

Smart Investing Owners Manual

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***“History shows us that the most successful investors
are not the ones who take the largest risks...”***

***The most successful investors are the ones who work
extremely hard to minimize the risks.”***

Warren Buffett



Desjardins
Financial Security
Investments Inc.

Thank you for taking the time to read the Smart Investing Owners Manual. The purpose of this document is to provide you with a reference source to help better and more fully understand:

1. The common personality traits I need to see in the people (money managers) who will be making investment (buy / sell) decisions with your money.
2. The investment process and philosophy that I require our money managers strictly adhere to.

I have learned over my years in this business that good, solid investment decisions are never born not out of random luck. Successful investment decisions are a product of intelligent and thorough data gathering, careful due diligence and logical decision making. The only way to truly determine if you are buying something at a bargain price, (or put another way, to ensure that you are receiving good value in return for your purchase price) is to first completely understand exactly what you are buying.

This "value for money" principle works when purchasing all kinds of assets such as automobiles, real estate, livestock and items at garage sales. Frankly, this same principle works equally as well when choosing equity (businesses) or fixed income (debt) investments.

By carefully ensuring that the money managers we choose to work with possess (1) a sound investment philosophy and process and (2) the necessary emotional and personality traits required, I believe that I will have put my clients on the path to enjoy the fruits of minimized investment risk, reduced volatility and solid investment returns for as long as they choose to work with me.

I sincerely hope this document helps you better understand the investment philosophy I employ with my clients. As always, please contact me to ask any questions you may have.

Sincerely,

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It all started when I discovered who Warren Buffett was

"Thirty years ago, no one could have foreseen the huge expansion of the Vietnam War, wage and price controls, two oil shocks, the resignation of a president of the United States, the dissolution of the Soviet Union, the fall of the Berlin Wall, a one day drop on the Dow of over 508 points, or treasury bill yields between 2.8% & 17.4%.

*But, surprise! – none of these events made the slightest dent in Ben Graham's investment principles. Nor did they render unsound the negotiated purchases of fine businesses at sensible prices. **Imagine the cost to us, then, if we had let fear of the unknown cause us to defer or alter the deployment of our investment capital.** Indeed, we have usually made our best purchases when apprehensions about some macro event were at a peak. Fear is the enemy of the faddist, but a friend to the fundamentalist.*

*A different set of major shocks is sure to occur in the next 30 years. We neither try to predict these nor profit from them. **If we can identify businesses similar to those we have purchased in the past, external surprises will have little effect on our long-term results.**"*

Excerpt from Warren Buffet's letter to
Berkshire Hathaway shareholders - March 1994

I first realized that I could make a career out of this business when I found out who Warren Buffett was. Mr. Warren Buffett was born in Omaha, Nebraska. He came from a childhood of limited means to become one of the world's wealthiest people (personal net worth: +40 Billion Dollars U.S.).

What's remarkable about Mr. Buffett's story is that he did not achieve his wealth via an inheritance or winning the lottery. He gained his wealth by investing in businesses from a very early age and while doing so, developed simple and logical investment principals which provided him with the ability to consistently make solid investment decisions. Mr. Buffett has taken these principals and used it to grow his holding company, Berkshire Hathaway (Berkshire), into a Fortune 500 company.

Berkshire owns a large number of well respected businesses such as GEICO, Dairy Queen, Fruit of the Loom, Net Jets, Shaw Industries, Benjamin Moore Paint, Borshiems and many more, along with being large shareholders in companies like, Coca Cola, American Express, Procter & Gamble, and Wells Fargo among others.

When I came to understand how Warren Buffett was able to build his wealth without the benefit of insider information or tricks, I determined that the best and the most honorable way to succeed in this business was to duplicate, to the best of my ability, Warren Buffett's investment process for my clients.

I have come to this understanding by not only reading everything ever written about Mr. Buffett that I could get my hands on, but by closely following him in the news. Each year, Mr. Buffett writes a letter to his shareholders (which can be downloaded from www.berkshirehathaway.com) in which he shares his investment opinions and explains his thinking. He also makes frequent appearances on television business shows like Fox Business News, CNN and CNBC. To date, I have attended Mr. Buffett's annual shareholders meeting in Omaha five separate times. During these shareholders meetings, Mr. Buffett and his partner Charlie Munger open the floor to questions. Those Q & A sessions last approximately six hours on average and are quite similar to sitting in on a university class on investment wisdom, philosophy and process.

I have taken the template that Mr. Buffett has developed and laid out for us and used that knowledge as a measuring stick when choosing money managers to work for my clients. The following is a brief description of Warren Buffett's investment process as described in the book, "The Warren Buffett Way", by Robert Hagstrom.

Warren Buffett's investment criteria for choosing companies to invest in.

Business Criteria

1. Is the business simple and understandable?
2. Does the business have a consistent operating history?
3. Does the business have favorable long term prospects?

Management Criteria

1. Is the company's management rational?
2. Is the company's management candid (honest) with their shareholders?
3. Does management resist the institutional imperative? (Do management decisions reflect emphasis on maximizing shareholder (owner) value or do their decisions reflect enriching members of management?)

