At Focus Capital Management, we often describe what we do as "deep-value investing". Different people use that term to mean different things, and we use the term somewhat idiosyncratically. I would like to take some time to explain precisely what we at Focus Capital Management mean by deep-value investing. Let's take it word by word.

Investing

Let us begin by defining the word "investing" and how the activity of investing differs from trading. There are many different ways that people attempt to make money in the stock market, some of which actually work. Some people engage in market making, constantly offering a bid and an ask in various securities, making a tiny bit of money on the spread, multiplied by very large volume. Some people engage in arbitrage, taking advantage of small differences in prices between the same or similar securities in different markets, differing structures, or the like. Others follow short-term price trends or try to run counter to such trends, amid various other forms of technical trading.

Although some of these methods and others can be successful and profitable, none of the above methods are *investing*. The key difference between trading and investing is whether you are buying and selling pieces of paper or a piece of a business. A trader is not concerned with the underlying business per se and is not seeking to own the underlying business, rather to profit from the swings and vagaries of the market itself. An investor, on the other hand, is concerned with the underlying business and the events affecting it, seeking to profit from owning the business and improvements in its prospects. By investing, we mean viewing stocks as slices of a business and purchasing those stocks whose underlying business makes the purchase attractive.

Value Investing

Let us now move on to define *value* investing. Even under the rubric of investing, there are many different strategies. Some people engage in macro investing, making top-down bets on countries or sectors. Others have event-driven strategies, where they attempt to predict specific major events (such as FDA approval for a biotech, merger offers or approvals, etc.) and the market's reaction thereto. Yet others have relative-value strategies, where they have no opinion on the absolute value of the underlying companies, only that Basket A is relatively cheap vis a vis Basket B which is relatively expensive, and they then attempt to profit from this by buying long Basket A and selling short Basket B.

Although some of these investing strategies and others can be successful and profitable, none of the above strategies are *value* investing. The key difference between value investing and other forms of investing is that value investing focuses on the underlying intrinsic value of the stock under consideration and attempts to profit from the difference between price paid and value received. This is the essential point around which all of value investing revolves: price vs. value. By value investing, we mean buying those companies whose underlying intrinsic value is higher than the price paid. In simple words, value investing is about purchasing undervalued companies.

Value vs. Growth: A false dichotomy

It is common to divide fundamental investing into value investing and growth investing. We believe this to be a false dichotomy which misses the point. The point of fundamental investing is to analyze companies and invest in those companies which are undervalued. This can be because it's a "value" stock which has an unjustifiably low P/E despite stable or improving prospects. This can be because it's a slowly dying company whose depressed P/E is even more pessimistic than duly warranted. Or this can be because it's a "growth" stock with an elevated P/E, but *which is still too cheap compared to its future prospects and underlying intrinsic value*. In our view, that is 100% *value* investing. Obviously, paying pie-in-the-sky valuations for sketchy future growth is not value investing. But that isn't growth investing either. That is just stupid investing (investing being a borrowed term for this endeavor). If it's not worth it, it's not worth it. If, after taking all possibilities and valuation into account, it is worth it, if you are purchasing the company for a price that is less than its analyzed value, then that is value investing.

This is what we mean by value investing. So what are we adding with the term *deep*-value investing? Read on.

The two factors of value investing

There are really two factors by which to measure an investment opportunity, value and confidence. By value, we mean the gap between market price and intrinsic value as measured by the investor. Equally important is confidence, how certain you are of your measure of value. Companies with stable businesses and wide moats will result in higher confidence in the assessment of intrinsic value. Companies whose businesses exhibit more volatility or have more moving parts will by necessity have a wider range of future possibilities, reducing an investor's confidence in his assessment of the intrinsic value. Companies with new, untested business models, or industries less familiar to the particular investor, will also result in lower confidence in the assessment of intrinsic value. The less confidence an investor has in his assessment of the value gap, the greater the gap necessary to remain an attractive investment opportunity. In some cases, the confidence level is too low to consider the company a particularly attractive opportunity, no matter the perceived value gap.

Value/Confidence = Return/Risk

These two factors, value and confidence, equate to return and risk. Value is the return that you expect to see from this investment, due to the gap between what you're paying and what you're getting. Confidence is the amount of risk you are incurring in pursuing that return. When confidence is lower, investors will generally demand a greater perceived value gap. In other words, when risk is greater, investors demand a higher return. More important than the higher return per se, the higher anticipated return itself decreases risk by increasing the buffer where things can go south and you will still make money. Margin of safety. The larger the value gap, the more confident you can be that there is indeed a value gap. At times, you can have your cake and eat it too, with both a high value gap and a high confidence level.

Deep-Value Investing

This is what we mean by *deep*-value investing. The addition of the adjective "deep" is not meant to simply portray more of the same. It is not meant to simply portray that not only are we buying undervalued companies, we are buying very undervalued companies. Rather, the addition of "deep" is meant to include this concept of confidence. In our practice of deep-value investing, we seek to invest in companies that are undervalued enough to give us high confidence in our conclusions and sufficient margin of safety that we will still come out on top even if events deviate from our anticipations.