Columbia Business School

Graham & Doddsville

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Editors

Jay Hedstrom, CFA
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Jake Lubel
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Sachee Trivedi
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Richard Hunt
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Stephen Lieu
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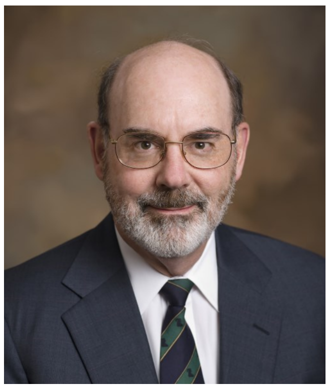
Preston Athey — Holding Winners Longer



Preston Athey

Preston Athey is a vice president of T. Rowe Price Group and has led the $8 billion T. Rowe Price Small-Cap Value Fund since 1991. During that time, the fund has returned nearly 11.9% per year after fees, making it a superior performer among its peers. Prior to joining the firm in 1978, he was a contract administrator on Admiral H. G. Rickover's staff at the U.S. Atomic Energy Commission. Preston earned a B.A. in economics from Yale University and an M.B.A. from Stanford University. He has also earned the Chartered Financial Analyst designation and is a Chartered Investment Counselor.

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Li Lu — Know What You Don't Know

Li Lu

Li Lu '96 is the founder of Himalaya Capital, an investment partnership focused on both public and private opportunities in Asia and North America. Mr. Li grew up in China and was a student leader in the 1989 Tiananmen Square protests. Prior to founding Himalaya Capital in 1997, Mr. Li worked in investment banking. He earned his B.A. in economics from Columbia College, a J.D. from Columbia Law School, and an M.B.A. from Columbia Business School.

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Paul Isaac — Know Your Style and Enjoy the Ride

Paul Isaac

Paul Isaac is the founder of Arbiter Partners, a New-York based hedge fund and nephew of noted value investor Walter Schloss. Prior to Arbiter, he was the Chief Investment Officer at Cadogan Management, a fund of funds. Mr. Isaac began his career at the Allied International-American Eagle Trading Corporation. He graduated from Williams College with Highest Honors in Political Economy and was a Thomas J. Watson Foundation Fellow.

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Li Lu

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G&D: How did your unique experience as a Tiananmen Square protest leader lead you to where you are today, running Himalaya Capital?

Li Lu (LL): When I first came to Columbia University, I was dirt poor. I did not choose to come here – I just ended up here because I had nowhere else to go, having just escaped from China after Tiananmen. I was in a new country where I didn't understand the language, didn't know anybody, and didn't have a penny to my name. So I was desperate and afraid. In retrospect, that is good inspiration for trying to figure out how to make money! I just wanted to know how to survive.

For the first couple of years, I really struggled with the language, but I eventually became much more comfortable. I always had this fear in the back of my mind of how I was going to make a living here. I didn't even think about success at the time – I just wanted to pay my bills. I grew up in Communist China and never had much money to my name, and then all of a sudden I had giant student loans. So naturally I tried to make a buck or two.

One day, about two years after I arrived, a friend of mine who knew my issues said, "If you really want to make money you have to listen to this fellow. He truly knows how to make money." I wasn't sure what it was all about. I just remember thinking that there was a "buffet" involved. So I assumed that it was some kind of talk with a free lunch! I said it was a good combination – a free lunch plus a talk about how to make money. So I went. To my dismay there was no lunch. [laughs] There was just a guy with the name "Buffett."

> ***"There are few people that switch in between or get it [value investing] gradually. They either get it right away or they don't get it at all. I never really tried anything else. The first time I heard it, it just made sense; and I heard it from the best."***

Mr. Buffett really made a lot of sense during that talk. It was like a punch in my eyes. It was like I had just woken up and a light had switched on. His honesty came through right out of the gate. And I thought this fellow was just so intelligent – he could put very complex ideas into such simple terms. I was immediately drawn to value investing. By the time the lecture was over, I thought that this was what I was looking for; I could do this.

