downside potential (risk understood as permanent loss of capital, not volatility). So if you wish to put it this way, I invest where expected value (statistical expectation) is pretty high. There lies one important layer of margin of safety.

Dividends impose a certain capital discipline on management, and dividend yields are important in the long term, so I like to see some. Buybacks, in my view, give too much discretionary power to management, distort profitability measures and have been a great example of misallocation (read: destruction) of capital. You only have to take a look at buyback levels in 2009 (when the market was far cheaper), down maybe 90% versus 2007. Thus, the same way that managements routinely overpay in M&A activity – a bounty for management teams, investment bankers, lawyers and takeover targets at the expense of the shareholders of the acquirer – they seem to wait until the stock is expensive before buying back their own stock. Such is the nature of the beast, I'm afraid.

My close friend Keith Martin - by the way, one of the very best investors I know, with one of the most outstanding track records in Canada, yet a true example of humbleness – taught me about the huge importance of process. An investor should learn from the masters, develop a sound process, compatible with logic, contrary to herd mentality and backed by statistical confirmation (and not requiring him to be a genius), and strictly stick to it no matter what, because if the process is right, results in the long term will take care of themselves. I repeat: in the long term. Discipline is key. If the well-known mantra for real estate is "location, location, location," I would say that for investment it is dual: "process, process, process" and "valuation, valuation, valuation" (thanks, James Montier). Believing in process means that it's wrong to judge every single decision on the basis of the results. The focus should be placed on the decision process. Good decision processes provide good results on average over the longer term, but individually taken, luck, fallibility or unexpected events can substantially distort the result. So be careful when engaging in cause-effect analysis: it's always less obvious than it appears at first sight.

In investing, character, discipline and the right process based on low valuations affect performance much more than a close knowledge of inventories, margins, market shares and management. Precisely, one of the things I like about investing is that it is a field where success is often linked to the practice of wise Christian virtues: humility, patience, faith, detachment.

When you approach an investment discipline, sooner or later you come to a fork in the road with a simple question: do you believe you can predict the future? It's crucial to have an honest answer. I am very skeptical of the ability of 95% of investors to forecast the future. Sure everyone reading this will agree with me because they think they belong to the 5%, human nature being what it is! I think that recurrent investor overreaction is much more reliable and predictable than sales, cash flow or – much worse – GDP forecasts. To me, the pillars of simple though profitable investing have more to do with counting on human fallibility, the expectations of instant gratification and the emotional overreaction caused by the frustration of those expectations than with having fantastic business insights or forecasting superpowers. But again, that's just my particular approach: other approaches may work fine, even much better than mine.

MOI: How do you assess the quality and incentives of management, and what CEOs do you admire most?

del Pino: The first part of the question is very interesting. I think the principal-agent problem is very real. In most businesses there's no owner, and management pursues its own agenda. Alignment of interests is particularly difficult in this case, but even when there's an owner, the pressure of the sign of the times can affect the balance of power. Let me give you a personal example. When I had just started working in my father's family office, he called me up one morning and asked me to write an in-depth, reasoned report on stock options, both conceptual and factual. It appears that once Ferrovial had gone public, the executive team had asked him to implement a stock option plan, and he didn't have a clue on that issue. He wanted someone he fully trusted to give a fair, unbiased but knowledgeable opinion. I wrote a twenty page report, duly documented and noted, based both on common sense and empirical evidence. Acknowledging that I was clearly going against the tide, my final conclusion was against establishing a stock option scheme in Ferrovial. He liked it and decided to distribute it to the management and members of the Board. In the end, the pressure was too strong and a stock option plan was put in place, probably more limited in scope and size than would have been otherwise (anyhow, it's easy to imagine that I didn't win any popularity contest among the management team with this). Well, my subjective take on this matter is that this scheme did more harm than good to the business, and played a part in the empire building that followed suit.

You know, stock options have much more to do with increasing executive compensation than with alignment of interests of any kind. Stock options are linked to bull markets and favorable accounting and tax rules: in a protracted bear market, they suddenly become less popular than real business performance measures. They are also extremely asymmetric, the life of an option-holder having nothing to do with the life of a shareholder. Finally, they place the bulk of management's reward on something that is beyond the managers' control to a very large extent — interest rates and other Fed actions, sectors going in and out of favor, financial crises, etc. Additionally, if you focus on stock prices, it is inevitable you'll end up with a short-term mindset. All in all, stock options seem to be a bad variable compensation tool.

