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Can Charlie Munger's Investing Playbook Still Work? Even He Wasn't So Sure

Value investing struggled during the long era of low interest rates. Warren Buffett's partner warned investors hunting for deals they should 'get used to making less.'

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Updated Jan. 6, 2024 12:12 am ET

Charlie Munger influenced generations of investors—none more so than his partner at Berkshire Hathaway BRK.B **0.17%** ▲ , Warren Buffett.

Munger's death doesn't just leave a void atop Berkshire. It also raises questions about how the value-investing style he championed might evolve when great companies at fair prices are harder to come by.

Munger pushed Buffett to pay up for quality businesses, steering him away from an early focus on the cheapest stocks. Together, they built Berkshire into a sprawling conglomerate with a massive stock portfolio and became two of the most legendary investors of all time.

Many investors agree that the years of ultralow interest rates following the 2008 financial crisis helped growth stocks trounce value shares, often identified as those that trade at low prices relative to their worth as measured by various financial metrics.

Falling rates make it cheaper for businesses to borrow, turbocharging growth. They also make stocks look more attractive relative to less-risky assets like government bonds—but tend to boost shares of companies geared toward future growth more than underpriced value stocks.

Some now question whether value stocks can thrive anytime soon as the Federal Reserve signals it will start cutting interest rates this year.

In the months before his death, Munger acknowledged that the traditional hunting grounds of value investors had been picked over. The low-hanging fruit was gone, he said. Investors had almost no choice but to own a few richly valued tech behemoths just to keep pace with the market, he suggested.

"I think value investors are going to have a harder time now that there are so many of them competing for a diminished bunch of opportunities," Munger said at Berkshire's 2023 shareholder meeting. "My advice to value investors is to get used to making less."

Yet many of Munger's pupils are staying faithful to his investing playbook: identifying the fundamental value of businesses and betting big when opportunity arises.

Investing in value

Snapping up shares of mediocre companies trading at bargain prices was a technique Buffett learned from Benjamin Graham, the father of value investing and his teacher at Columbia University's business school.

In 1958 and 1959, for example, Buffett bought shares of Sanborn Map, which had a weakened map business, an investment portfolio worth some $65 a share and a share price of $45. After lobbying from Buffett, who had become a director, Sanborn agreed in 1960 to use its portfolio to buy out stockholders. Buffett made a roughly 50% profit, according to Roger Lowenstein, who recounted the episode in "Buffett: The Making of an American Capitalist."

The so-called cigar-butt approach had major weaknesses, Buffett later wrote: It didn't work well when investing large sums of money and was the wrong foundation on which to build an enduring business.

He credited Munger, who died Nov. 28 at age 99, with shifting his investment strategy and setting Berkshire on the path to the company it would become.

"The blueprint he gave me was simple: Forget what you know about buying fair businesses at wonderful prices; instead, buy wonderful businesses at fair prices," Buffett wrote in a 2015 letter marking the 50th anniversary of his control of the company.

Today, Berkshire is the seventh-largest U.S. company by market value and operates businesses ranging from Geico to BNSF Railway to See's Candies that Buffett and Munger acquired using those value-investing principles. It also has more than $150 billion in cash and a stock portfolio of more than $300 billion featuring the likes of Coca-Cola, American Express and Bank of America.

In his annual letter to shareholders in February, Buffett wrote of the importance of a small number of successful investments. Berkshire spent $1.3 billion to assemble the stake in Coke in the 80s and 90s; it is now worth roughly $24 billion and spits out more than $700 million in dividends annually. Berkshire's buying of American Express was essentially completed in 1995, also for $1.3 billion. That stake is valued at more than $28 billion, and is paying Berkshire annual dividends of more than $300 million.

Berkshire's own stock has crushed the market. In the 40 years through 2023, the S&P 500 rose nearly 2,800% on a price basis, according to FactSet. Berkshire, by contrast, soared more than 41,000%. It ended 2023 as the most heavily weighted member of the Russell 1000 Value benchmark index.

Munger's version of value investing has largely prevailed among bargain-hunting stock pickers. Prominent practitioners of the style say it evolved from the early days of identifying cheap stocks. In an age when millions of investors can access the same information, it's hard to be the first to identify a screaming bargain.

"The methodology of value investing has changed. You can't buy cigar butts anymore. They've been culled over," said Mario Gabelli, founder, chairman and chief executive of Gamco Investors. Gabelli, a longtime stock picking value investor, bought Berkshire's Class A shares through his Gabelli Asset Fund in 1985, for about $2,000 apiece. Today, they trade at more than $550,000.