At the time, I couldn't really start companies, and I didn't want to work in a big company because of the differences in language and culture. Investing, on the other hand, sounded like it required a lot of reading and mathematics, hard work, and good judgment – I was confident that I could do those things well. And the fundamental principles of value investing appealed to me – buy good securities at a bargain price. If you're wrong, you won't lose a lot, but if you're right you're going to make a lot. It fit my personality and temperament very well. Warren used to say, "Value investing is like an inoculation – either it takes or it doesn't." I totally agree with him. There are few people that switch in between or get it gradually. They either get it right away or they don't get it at all. I never really tried anything else. The first time I heard it, it just made sense; and I heard it from the best. I guess it turned out better than a free lunch.

G&D: How did your investing process develop differently from Buffett's?

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Li Lu

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LL: Part of the game of investing is to come into your own. You must find some way that perfectly fits your personality because there is some element of a zero sum game in investing. If you buy, somebody else has to sell. And when you sell, somebody has to buy. You can't both be right. You really want to be sure that you are better informed and better reasoned than the person on the other side of the trade. It is a competitive game, so you're going to run into a lot of very intelligent, hardworking fellows.

The only way to gain an edge is through long and hard work. Do what you love to do, so you just naturally do it or think about it all the time, even if you are relaxing, and even if you're just walking in the park. Over time, you can accumulate a huge advantage if it comes naturally to you like this. The ones who really figure out their own style and stick to it and let their natural temperament take over will have a big advantage.

The game of investing is a process of discovering: who you are, what you're interested in, what you're good at, what you love to do, then magnifying that until you gain a sizable edge over all the other people. When do you know you are really better? Charlie Munger always said, "I would not feel entitled to a view unless I could successfully argue against the best counterargument of the smartest opponent." He is right about that.

Investing is about predicting the future, and the future is inherently unpredictable. Therefore the only way you can do it better is to assess all the facts and truly know what you know and know what you don't know. That's your probability edge. Nothing is 100%, but if you always swing when you have an overwhelmingly better edge, then over time, you will do very well.

G&D: How did you become friends with Charlie Munger? Do you have a friendship with Warren Buffett as well?

LL: Charlie and I have some very close mutual friends. Over time, we started talking about businesses, and then it evolved into a strong bond. I view him as a mentor, teacher, partner, and friend, all in one. I am also friendly with Warren, but not nearly as close as with Charlie because Warren is in Omaha. I admire him, and I learn more about him from his writings and deeds than through interpersonal interactions. I have a lot of interaction with Charlie, so I know him both as person and through his writing and personal deeds.

G&D: Do you have a favorite Charlie Munger quote?

LL: Oh, there are so many. We share a fundamental ethos about life and about approaching investing. So I learn more about how to conduct myself personally as much, if not more, than investing.

G&D: How would you define your circle of competence?

LL: I let my own personal interests define my circle of competence. Obviously I know something about China, Asia, and America – those are things that I am really familiar with. I have also over the years expanded my horizon [in terms of analyzing businesses].

I started out looking for cheap securities. When you start out, you really have no choice. You don't have enough experience, and you don't want to lose money, so what do you do? You end up buying dirt-cheap securities. But over time, if you are interested in businesses in addition to securities, you begin to become a student of businesses.

Eventually, one thing leads to another and you begin to learn different businesses. You learn the DNAs of businesses, how they progress, and why they are so strong. Over time, I really fell in love with strong businesses. I morphed into finding strong businesses at bargain prices. I still have a streak in me that favors finding really cheap securi-

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"There is some element of a zero sum game in investing. If you buy, somebody else has to sell. And when you sell, somebody has to buy. You can't both be right. You really want to be sure that you are better informed and better reasoned than the person on the other side of the trade."

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ties – I just can't help it! But over time, I've become more attracted to looking for great businesses that are inherently superior, more competitive, easier to predict, and with strong management teams. I'm just not quite satisfied with the secondary market. As I said, there is an aspect of the securities business that is zero-sum. And that's the area in which I don't feel entirely comfortable. I'm more interested, by my nature, in win-win situations.