Therefore, alignment of interests is a very delicate issue even when there's a clear owner, never mind when there's no owner. Capital allocation is maybe where focus should be placed if you want management to think like long-term owners. As Peter Drucker liked to say, dealmaking beats working, because dealmaking is romantic, sexy. You should control that. Also, as general rules, incentives should attract management to the long term rather than to the short term, to cash rather than accrual accounting, to ROIC rather than growth, to robustness rather than size and to real business economics rather than to the stock market. The general sense of these statements is pretty clear.

Regarding the last part of the question, in general I admire entrepreneurs and business founders more than CEOs, the same way that I feel more comfortable with the motivations of a soldier than with those of a mercenary. Entrepreneurs that I admire: my father would come first, of course; Sam Walton was amazing, Ross Perot, Richard Branson (as businessman) and of course the great classics like Henry Ford, Andrew Carnegie or Thomas Edison. Prem Watsa, whom I've known for a number of years, is a great mix of investor and entrepreneur. I know many other unheard of, unbelievable entrepreneurs who own private businesses. Regarding CEOs, more specifically, I would highlight Henry Singleton of Teledyne, Ken Iverson of Nucor, John Bogle and the late Rafael Termes, CEO from 1966 to 1990 of Madrid-based Banco Popular, who made it the most profitable bank in the world several years in a row and was as smart as he was gracious, as intensely professional as deeply spiritual (note: the bank has changed a lot since then).

MOI: What investment-related lessons could you draw from your family's experience with Ferrovial, particularly in the areas of corporate governance and alignment of interests with those of minority shareholders?

del Pino: Corporate governance is not the same in the Anglo-Saxon world as in Continental Europe, not to mention Asia. In general, boards work if the guy in power wants them to work. In order to achieve that, he has to be a self-confident person, capable of accepting being challenged and prone to having independent minds around him rather than yes-men. Board members should bring good reputation to the company, rather than the opposite, and be financially independent. However, I must say that most corporate governance problems in the Western world (in many Asian countries this is different) do not arise from any abuse by majority shareholders of minority shareholders. That's a convenient myth. Most problems come from agency-principal conflicts between management and shareholders in businesses where there's no clear owner.

Management abuses shareholders much more often than majority shareholders abuse the minority. After all, all shareholders are to a very large extent in the same boat. However, the progressive disappearance of the traditional business owner in the West (the principal) has created a vacuum which management (the agent) is more than happy to fill, acting without any counterweight. One of its consequences is the incredible excesses of executive compensation, which has reached totally absurd levels, very particularly in the U.S. Michael Porter showed great insight when he wrote that managers had the natural instinct of seeking fragmented ownership to preserve their independence from owners in decision-making. On an anecdotal note, the lack of owners is a bounty for parasitic businesses (I use this adjective as descriptive, not as a moral judgment), such as investment banks, consultants or law firms who sing, like Nicole Kidman in the movie Moulin Rouge, "the only way of loving me, baby, is to pay a lovely fee".

In fact, in my screening process, family businesses or high insider ownership are a clear positive in considering a potential investment. In these cases, there is an embedded interest in creating long-term value and earnings power, and there is an aloof attitude towards short-term stock market gyrations. Of course, the mutual fund industry, with its nervous portfolio turnover, joins forces with the parasites to promote the opposite no-owner, short-term focused business model.

MOI: You focus exclusively on investing your own net worth, i.e., without institutional or client-related constraints. How do you protect your portfolio from permanent loss of capital, and what is your take on holding cash?

