The Lucri Alpha Investment Philosophy

The basic philosophy of Lucri Alpha is based on value investing as introduced by Benjamin Graham and Philip Fisher. The interested investor is hereby recommended to read **“Common stocks and uncommon profits”** as well as **“Conservative investors sleep well”** by Philip A Fisher ISBN 0-471-44550-9 and “**The Intelligent Investor”** by Benjamin Graham ISBN 0-06-015547-7. Both books have been written decades ago, but time has not eroded the evergreen principles contained in them – as one would expect from true fundamental principles.

Investments will only be made when a mispriced opportunity is evident. Lucri Alpha will buy shares when the price is below the intrinsic value by a large margin (called the “margin of safety” by Benjamin Graham and later used by Warren Buffet with great success) and only sell when the price is above the intrinsic value, again by a large margin. This implies that the intrinsic value of a common share must be quantified. Thereafter, a good measure of patience and discipline is applied while waiting for a mispriced opportunity. Shares will also be sold when the investment risk shifts to an unacceptable level in relation to the potential reward or when the reason for buying the share in the first place is not present anymore.

The intrinsic value of a share is being determined via historical growth in equity per share and a discounted cash flow model based on historical cash flow (dividends). Lucri Alpha believes that the quality of the business model and leadership of a company can be extracted from historical performance over a long time span – the timeline should be long enough to cover the full economical cycle, the upswing and the downswing. The downswing is especially crucial in order to measure the quality and robustness of the business model, the quality of management and the behaviour of the leadership under stressful conditions. While we acknowledge that past performance cannot be extrapolated into the future, we firmly believe that factors common to the future can be extracted from the past in order to determine highly likely outcomes in the future. In our experience, this approach yields much higher accuracy that attempts at predicting the future by looking at possible future developments exclusively. In our view, this “looking into the crystal ball” approach does not yield good results irrespective of who is attempting to predict the future.

While a good measure of typical left brain analyses is being applied, this is not sufficient to arrive at an investment decision – it only serves as an initial filter to narrow the population of potential investments. Right brain creativity needs to add essential ingredients to the investment process, as investing is also an art which requires a lot of investment instinct.

A checklist of 100 fundamental questions is also applied to narrow the investment opportunities down to only a few. After this process Lucri Alpha will have a good idea WHAT to buy. The next crucial element in the investment process is timing – to know WHEN an investment should be made. Lucri Alpha does not apply technical analyses techniques at all. When the intrinsic value of a company is known, it is simply a matter of waiting until deep value is evident. Thereafter, time in the market is more important than timing. Deep value normally only appears when a share is out of favour – when few investors is interested in buying it. This can follow a setback that the company experienced. As long as the setback will cause a temporary loss of profitability opposed to a permanent loss, the share may present a buy opportunity. Some shares may be too “dull” for the average investor and will therefore not draw attention – another possible cause for a share to trade below intrinsic value. Value is what you get and price is what you pay – the two is not necessarily the same. Lucri Alpha believes that the share market is not always efficient – mispriced opportunities do appear from time to time. When a share is being bought at deep value, “delayed Alpha” is being generated. This means that opportunities for outperformance relative to the market are being created. While it is impossible to predict exactly when the market will correct the pricing to approach the intrinsic value, the patient investor just needs to wait until it happens somewhere in the future – therefore the term delayed Alpha.

In order to outperform the market, a concentrated portfolio is needed. The Lucri Alpha philosophy is to place eggs in fewer baskets, but to watch the baskets closely to minimise risk. This is in contrast to a highly diversified approach where so many baskets are being used that it is impossible to watch all the baskets thoroughly – which more often than not leads to increased risk.

Lucri Alpha does not believe in buying a share just in the hope that someone else will buy the share from us at a higher price. Buying a share without knowing its intrinsic value is pure speculation – which, in our opinion, will sooner or later lead to a permanent loss of capital.

This is also the reason why Lucri Alpha does not apply technical analyses that is only based on share price movement without knowledge of the fundamental drivers of value.

A low priced stock (low multiple or P/E) can be risky due to a low quality balance sheet, vulnerable business model or low quality earnings. A highly priced stock (high multiple or P/E) can be risky purely due to the high price that the investor pays, even if he/she buys a high quality company. More often than not the investor finds true value and low risk (highest possible reward to risk ratio) in a medium priced stock with a wonderful business model and leadership – the stock is still undervalued despite a rather demanding multiple relative to the cheaper stocks.

Lucri Alpha is prepared to pay for high quality. The wonderful company that succeeds in compounding its cash flow per share at double digit numbers in real terms over decades can be an excellent investment at a price that most value investors will regard as overpriced. Time is the friend of the wonderful company with a robust business model – while time can destroy value in a company with a vulnerable business model.

The Lucri Alpha philosophy results in infrequent trading as deep value does not occur frequently. This should not be seen as inactivity, as constant analyses need to be applied behind the scenes in order to immediately recognise value when it appears. When this happens, swift and decisive action is needed before the market recognises the value and share price correction commences.