Trading

# The real value trap

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**BUYING CHEAP IN** a beaten market is the first step to value investing. While most investors are trembling in fear, value investors are now ready to enter the market for the long term.

Although some value fund managers are on a buying spree, others are caught in a value trap.

The "Oracle of Omaha" Warren Buffett is brave when others are fearful. Since 2008 Buffett's investment conglomerate Berkshire Hathaway has put more than US$37 billion (HK$288.6 billion) to work.

The investments have ranged from direct stock purchases to preferred share investments in Goldman Sachs and General Electric.

Buffett knows his investments and investors trust him wholeheartedly, but in other parts of value land, many fund managers face extreme pressure from investors.

Some of the best value fund managers are performing badly this year.

For example, Bill Ruane (Buffett's ex-schoolmate) of Sequoia Fund is down 20 percent, Bill Miller of Legg Mason Value Trust is down 48 percent and Marty Whitman of Third Avenue is down 41 percent.

These celebrity managers have the credibility to weather the storm. With their track record and experience, they can calm investor sentiment.

Smaller value fund houses, however, are caught up in the turmoil because their long-term investment horizon misaligns with short-term investor interest.

In the long run, we are all dead, said economist John Maynard Keynes. Though many value managers are candid and rational, investor panic leads to massive capital redemption, indirectly putting the managers out of business.

Mark Sellers III of Sellers Capital in Chicago, who successfully managed a US$300 million fund, recently threw in the towel because panic withdrawals from investors were causing him extreme stress.

In his letter to investors, he stated that he had totally neglected his family and friends to manage the fund. With pressure from all sides, he realized that it was time to quit because life is not just about managing money.

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A former Morningstar analyst, Sellers had managed the fund since 2003, and I met him at the Berkshire Hathaway annual general meeting in 2006. As we shared the same philosophy and dream, we continued to exchange ideas.

In 2007 when I visited Sellers in Chicago we discussed how investors should be careful of value traps, or stocks that are beaten down but do not show value.

Amid the current market turmoil the value trap lies not only in the stocks we might pick, but also in fellow investors who promise to stay for the long term yet quickly flee when crisis strikes.

After all, patience is the ultimate virtue in value investing, and impatience would set a value manager up for the perfect trap.

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