I want to create wealth together with the business operators and employees when I invest. So that led me to venture businesses. I try to apply the principles of intelligent investing there, but I actually can contribute quite a bit, so it becomes a win-win situation.

Over my career, I've had the satisfaction of building a number of different venture businesses. Some of them became enormously successful, even after we sold them. You could say we sold them too early! I was the first investor in Capital IQ, and then look at what happened. If we would have kept it, we would have been far richer! It's not like we didn't make a lot of money in that investment. We did. [laughs] But I like it that way. I like to create something that everybody finds useful. We created employment, and we created a beautiful product that's sustainable, and everybody made a lot of money, even the people who bought the business from us.

I like win-win situations. I do not complain about selling Capital IQ too early. We made a lot of money on that investment, and we contributed a great deal. I remain friends with the founders. That aspect gave me enormous pleasure. But the venture side is hard to scale; you must put in a lot of effort. So, over time, I gradually moved into helping in a different way. Even in public securities, you can still be very helpful and constructive. So, that's who I am. I'm still learning, and I'm still interested. I'm still young, and still incredibly curious. So, who knows? Hopefully, I will continue to gradually expand my circle of competence.

G&D: How were you able to figure out that Capital IQ would become so successful?

LL: In the beginning it was Bloomberg. We wanted to create something just like Bloomberg, and in the process, we grew to appreciate Bloomberg much more because it was so hard to compete with them. Then we realized the investment banking side was not fully penetrated.

So we basically applied what we learned about Bloomberg and created a similar product for the investment banking side. Over time, we also penetrated different businesses like private equity. We learned quickly that we couldn't really compete with Bloomberg.

G&D: You don't short stocks at Himalaya, correct?

LL: That's right; not any more. That change occurred nine years ago. Shorting was one of the worst mistakes I've made.

G&D: Is your lack of a short book due to your desire to be a constructive third-party for companies and their management teams?

LL: Yes. But also, you can be 100% right, and you could still bankrupt yourself. That aspect of shorting just frustrated me too much! [laughs]

Three things about shorting make it a miserable business. On the long side, you have 100% downside but unlimited upside. On the short side, you have 100% upside and unlimited downside. I do not like that math. Second, the best short has some element of fraud. However, a fraud can be perpetrated for a long time. Of course you borrow to short, so they could really just wear you down. That's why I could be 100% right and bankrupt at the same time. But, you know what, you go bankrupt first! Lastly, it screws up your mind. Shorts just grab your mind and take away from the concentrated effort that is required to do proper

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"The only way to gain an edge is through long and hard work. Do what you love to do, so you just naturally do it or think about it all the time, even if you are relaxing…Over time, you can accumulate a huge advantage if it comes naturally to you like this."

Li Lu

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long investing. So, those are the three reasons why I just stay away from shorting.

It was a mistake on my part. I shorted for a couple of years. I don't discard people who are really doing well at shorting – it's just not me. If I want to add a fourth reason, it is that the economy overall has been really growing at a compounding rate for 200-300 years, ever since the modern science technology era. So, naturally, the economic trend favors long positions rather than short.

But you cannot live life without making a mistake. Every time I make a mistake I learn something.

G&D: How were you able to get Charlie Munger interested in a company like BYD [a Chinese company which manufactures electric cars, batteries, electronics and solar equipment] given that Berkshire Hathaway typically shies away from technology-oriented companies?

LL: I don't think that Warren and Charlie are ideological. Neither am I. It's really how much you know. The story of BYD is relatively simple. This guy, who is a really terrific engineer, started the business from just a $300,000 loan with no additional money until the IPO. He created a company with $8 billion in revenue and 170,000 employees and tens of thousands of engineers. He solved a whole bunch of different problems. So you have to admit the record is impressive. They also happen to be in the right industry and the right environment, and they get the right support from the government. Their engineering culture consistently demonstrates its ability to tackle big, difficult problems. It works. So it's hard not to be impressed by the record the guy has. At the time we invested, we had quite a bit of a margin of safety.

"...you cannot live life without making a mistake. Every time I make a mistake I learn something."

