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On this week's Consuelo Mack WEALTHTRACK: Veteran value fund manager, IVA Advisers' Charles de Vaulx explains why he has nearly 40% of his portfolios in cash.

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CONSUELO MACK: This week on WEALTHTRACK, we discuss value investing with International Value Advisers Charles de Vaulx. Why is value so hard to find these days, and why is he holding nearly 40% of his portfolios in cash? That's next, on Consuelo Mack WEALTHTRACK.

CONSUELO MACK: Hello and welcome to this edition of WEALTHTRACK, I'm Consuelo Mack. Do you consider yourself to be a value or a growth investor? How do the funds you hold describe themselves? Investment styles go in and out of favor. An extreme example was during the tech boom when growth was hot. Investors were willing to pay up if a company had a dot com in its name and revenues were growing. Traditional value metrics such as price and earnings didn't seem to matter, until of course they did. Growth crashed and value took the lead in the 2000s.

But as you can see from this chart, comparing price earnings multiples between the two styles, in the slow growth years after the financial crisis the spread or difference between valuations of growth and value stocks grew to historically high levels with growth making a strong comeback and value oriented companies lagging badly. As you can see from this chart, last year was the first time in four years that value outperformed growth. Until then, self-described value managers have had a tough time beating the overall market and even their benchmark indexes like the Russell 2000 value index, which are chock full of many lower quality companies that are cheap for a reason. In many cases they are highly leveraged, have no earnings or have problems.

This week's guest is a self-described value manager with a precise definition of what value means to him and his firm. He is Charles de Vaulx, the chief investment officer and co-portfolio manager of International Value Advisers, a value oriented global money management firm he co-founded with de Lardemelle in 2008, at the beginning of the financial crisis. Before founding IVA, both spent many years working with legendary value investor and frequent WEALTHTRACK guest, Jean Marie Eveillard. They manage several portfolios, but their major

holdings are in two mutual funds their flagship IVA Worldwide Fund and the IVA International fund. Both were closed to new investors in 2011 because they didn't want them to get too big, and also what they perceived as lack of opportunities in the market, a view they hold today.
IVA worldwide has outperformed its Morningstar peer group and market benchmark with less than market risk since inception, but has trailed the market in recent years, a fact that does not bother this investor whose goal is absolute returns overall with capital preservation in the short term and market outperformance over a full economic cycle. We are not there yet.
I began the interview by asking de Vaulx what value means at IVA.

CHARLES DE VAULX: Value is what you get. Price is what you pay and value is what you get. Value investing was invented by Ben Graham several decades ago, and basically the premise of the investment approach is the belief that at times, some stocks will trade either way below or way above the real value, the intrinsic value of the underlying company, and the goal is to try to find stocks and buy them when they trade below the real value. Now the real value is what a rational buyer would pay in cash to own 100 percent of the business. Over time, some of the disciples of Ben Graham decided to focus on very cheap securities where the underlying business was average or mediocre. Other value investors were willing to pay up for quality, and I think Warren Buffett himself evolved from one to the other. Many people today use an overly narrow definition of value investing, especially the quantitative types try to, say in the S&P 500, isolate which stocks are the growth stocks, which are the momentum stocks, the quality stocks, the value stocks. Too often the definition of value stocks are those that trade at either a low price to earnings ratio, or a low price to book value of the company, or stocks that offer a high dividend yield. I believe that that's an overly narrow definition of value investing because sometimes the price to earnings may be low, but those might be peak earnings.

CONSUELO MACK: So the quantitative screens can miss those finer points.

CHARLES DE VAULX: Exactly. Conversely what's interesting is at Columbia University they have classes. They teach value investing and they, I think influenced by how successful Warren

Buffett had been, started to teach their students five, ten, 15 years out that they now as value investors should favor the better businesses. They should pay up. They should find the compounders, high-quality companies, companies with big moats, companies with pricing power. While they were teaching those things, Warren Buffett – sneaky him – is when he turned around and bought Burlington Northern for Berkshire Hathaway. Now he bought the entire company on the basis that for 40 years that had been a mediocre business, and his hope for several reasons was it would transition from being a bad business to an okay business, again a far cry from the fabulous brands, franchises that people started to associate with him. So the bottom line is that proper value investing will always be eclectic. Another thing to point out is that rule number one of value investing, a stock has to be cheap, price versus value. But rule number two is that it has to be cheap but safe, to paraphrase Marty Whitman from Third Avenue. It has to be cheap but safe.

CONSUELO MACK: So an International Value Advisors, are you eclectic?

CHARLES DE VAULX: Now we do have a bias...

CONSUELO MACK: What is your bias?

CHARLES DE VAULX: We have a bias towards better businesses especially because – which hopefully we'll touch upon later – we have a bias towards family-controlled businesses, companies with big inside ownership. We like to eat our own cooking. We like to invest in our funds. We like to invest in companies that eat their own cooking.

CONSUELO MACK: Let's go to that right now. Why is that an important characteristic?