Financial Criteria

1. What is the return on equity? (operating earnings / net shareholder investment)
2. What are the company's "owner's earnings"? (revenues – expenses)
3. What are the profit margins? ((owner earnings / revenues) X 100)

Value Criteria

1. What is the current value of the company?
2. Can it be purchased at a significant discount to its value? (bargain)

Smart Investing goals for each client

Although every client I work with has a unique set of circumstances which require a specific and individualized set of solutions, the following are the three overall general goals that I am working to accomplish with each and every client that chooses to work with me:

- ✓ Minimize investment risks.
- ✓ Avoid investment mistakes.
- ✓ Achieve above average investment returns over time.

Ongoing Investment Management Process

My experience and research has shown me that successful long term investing requires a combination of both appropriate asset diversification and sound money management (investment decision making). In order to remind yourself of the appropriate asset diversification we arrived at for your particular set of circumstances, please review your personal "Investment Policy Statement".

Sound money management is a combination of both sound due diligence (data gathering and interpretation – "Process") and the emotional and personality traits required ("People") to allow the investment decision making to be driven and dictated by substantial and tangible facts (i.e. valuations), not uninformed speculation and baseless predictions based on emotional responses to movements in the stock markets.

The following is a description of the "Process" I need to see in a money manager's investment philosophy prior to allowing the manager to work on the behalf of my clients.

Investment Process

- Think of investing as the purchasing of actual businesses, not the trading of stocks.
- Detailed and probing interview and information gathering process from company management prior to investing.
- Regular execution of “On Site” corporate inspections.
- Detailed and thorough analysis of the company’s business operations and financial statements with a purpose to gain complete understanding the company’s organization, future outlook and potential headwinds.
- Sensible calculation process resulting in an estimated conservative value for the business.
- A priority to first focus on what can go wrong (avoiding losses), and only then identify the potential future prospects and gains. (managing investment risks by insisting on “quality” or “best of breed”).
- Strong emphasis on investment decisions being triggered based on undervalued or “bargain” prices in return for quality.
- Actively looking for opportunities to take advantage of the mistakes the stock markets make from time to time.
- A sound and sensible “Sell” discipline.
- Allowance for flexibility (no matter I work with is restricted as to the size (market cap) or type (market sector) of business they can invest in.

People

The following is a description of the human qualities I need to see in a money manager prior to allowing them to make investment decisions on behalf of my clients.

- “Integrity” – “If you stand for nothing... you will fall for everything that comes along.” Many people look for shortcuts and they will go to great lengths in order to try and find them. In the investment world, there simply are no shortcuts. All we have are the basic fundamental principals that have been proven to deliver value to investors over time. I decided very early in my career to build my practice by exclusively working with money managers who (1) believe in the same “value” investing principals that Warren Buffett follows, and (2) possess the integrity to stick to them.
- “Experience” – The more experience someone has in a particular field, the better quality decisions they tend to make. It is for this simple reason that I have built my practice by working with money managers who possess a minimum of 15 years of investment experience. Money Managers with a wealth of experience tend to make far fewer mistakes and this has served clients well over the years.
- “Intelligence” – In order to make a quality investment (either buying or selling) decision, an investor must first fully understand a business in order to properly estimate the actual worth of the company. Businesses today are larger and more complex than ever before, making understanding them a more difficult task. I need to see that a money manager is taking all of the appropriate and necessary steps to fully understand the businesses they are making investment decisions on. I believe that anything short of this is purely speculation.

- “Dedication” – It is more important in the long run for money managers to stick to what they know is right, even if it is not the most popular decision at the time. This is one of the lessons we learned from the technology bubble in 1999. It would have been very easy for money managers who believe in owning quality profitable businesses to compromise their beliefs, as the popular trade at that point in time was to buy into frenzied speculation (no product, no revenue, no profit... just a future idea). Money Managers, who stuck to their principals, although enduring some short term pain, were rewarded in the long term as they were able to invest in quality, profitable businesses at bargain prices and deliver those profits to their investors in the years that followed.
- “Patience” – I work with money managers who hold out for both the right business and the right price. There are lots of quality, well managed and profitable businesses available today. Not all of them trade at levels that represent good odds of significant capital gain appreciations over time. I work with money managers who have shown they possess the patience to wait for the appropriate price level before committing my client’s money to an investment decision
- “Can keep their emotions in check” - I work with managers who don’t allow their emotions to dictate their investment decisions. (Sniper approach as opposed to the shot gun approach) This is a character trait that is next to impossible to teach, but vital to long term investment success.
- “They love what they do” - Another character trait that unfortunately can’t be taught. I love to work with money managers who enjoy the process of uncovering the next quality investment opportunity and the intense analysis, curiosity and hard work it requires to do execute the process well on a consistent basis.

Money Managers I will NOT work with

I simply refuse to recommend to clients or work with money managers who:

- spend a significant amount of time attempting to predict future stock market fluctuations.
- have been managing money for less than 20 years
- are limited where they can invest either by market cap (size of business) or sector (type of business).
- on average, hold more than 75 holdings (prefer a maximum of 50)
- have a history of allowing their emotions to dictate their investment decisions.
- possess excessively high “turn over” rates in their funds
- possess excessively short “holding periods” in their funds
- do not possess a disciplined “Sell” strategy
- display a history of guessing

Recommended Reading List

"The Warren Buffett Way" - Robert G. Hagstrom

**"Damn Right – Behind the scenes with Berkshire Hathaway
billionaire Charlie Munger" - Janet Lowe**

**"Buffett – The making of an American Capitalist" - Roger
Lowenstein**

**"There's Always Something to Do – The Peter Cundill Investment
Approach" - Christopher Risso-Gill**