They play in a big field with open-ended possibilities and have a reasonable chance of being successful. As I said, nothing is a sure thing, but this strikes me as having as good of a chance as any. Charlie was equally impressed by the company, which then led to the investment. Berkshire is not ideologically against technology stocks. They're just against anything they don't feel comfortable with. They have that $11 billion investment in IBM, which, I can argue, is a technology company. But I can guarantee that's not how they think about things. It has nothing to do with whether it's a technology stock or not.

G&D: Buffett admitted in a 2009 Fortune article that he doesn't really understand BYD.

LL: That is true. Warren and Charlie have a great partnership and Charlie knows more about BYD than Warren. But I would not bet against the collective track record of those two. It's not that they don't make errors from time to time. Everybody is capable of doing that. They have a few, but very, very few over a long investment career.

G&D: Do you see the quality of BYD cars improving?

LL: This company is a learning machine. Think about it – they really didn't get into industry until 10 years ago. They didn't produce their first car until eight years ago. They are in a market where every single international major brand is competing, with an all-out effort, because it's such a big market. So they never had any home advantage whatsoever because China's auto market started out completely open with everybody competing. Yet there's a little car company

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Pictured: Christopher Davis of Davis Advisors at the 2013 CSIMA Conference.

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with very little money, and, in less than 10 years, it's selling more than half a million cars a year and has carved out a position for itself. You have to say, the record is not too bad, and so there's something to it. They also have an engineering culture and a can-do spirit. They consistently demonstrate that they're able to tackle really complex engineering problems and come up with very practical solutions faster, cheaper, and better than most other people. That is an advantage in the manufacturing economy.

G&D: Can you talk about your investment process?

LL: Ideas come to me from all sources, principally from reading and talking. I don't discriminate how they come, as long as they are good ideas. You can recognize good ideas by reading a great deal and also by studying a lot of companies and constantly learning from intelligent people – hopefully more intelligent than you are, especially in their field. I try to read as much as I can. I study all of the interesting and great companies, and I talk to a lot of intelligent people. You know what? In some of those readings or conversations, ideas just click. Then you do more research and then you get comfortable or you don't get comfortable.

G&D: Are the people that you talk to fellow investors or are they people like customers, suppliers, and management?

LL: All of them. I don't talk to as many investors – very few. I am more interested in talking to people who are actually running businesses and entrepreneurs or CEOs or just good businessmen. I read all of the major newspaper publications and annual reports of the leading companies. I get a lot of ideas out of those too.

"You can recognize good ideas by reading a great deal and also by studying a lot of companies and constantly learning from intelligent people – hopefully more intelligent than you are, especially in their field."

G&D: How do you assess if the management is being forthright with you? How useful is it to speak with the management?

LL: Well, management always has a big influence on your success, no matter how good or how bad the business is itself. Management is always part of the equation of making the company successful, so the quality of management always matters. But to assess that quality is not that easy. If you can't assess the quality of management, you may have to make a decision in spite of that. That's just part of the process. So you have to figure out other ways such as looking at the quality of the business, the valuation, or something else until you can justify an investment.

If you do have a way to assess the quality of the management team, either because you're an astute student of human psychology, or you have a special relationship with the people, then you'll take that into consideration. Why wouldn't you? The management team is part of what really makes a company.

But, it's not that easy. It's not that easy to have an in-depth, solid understanding of the management team. Very few people are able to do that. I admire people that say, "Hey, look. Whatever the information, whatever the kind of presentation they make, I will never be able to learn about management beyond that. I know it's a show for me, so I might as well just discard it." I respect that.

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Investing is about intellectual honesty. You want to know what you know. You want to know, mostly, what you don't know. If understanding the management team is not in the cards, it's not in the cards.

G&D: What is your domestic versus international allocation?

LL: I don't have a preconceived notion about allocation. I let the opportunity dictate where I end up. I just happen to have more interest in Asia and the U.S., so that's where I end up. I do not feel that interest in Europe. I do not feel that in Africa. But I approach it with an open mind. I want to really find the best company at the best price, run by the best people and available to me at the time I am looking. Those don't necessarily always meet, and it's OK.