CHARLES DE VAULX: Because it's the power of incentives when it's the people's own money. Because they are proud of the company, they may be willing to have a longer-term view. They're willing to sacrifice earnings, maybe willing to spend money on research and development and advertising, therefore, penalizing reported earnings yet for the good of the company down the road. Also, family-controlled businesses around the world have a history of being a lot more cautious financially. They're less willing to have too much debt. They want to finish the race. Now conventional wisdom on Wall Street 30 years ago was that most family-controlled businesses were bad. In other words, so later the son, grandson, daughter, granddaughter would get to run the business. They would run it to the ground.

CONSUELO MACK: I mean I worked for a family-run business, for instance, where the third generation kind of exactly lost the discipline and just wanted to pay themselves dividends. So right.

CHARLES DE VAULX: Also the idea that ultimately they may not care about outside shareholders and so it gets sleepy, whatever. But the Credit Suisse, the investment bank, in fact devised at least 15 years ago an index called the Credit Suisse Family Index, where they track around the world and by country stocks of companies with big inside ownership, Berkshire Hathaway being one of them; L'Oréal, a very successful cosmetics company in France.

CONSUELO MACK: You own Berkshire Hathaway. Tell me. Do you own L'Oréal? I'm trying to remember if you do.

CHARLES DE VAULX: Not now, but we've owned it in the past.

CONSUELO MACK: You've owned it in the past.

CHARLES DE VAULX: We own it indirectly through Nestlé. Nestlé has a stake in L'Oréal, and so surprise, surprise. Not only for the past 20 years but going back 40, 50 years in virtually every country in the world companies with big inside ownership do better. One country where it's striking is Japan. In fact, many of the companies we own in Japan are family controlled although not the largest holding; we have Astellas Pharma which hopefully we'll talk about. Shimano bicycle parts manufacturer, a very successful company in Japan is successful on a global scale. We don't own it now, but we have in the past. Again, still big family influence.

CONSUELO MACK: So a company that you do own now that is family controlled, aside from Berkshire Hathaway, is there one that comes to mind that kind of exemplifies what you're talking about?

CHARLES DE VAULX: In France, Bolloré Investment is a conglomerate, so we own Bolloré. We own the holding company called Odet, O-d-e-t, and that's run by Vincent Bolloré, and now he does have some of his kids involved in the business. It seems that they are very bright and competent. What we've also observed is over time when the family feels that they don't have the competency within the family; they show a willingness to hire outside people.

CONSUELO MACK: Johnson & Johnson was a good example.

CHARLES DE VAULX: The person who runs Pernod Ricard, the liqueur company French-based yet global and successful, is not part of the Pernod family. Sodexo is another holding of ours. It's a food catering business. That's the core of what they do, so they compete against Aramark in the U.S., but they own Marriott Services in the U.S. They bought that a long time ago. So it's family followed by family from the south of France and for ten years at least now the fellow who runs the company, the CEO is not part of the family.

CONSUELO MACK: How do you even begin to decide whether or not you're going to put the time and effort into research a company to consider buying it?

CHARLES DE VAULX: So that goes back to your question. How do you at IVA define value? Now we, I have to confess, have a bias towards quality businesses, especially family-owned. So if I were to generalize, I would say this. Many of our value competitors start the process of identifying likely investments, they start with the price. In other words, they run screens especially with technology today. Machines spit out to me every Friday afternoon as we speak all the stocks around the world that trade below one times book value, below five times earnings.

CONSUELO MACK: So you're getting that at IVA. You're using the technology.

CHARLES DE VAULX: We get all that, but we don't believe in those screens because the names that will end up on the screens will be names of cheap-looking stocks, but most of them will either be among the lousiest competitors within the industry, or will be operating industries that are overly competitive where they might be over capacity, steel, shipping, shipbuilding, you name it. So at us at IVA, it's different. What makes us want to investigate a stock idea, it's not, oh, it looks cheap. It's more we read about it, there seems to be something unique about it. There seems to be something superior about it. It may not optically look cheap, but let's hope and pray that it may still be cheap. So a good example would be good businesses that are cyclical. I mentioned temporary staffing. Freight-forwarding. The freight forwarders like Expeditors International, Kuehne + Nagel, they do not own the planes or the ships or the trucks. Sometimes they just lease a few warehouses, so it's not a capital-intensive business model. It's cyclical but not as massively cyclical as an airline company or shipping company, but it's cyclical and because it's a good business, the only way we in the past have been able to buy those stocks cheaply is when the economic outlook gets worse, during an economic downturn. Other investors are short-sighted. They're not willing look through the value of the economic downturn, and that's when some of these ... so quality stocks that are cyclical appeal a lot to us, because the downturn allows us often times, because we have a longer-term horizon, to look through the downturn. Advertising would be wonderful example, billboard advertising. Economic downturn advertising. The earnings of these companies will go down. Other investors will drop those stocks with the idea that they'll buy them back later when things are better, but it's too late.