del Pino: I love cash. Of course, holding large amounts of cash makes no sense strategically, but it does make an awful lot of sense tactically, even when our extravagant central bankers make it so hard, having arbitrarily killed the notion of risk-free return, and created an ugly-looking monster called return-free risk. Here we get into the difficult territory of asset allocation, on which I still have not found the Rosetta stone. Asset allocation (based on pricing, not timing, of course) is a key element of performance in sideways markets, like the 1966-1980 period or the one we seem to be living through in the last few years, and tends to be forgotten in bull markets when it systematically lowers returns. The difficult issue with asset allocation (and I mean an oversimplified decision between, say, equities, cash and precious metals) is that not one, but three questions have to be answered correctly, and being right in all three is quite complicated: when to reduce exposure, by how much, and when to come back. Therefore it is an open debate for me. Historically I have been better at answering the first question than the second one, and the second one better than the third one. However, asset allocation worked extremely well for me during the financial crisis – and there's nothing more dangerous than being right, because you either overstay or get too excited and lose focus. Hubris is waiting for the investor at the other side of success, and you'd better be aware of this. This is especially the case when you are right being contrarian. It's time to go for a long vacation, take a very deep breath, view things from the aspect of eternity, as Spinoza said, and free yourself from taking yourself too seriously in such a small endeavor as an ephemeral professional victory.

It's easy to say when the market is expensive (as it is now: some things remind me of 2007); it's more difficult to say whether it will get even more expensive or for how long, and it's very hard to overcome the temptation of throwing in the towel after being wrong for a while. But, either on a stock-by-stock basis or on an asset allocation basis, you are usually wrong before being right. It's a question of patience and fortitude, though it's easier to say than to do.

MOI: Given your global approach to investing, how do you assess competing opportunities in the many investment jurisdictions available to you?

del Pino: Let's try first to give the global view. The West is getting worse and worse, rolling with exceeding smoothness downhill, printing money and spending it. For a while, nothing seems to happen, and the treatment looks efficient and harmless. But then, inevitably, all hell breaks loose. Politicians are robbing our liberty with the excuse of providing security (financial or physical). That's what happened in communist countries: they said, "give us your freedom and we will give you security", and the people ended up without either. This is precisely what is happening in the West in slow motion. Most Western governments (plus Japan) are essentially broke. Taxes and all sort of bureaucratic rules are going up, and tough decisions are being postponed because of fear of losing elections. The Welfare State is in crisis (more promises than money), the democratic political model is in crisis (votes in exchange of subsidies), the fiat money experiment is in crisis (central bankers gone totally crazy) and the fractional reserve system is in crisis as well (highly leveraged banks, imaginary deposits). The U.S. is no longer the U.S., I'm afraid, and I miss it as a role model. Canada is a country where I feel very comfortable, liking the people and the jurisdiction better than the climate. My goodness, Canada even exports central bankers! However, I think that specific export item has left a ticking bomb behind – but time will tell. Singapore is a country I very much admire; I also like the Nordic countries, Switzerland, Austria, Poland, Chile... The fragility of the euro hasn't changed: it remains a political French invention with a flawed economic model and a Soviet-style mammoth-like bureaucracy. The UK, which is out of the euro not because of special insight but because Soros expelled the pound from the ERM, is serious and strong enough to become a role model, but it's in dire straits and following the wrong path by reigniting the real estate bubble, with the BoE being the champion of all money creators. Japan, having defied the law of gravity for a long time, seems to be looking for a second iceberg to run into as if the first one were not enough. Unfortunately (because I like and respect Japanese culture a lot), I think Japan will prove to be an example of how incurable monetary and fiscal excesses really are, and maybe when this becomes apparent the West will stop before destroying its own system likewise. When I was younger, only banana republics created money to buy public debt. Today, we are all banana republics. Interesting times, no doubt!

With this in mind, whether you like it or not, you have to think and decide about currencies and jurisdictions where property rights are respected, where there's rule of law and where public indebtedness does not all but assure outright confiscation. Or maybe all you can do is search for the lesser evil within a truly hostile environment.

MOI: Can you recommend one or two books that have given you new insights?

del Pino: Well, I love western movies, and to me there's John Wayne and then, there's rest; I like classical music, and to me there's, similarly, Beethoven and then, the rest. In terms of investment books, there's *The Intelligent Investor* and then, the rest. If I had to mention the next one I'd include Dreman's *Contrarian Investment Strategies* (the 1998 edition).

Fernando del Pino is a private investor and former board member of Ferrovial (Madrid: FER), which was founded by Fernando's father, Rafael del Pino y Moreno, in 1952. Fernando helped manage the family's proceeds of the Ferrovial IPO in 1999. After serving on Ferrovial's board for eight years, Fernando left the company in 2007. He focuses on investing his private capital via Myway Investments.