You start out by holding cash, and that is a pretty good opportunity cost, because it doesn't go down. So any time you find an investment, it has to be an improvement on an overall risk-adjusted basis. You may find some very interesting things, and now you've got a basket of a few interesting securities plus cash. That is a pretty good opportunity cost, and the next time you add another security, it better make the portfolio better than the existing one. You just constantly improve your opportunity cost.

G&D: Is your fund open to new investors?

LL: The fund has been closed to new investors for nine years. However, we will open it up a bit this year. We have more opportunities than we have money around, but that's rare. I usually don't want to increase our size. My ambition has never been to run the largest fund. I never wanted to earn the most money out of a fund. I just wanted to have, by the time I finished my career, one of the best track records on a risk-adjusted basis.
If I achieve that, I will feel very good about myself.

"That way we're all in the same game together. … That ethos is what makes Charlie and Warren so special. They believe in fundamentally earned success. That's why, despite their enormous success, nobody criticizes them very much."

That's my goal, and therefore the compensation structure of the fund reflects that. Over time, I switched into the best compensation structure I knew in the industry, the original "Buffett partnership formula". We don't take any management fee. We provide a 6% return for free to our investors and then take 25% after that. I don't invest anything outside of the fund. I put all of my investment capital into my funds. So it's a true partnership. There are very few conflicts between the general partners and the limited partners.

That way we're all in the same game together. I have zero incentive to take new money for the sake of taking new money because I don't take things off the top. The minute that new money arrives, it begins to compound 6% on an annual basis against me, so I better be able to find something that is worthwhile and doing better. When I make money, I feel like I earn it, and when my investors make money, they earn it. It is just a better way to structure a business – you feel that everybody's success is deserved. That ethos is what makes Charlie and Warren so special. They believe in fundamentally earned success. That's why, despite their enormous success, nobody criticizes them very much. When you create the hundreds of billions in wealth for everybody

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while taking a salary of $100,000 per year for more than 40 years, it's hard to criticize them.

G&D: Are there industries that you completely stay away from?

LL: I'm not ideologically opposed to anything. I am against any ideology. [laughs]

There are lots of things I don't know. I'll be the first one to admit. But it doesn't mean that I'm not curious from time to time. Maybe I know some aspect of the story. That little aspect might even constitute the investment. I don't know. I don't want to rule it out, but I can say that when you present me an idea, I can quickly tell you whether it's a "no" within a few minutes.

There are basically three buckets that Charlie has. "Yes", "no", or "too hard". Most of the things fall in "too hard." Some get a quick "yes" or "no", but if it's too hard, it's too hard. So you end up not doing a lot. You end up really concentrating on the ideas where you truly have the time and energy to fully understand the situation better than anybody.

G&D: How to you get comfortable with the risk/reward of a high tech company like BYD that is undergoing pretty rapid technological change? Do you think you have a good sense of what BYD will look like 10 years from now?

LL: Most businesses are subject to change if you stay with them long enough. There's not a single business that I know of that will never change. That's the fascinating thing about business. Successful businesses have some combination of things that enable them to adapt to changes better than anyone else. In each situation, it's slightly different.

"I think you want to avoid wrong decisions as much or more than you want to get it approximately right. If you avoid the wrong decisions, you'll probably come out okay over time."

Every company in today's age is a technology company somehow, but the technology may not be on the cutting edge, and may not play an important role in the success or failure of the overall business.

Successful technology companies are the ones that are capable of reinventing themselves and dealing with change. Take the example of Intel. The whole business changes every 18 months. Failure to change leads to quite a substantial disadvantage and yet they're able to build their culture based on that change.

Take Samsung – their early memory chip business decreased in price by 1% every week, and yet they really developed a culture that precisely deals with that change. So when they apply the same culture to something like a cell phone, they get ahead very quickly. Now they're outselling Apple. So culture really plays an important role in those faster-changing environments, enabling certain companies to always surge ahead of everybody else.

G&D: Do you need to understand the technology on an engineering level to have a good sense of the risk/reward?

