OUR INVESTMENT PRINCIPLES

The investment process used by Pastel & Associés consists in investing in a small number of publicly listed companies, chosen after a detailed analysis of their economic value and long-term prospective return. The objective of our investment process is twofold: to reduce the risk that our funds suffer a permanent loss of value, and to generate for each of our funds a satisfactory long term rate of return per share*. By keeping to the following principles, we believe that over long enough holding periods we should succeed in achieving such a dual goal. Although history is no guide to future results, our two funds, Margin of Safety Fund and Valeur Intrinsèque have done so for the holding periods starting at their inception (respectively 1998 and 2001) to today (Dec 31st, 2015).

Independence

• It is only by investing outside of the consensus that one can reasonably expect long-term out-performance. In order to do so, one can either go systematically against the consensus, or follow an investment process independent from the consensus without always trying to swim against the tide. Pastel & Associés has opted for the latter approach. As a result, we have developed, over the years, our own tools for detection, investment analysis and decision-making. This allows us to manage our funds with neither interference nor influence from brokers, bankers and external advisers.

Price, intrinsic value and risk

• The market price of an asset is not a reliable source of information about its long-term value, but just the “clearing” level at which sell and buy orders balance out. Ultimately, how far, up or down, the price is from the asset’s value-in-use (or intrinsic value) is what matters. In some cases, the best estimate of such value will be a multiple of “normalized” free cash flows, at other times a multiple of net reported earnings will be used, and in other instance we will prefer to rely on adjusted net book value.

• An asset does not generally have a single, precisely defined intrinsic value but a series of possible intrinsic values. At Pastel & Associés we try to identify the outer bounds - if any - of this range of values as accurately as possible and then work out the subjective probabilities that such values be realized.

• When investing in stocks, volatility is both an unavoidable phenomenon and a formidable ally. Instead of fearing it, at Pastel & Associés, we turn it to our funds’ advantage in order to prey on the opportunities it offers. Rather than worrying about volatility, or other variables such as Sharpe’s ratios or maximum drawdowns, we focus instead on the only relevant notion of investment risk - that is, the possibility of permanently losing a substantial portion of the invested capital.

• Common sense tells us not to put all our eggs in one basket. But robust and sustainable baskets are thin on the ground, so Pastel & Associés’ funds tend to be quite concentrated, with generally fewer than 30 so-called “risky” assets in portfolio.

Time and patience

• Because, for us, “pricing” trumps “timing”, we are not interested in calling market price bottoms or tops. And we are usually not good at it. As a result, all too often, our investments will, initially, trade in the red for on occasion long time intervals, while our sales will cause us to miss additional profit opportunities. But as our decisions go generally against the market consensus which usually takes time to reverse, how could it be otherwise? In investing, as in many other aspects of life, patience is of the essence.
• Time can be an investment manager’s friend or foe. For an investment to pay off at some point in the future, it must be able to withstand the multiple crises it will inevitably run into along the way. For that reason, it is important to generally avoid investing in companies that are too fragile, over-indebted or vulnerable to obsolescence for technological, regulatory or other reasons.

Margins of safety

• There will be only one actual future, but there are multiple possible ones. Instead of trying to forecast the unpredictable, at Pastel & Associés we concentrate on trying to assess what would happen to the value of an asset under worst-case scenarii; we then invest only if the possible losses under such scenarii are either non-existent or relatively small. In most cases, this consists in buying an asset when its price is less than or equal to the lower bound of the range of possible intrinsic values.

• Market undervaluation of a stock is not a reason in and of itself for investing in it. First, one must “kick the tires” by looking for drivers of value such as:

- Top executives who excel at allocating capital rationally among organic re-investment, external growth, dividend payouts and share buybacks

- A business culture and a management team with a proven ability to optimize the firms’ operations in terms of cost control, revenue growth, market share capture and retention …

- Sustainable and clearly identified competitive advantages, including pricing power, controlled distribution, reputation, near-captive clients, product or service “criticality”, or annuity-type revenues …

- …

* The investment time horizon of the funds Valeur Intrinsèque and Magin of Safety Fund is 5 years or longer and the risk of permanent loss of capital is significant.