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Term of the Week- Value Investing

Value investing is a style of active investing and involves buying companies which are presently trading at a price below their intrinsic value, with the expectation that over time the market will fully appreciate the stock's value, and its price will increase to reflect this fundamental value.

Value investors do not believe in the "efficient markets" hypothesis and believe stock prices do not contain all the available information about a company – and that undervalued companies, over time, will revert to their mean when the rest of the market fully appreciates their fundamentals.

They avoid herd behaviour and often have very long term holding periods – take Warren Buffett for example (see below) who defined his favourite holding period as forever.

While there are many metrics and ways of deciding what a value company is, a common metric is a company which has strong revenue and earnings growth but a low price to earnings ratio relative to its industry. Financial statement analysis and a detailed understanding of a company and its management are crucial for a successful value investing strategy.

Value investing was the investment style of the legendary investor Warren Buffett, the CEO of the American Conglomerate Berkshire Hathaway, but it was first developed as a concept by Benjamin Graham and David Dodd of Colombia Business School in 1934.

Now Warren Buffett has handed on the reins and will step back to the position of Chairman, investors and media alike are appreciating just how successful his investment strategy has been over his long career. Warren Buffett's returns between 1965 and the end of last year are in the region of 5,500,000%, compared to a return of 39,054% for the S&P 500. Put another way, $100 invested in Berkshire Hathaway shares in 1965 would now be worth $5.5 million… a testament to the incredible success of his value investing strategy.

Robert Dougherty, Investment Specialist
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This article is not a recommendation to invest and should not be construed as advice. The value of an investment can go down as well as up, and you may get less back than you invested.