LL: It certainly is a plus, but not a must. If you were really a great engineer in the product the business is selling, obviously it's a plus. But it's certainly not a must because no matter how good you are at a certain area, you're not so good in other areas. The pace of change is such that whatever you are now specialized in will become obsolete. But that doesn't disqualify you from making a judgment

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on how a company can develop a culture to deal with that. Successful companies are able to deal with change consistently by hiring the right people, building the right culture, and staying ahead of their competitors. That's the aspect that really makes them successful. And that's kind of a predictable aspect of businesses.

There is always a certain element that is unpredictable. And there is a certain element that is predictable. You want to have a little of both. But overall, I think you're right. In a business that is subject to rapid change, it is a lot more difficult to make a reliable forecast. There is no question about that. But it doesn't mean an investor cannot make a few predictions that could indicate that the odds are in your favor. You want to play when you feel very comfortable that the odds are in your favor. Many times, that's searching among typically stable businesses where something has changed all of a sudden.

Take Eastman Kodak for example. It used to be one of the best companies; it invented photography. But look at where they are now. Take Bell Labs and AT&T. They used to really have all the power. They had monopoly businesses. Where are they now? Just a name. That is the nature of brutal capitalism. It's the nature of the business. Things that appear to be predictable and stable are not. Things that don't appear to be very stable actually turn out to be.

I think you want to avoid wrong decisions as much or more than you want to get it approximately right. If you avoid the wrong decisions, you'll probably come out okay over time. But, I agree with you, it's not easy and it's not precise or a science at all. Hopefully one improves overtime.

"The most important thing in our business is intellectual honesty. What I mean is four different things: know what you know, know what you don't know, know what you don't have to know, and realize that there is always a possibility that 'you don't know that you don't know.'"

G&D: How do you make your sell decisions?

LL: One should make sell decisions on one of three occasions. Number one, if you make a mistake, sell as fast as you can, even if it's a correct mistake. What do I mean by a correct mistake? Investing is a probability game. Let's say you go into a situation with 90% confidence that things will work out one way and a 10% chance they work out another way, and that 10% event happens. You sell it. Then there's a mistake that your analysis is completely wrong. You thought it was 99% one way but it was actually 99% the other way. When you realize that, sell as fast as you can. Hopefully at not too much of a loss, but even if it is a loss it doesn't matter – you have to sell it.

The second time you want to sell is when the valuation swings way too much to the other end of the extreme. I don't sell a security because it's a little overvalued, but if it is way overboard on the other side into euphoria, then I will sell it. If you are right and hold a company for a long time, you have accumulated a large amount of unrealized gains. A big portion of those unrealized gains act like borrowings from the government interest free and legally. So when you sell that position, you take all the leverage and you take a bunch of the capital out, so your return on equity has just become a

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Pictured: Mason Hawkins of Southeastern Asset Management at the 2013 CSIMA Conference.

Li Lu

Pictured: Tom Russo of Gardner Russo & Gardner and Timothy Hartch of Brown Brothers Harriman at the CSIMA Conference in February 2013.

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little less.

The third occasion when to sell is when you find something that is better. Essentially, a portfolio as I said is opportunity cost. Your job as a portfolio manager is to constantly improve on your basket. You start with a high bar. You want to increase the bar higher and higher. You do that by constantly improving the opportunity costs; you find something better. Those are the three reasons that I would sell.

G&D: In your 16 years running Himalaya, you've experienced three major financial crises: the Asian financial crisis of 1997, the dot com bubble burst in 2000, and the financial crisis of 2008. How have you navigated these crises as a fund manager, and what have you learned from them?

LL: That's an excellent question. You know every time that that happens, they always bill it as "once in a century," except these major events happen every five years in my case. [laughs] What is interesting about crisis is that it puts your intellectually honesty to the test.

The most important thing in our business is intellectual honesty. What I mean is four different things: know what you know, know what you don't know, know what you don't have to know, and realize that there is always a possibility that "you don't know that you don't know." Those four things are distinctly different. In a crisis, things emerge that test you on all four categories.