Li Lu, founder and chairman of Himalaya Capital, a value-investing firm in Seattle, said Munger helped shift how the investing philosophy was practiced. Munger entrusted Li Lu to manage $88 million of his family's money in the early 2000s and once viewed Li Lu as a top candidate to manage Berkshire's portfolio.

"He is more responsible than anyone—and even Warren would acknowledge that—in moving the discipline of value investing from just simply buying cheap securities into buying and holding quality businesses for the long haul," Li Lu said.

Li Lu in 2002 invested in BYD, a Chinese battery and electric-vehicle maker, and later introduced Munger to the company. In 2008, Berkshire invested about $230 million in BYD. By 2021, Berkshire's stake was worth $7.7 billion. BYD now competes with Tesla as one of the top sellers of electric vehicles in the world.

A low-rate world

Value investing once enjoyed a lengthy record of success. On average, value stocks outperformed growth by about 7 percentage points annually between 1970 and early 2007, according to an analysis from Goldman Sachs Asset Management.

But then the Fed slashed its benchmark rate to near zero when the financial crisis roiled the economy in 2008. After raising rates modestly in subsequent years, the central bank again cut them in early 2020 to support an economy reeling from the Covid-19 pandemic.

Low rates tend to help some stocks more than others. Growth companies are expected to significantly expand their businesses, raking in increasing amounts of cash down the line. The present worth of a value stock, by contrast, is usually weighted more heavily toward earnings in the near future.

That difference means that growth stocks can get an outsize jump in value when lower interest rates boost the worth of far-off cash flows.

The Russell 3000 Growth index, which follows companies that are growing at an above-average rate, has advanced about 700% over the past 15 years. The Russell 3000 Value index, which tracks companies that trade at lower prices compared with their book value and have lower expected growth rates, has risen roughly 200%. Companies that don't fall neatly into one category can belong to both indexes.

"Can't fight that math," said Bryant VanCronkhite, senior portfolio manager on value strategies at Allspring Global Investments. "Growth has had a tailwind due to the trend of lower interest rates."

That tailwind has contributed to the dominance of big tech stocks in recent years. From the end of 2019 through the end of 2023, Nvidia and Tesla shares soared more than 700%, while shares of Apple, Microsoft and Alphabet more than doubled. The S&P 500, meanwhile, rose 48%.

So what is a value investor to do? According to Munger, you might have to buy one of those tech giants.

"I think that the modern investor, to get ahead, almost has to get in a few stocks that are way above average," Munger told The Wall Street Journal in an October interview. "They try and have a few Apples or Googles or so on, just to keep up."

Berkshire has followed that playbook, amassing a position in Apple that was worth more than $156 billion at the end of September, by far its largest stockholding.

Though Buffett had expressed aversion to tech stocks, describing them as hard to understand, he said he came around to Apple by seeing the company as a retail behemoth with deeply loyal customers.

Since Berkshire first bought about $1 billion of Apple stock in early 2016, the share price has risen roughly 600%. At the time of Berkshire's initial investment, Apple shares traded around 10 to 11 times the company's last 12 months of earnings, according to FactSet. Now, the stock trades at roughly 30 times trailing earnings.

Crowds watch Buffett and Munger on a screen at Berkshire Hathaway's annual meeting. Value investors have flocked to the meeting for decades to gather investing advice from the two men. PHOTO: REUTERS

Buffett, for his part, wrote in a March 1993 letter to shareholders that he found the term "value investing" redundant.

"What is 'investing' if it is not the act of seeking value at least sufficient to justify the amount paid?," he wrote. "Consciously paying more for a stock than its calculated value—in the hope that it can soon be sold for a still-higher price—should be labeled speculation."

Characteristics like the ratios of a company's share price to its earnings or book value can't determine whether an investor is buying something for what it is worth, he went on to say. Instead, investors should discount the cash flows that can be expected from a stock.

Revival interrupted

The year 2022 seemed like it could be the start of a revival for value stocks.

The Fed, dead set on fighting inflation, started raising rates at the fastest pace since the 1980s. Markets swung to favoring investments that generated immediate cash.

Megacap tech stocks like Apple, Meta Platforms and Netflix dropped, dragging the S&P 500 down with them. The Russell 3000 Value index outperformed its growth counterpart in 2022 for the first time since 2016.