For example, during the

"The most important thing in our business is intellectual honesty. What I mean is four different things: know what you know, know what you don't know, know what you don't have to know, and realize that there is always a possibility that "you don't know that you don't know."

Asian financial crisis, all of the sudden the world was saying, "how much debt do these companies have?! Oh my goodness, they really have that much of a dependence on debt! Oh my God, the whole country could go down!" Everyone was constantly in crisis mode. All of the things come out that you don't normally care about and normally don't pay attention to. Normally you think, "Well, that has nothing to do with my investment in this company." Then all of the sudden, you say, "Oh Jesus, it has everything to do with my company." Well, you are right or you are wrong. That crisis will put those questions to the test.

That's why people freeze in the midst of a crisis. People freeze because they were not intellectually honest before. They never quite distinguished certain issues or questions and put them into the appropriate basket. If you make an overall judgment, for example, of how the U.S. is going to perform over time through ups and downs, and you go into it knowing that there is a possibility something much worse could happen. Maybe it's small, but when it happens, it happens. At that time, the question becomes "Is it an unknown unknown," or do you know that you don't have to know? You absolutely will be asked that question.

So the financial system might be in trouble. Yes, a business needs financing, but I suppose if life goes on, my business will be there, however it will end up. So the question then becomes, "Do I have to know how

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the financial system will sort out its problems for me to predict my business?" That's the question and that's the question that you want to answer before a financial crisis hits.

If you can answer that question honestly and correctly, you will do more after the financial crisis. Christopher Davis's grandfather used to say that you make the most money out of a bear market financial panic – you just don't know it at the time. It's always the case. Less intelligent investors will be sorted out. Intelligent investors are the ones who are always intellectually honest. They can distinctly know whether they know or they don't know, and know what they don't have to know, and that there exist unknown unknowns. If you can really put things into those categories correctly, you will pass the test. Otherwise, you will have gotten yourself in trouble.

G&D: In 2010 panel at Columbia Business School, you mentioned that Asia's role in the global financial system is becoming increasingly important. Can you talk about this view for our readers?

LL: Asia will become an important economic force, not necessarily just in a financial sense. The financial part is a derivative of Asia's overall economic performance. Asia, and particularly China, is shaping up to become a bigger economic force in our global marketplaces because of the sheer size of it and the path that they're on.

China is on a historic path of continuing to grow into a modern economy. They still have a long way to go, but they have come a long way from the starting point. Because of the enormity of the size of China, it will have a huge impact in Asia and the rest of the world. So China and the U.S. together would make the Pacific Basin somewhat of an economic center the same way that the Atlantic Ocean was around Europe and the U.S. A lot of opportunity will emerge. That doesn't mean that it's a one-way street or a smooth pass. All sorts of things could happen. It doesn't mean you're going to make money guaranteed. But it does offer a tremendous amount of opportunity to those who can navigate this development. The importance of China cannot be ignored.

"China is so big. It has all sorts of extreme phenomena. Yes, there are ghost towns, but there are also towns that are utterly, utterly crowded … China is a case of contradiction, as it has always been, and will always be; you'll always find evidence of every theory you want to prove."

G&D: Do you have any concerns on a real estate bubble in China? We saw a 60 Minutes piece about the ghost cities in China, and it was very striking.

China is so big. It has all sorts of extreme phenomena. Yes, there are ghost towns, but there are also towns that are utterly, utterly crowded. I mean, every space is occupied, and there are towns seemingly out of nowhere that have an enormous number of high rises that are all occupied. I remember, twenty years ago that Pudong was viewed as a semi-ghost town. Today, you cannot help but be impressed by the economic vibrancy there.

We live in Manhattan, but think about it: there are 10,000 high rises in Shanghai that are taller than thirty floors, multiple times that of Manhattan – that is enor-

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mous. Manhattan probably has the highest concentration of high rises in the whole world other than Shanghai. The scary part is that China's not done. So, I say China is a case of contradiction, as it has always been, and will always be; you'll always find evidence of every theory you want to prove.

But overall, the economy still has a long way to go. They still have a sense that this is their time. It doesn't mean that they don't have problems; they have an enormous amount of problems, but so does America, and so did America over the last 200 years.

If you go through the American Civil War, the country killed two percent of its population. And yet, not only was it rebuilt, but it was rebuilt at a furious pace. And it went through two great world wars. After World War II, if you thought Japan and Germany were doomed, boy were you wrong.

G&D: Do you think real estate has gotten a little ahead of itself where there would be a need for a correction, or do you think that demand will just catch up?

LL: I put that in the "too hard" basket. I also put in the basket of "I know I don't have to know." It certainly is "I don't know", but I also know that I don't have to know! I don't want those things to worry me.

G&D: How do you view the overall attractiveness of equities today?

LL: I also put that into "too hard" and "I know I don't have to know." I only think about it when things go to an extreme. I don't foresee that as going to the extreme, either way. In that case, I know I don't have to know.

"I pay attention to those macro trends only in the hope that I can have comfort that they're a tailwind as opposed to a headwind. Now, how much they can help if they're a tailwind, or how much they can hurt if they're in my face, I don't know."

G&D: A lot of smart people believe that renewable energy is the next big revolution. You've done a lot of work on battery technology and BYD, so is that something that you think about beyond batteries? What do you think the energy revolution will look like?

LL: I pay attention to those macro trends only in the hope that I can have comfort that they're a tailwind as opposed to a headwind. Now, how much they can help if they're a tailwind, or how much they can hurt if they're in my face, I don't know. But I want such macro trends to be behind me rather than in front of me. So that's the extent that I want to know mega trends.

But as a concerned citizen, I'm intellectually curious about it. But it doesn't mean that I'll be able to know for sure how a given development is going to come about. In fact, we don't know, and that's why the free market with millions of participants acting in their own self interests will figure out a way. To predict ahead of time is not easy, and the good thing is that you don't have to be able to do that.

If such trends are at your back, that's fabulous, especially if you don't need them to be at your back. If they're really a headwind, you do want to examine them a little more. So that is how I view this renewable energy issue. I know that at some point, human civiliza-

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tion will have to find something other than fossil fuels. We don't have enough fossil fuels, and we need to preserve them for agricultural and food security reasons. We also can't afford to have the weather deteriorating the way it has been over the last few decades. Eventually it will catch up to us.

So for multiple reasons I understand why we need to figure out alternatives to fossil fuels. But am I qualified to make an informed investment decision based on that now? Probably not. But if that one happened to be at my back, hey I'm all for it.

G&D: Do you have any advice for students who are interested in getting into investment management, especially for those readers who can't go and listen to Warren Buffett speak during their lunch break?

LL: If you do get a chance to meet Mr. Buffett, I'd run to it if I were you. I wouldn't even take an airplane; I would just run to Omaha! [laughs]

Start by learning from the best – listening, studying, and reading. But the most important thing in understanding the investment business is by doing it. There is no substitute to actually doing it. The best way to do it is to study one business inside and out for the purpose of making the investment – you may not actually invest. But having gone through the discipline of understanding one business as if you own 100% of that business is very valuable.

To start, take an easy-to-understand business. It could be a tiny business – a little concession store, a restaurant, or a small publicly traded company. It doesn't matter. Understand one business and what really makes it tick: how it makes money, how it organizes its finances, how management makes its decisions, how it compares to the competition, how it adjusts to the environment, how it invests extra cash, and how it finances the business.

"Start learning from the best — listening, studying and reading. But the most important thing in understanding the investment business is by doing it. There is no substitute for actually doing it. The best way to do it is to study one business inside and out for the purpose of making the investment."

You should understand every aspect of one business as if you own 100% but you don't actually run it. This causes you to be desperate to understand every aspect to protect your investment. That will give you a sense of a disciplined approach. That's how you truly understand business and investing. Warren always says that to be a good investor, you need to be a good businessman, and to be a good businessman, you need to be a good investor in terms of capital allocation.

Start by understanding one thing within your control that you can understand inside and out. That is a terrific starting point. If you start from that basis, you are fundamentally in the right direction of becoming a great security analyst.

G&D: It was a pleasure speaking with you, Mr. Li.

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