CONSUELO MACK: Are buybacks an important consideration for you?

CHARLES DE VAULX: We have a bias towards owning good businesses, meaning companies that throw off free cash flow. Now maybe they do so in a cyclical manner, and so we'd much rather the company give us that money back in the form of dividends or, even better, start buybacks as long as the buyback is done because the stock is cheap, as opposed to buybacks that are done just to offset the dilution of all these stock options given to senior executives.

CHARLES DE VAULX: So to answer your question, we like buybacks the way Astellas Pharma does buybacks. Because there are very price-sensitive, they realize that it's a way to add value or Warren Buffett style. He will only do buybacks now should the stock fall below 1.2 times book value, because he knows that the real value of the company is so much higher than that, that any buyback is very accretive

CONSUELO MACK: So aside from the value approach that you take in looking at good companies and you're looking at family ownership, it's a very specific stock-by-stock.

CHARLES DE VAULX: It's stock-by-stock. Now, you had asked me earlier, what does value investing mean at IVA? This is a very important point that I'll make now. Value investors thought for a long time that they could ignore the big picture, the macro economic environment. Only God knows the future. He ain't telling us. Why even waste time trying to guess what the inflation rate will be and interest rates? Yet we've gone back, not only at IVA but before that at First Eagle, we have believed that the use of debt in so many economies has become pervasive, more and more government debt, more and more debt that households are willing to incur, more and more debt that corporations are willing to put on the balance sheets. So over time whenever we see countries or industries where too much debt has been taken on, we pay a lot of attention.

CONSUELO MACK: It's a negative.

CHARLES DE VAULX: When the debt has been taken on, it helps that country. It helps that economy. That country may be on steroids. Things may look cheap. Companies may be highly profitable, but we know that that debt is artificial and at one point the party will stop. To give you an example, there was a huge debt boom in Japan in the '80s at the corporate level, not the household level, and that was one of the reasons then along with valuation as to why we pulled out totally of Japan by mid '88. We looked silly for a while until late '89, but boy was it sweet to have zero percent in Japan when the bubble burst.

CONSUELO MACK: So your view of Japan today which is the government is very highly indebted as a percentage of GDP...

CHARLES DE VAULX: So that's a big negative. At the same time, corporations have more net cash than ever. So it's not as bad as just looking at the government debt. It's complicated, but still we don't like those trends in Japan.

CONSUELO MACK: A couple of other key characteristics. Your willingness to hold large amounts of cash and also your willingness to invest in gold. For instance, 38 percent cash levels in your Worldwide Fund that strikes me as a very high amount of cash.

CHARLES DE VAULX: It is. It basically is a result of the fact that we are struggling today to find enough truly cheap stocks or high-yield bonds around the world, as opposed to say us guessing that the stock market may be about to go down. We have no idea and frankly we don't care. We take the view that markets are here to serve us. If they want to be euphoric, if they want to believe in Trumponomics, great. It will be a chance for us to sell a few things probably. If they want to be manic depressive and get cheap enough, great. We'll probably find some things to buy. So today the reason why we are struggling to find cheap stocks is because interest rates are so low in U.S. dollars, and in euros, in yen. In fact, interest rates if you adjust for inflation is even lower, typically negative, and so those negative rates have enticed people, investors, to pay up for stocks and bonds, making them way too expensive for us.

CONSUELO MACK: So is that one of the reasons that, for instance, in the last three and five-year periods you've underperformed your benchmark even though since inception you way outperform?

CHARLES DE VAULX: Yes. Of course the inception was in '08, so we're able to highlight our wonderful resiliency in the down market. Yes, that's the reason for it, and it is the good news. I mean on one hand with hindsight, it seems that we've had too much cash for the past five years with hindsight that is. Now we felt the risks were there. We believe that the risks are still there, but the good news if you look at the stock picking that we've done, it has been good which is why when I hear so many of my value competitors say, "Well, we're not doing well because value investing is out of favor," I say, "Wait a minute. It's your kind of value investing has not been working, but in our case the way we at IVA do it, it's been working like a charm." Our only crime, if you will, is to have had all that cash.

CONSUELO MACK: So you have not been tempted (Laughs) to just say we have conviction in the equities that we've got and let's just double up on them or...

CHARLES DE VAULX: No, no. Investing has a lot to do with resisting temptations, Consuelo. Let me remind you. Also, because the real answer is our mandate is very unique. It's not to try to deliver the best performance possible and showcase our stock picking. Our mandate is two-fold. It's not to lose money on every calendar year basis. Ideally we want our returns to be as absolute and as positive as possible, and second mandate, over a full economic cycle, whether it's five years, seven years, eight years, yes, we should beat our equity benchmark.

CONSUELO MACK: So it sounds as if the current environment that we're in, the investment environment, is very risky.

CHARLES DE VAULX: It's very risky, yes, and of course people may not realize because I guess they don't want to. It's because they hate so much earning nothing on their savings account. In fact they lose money to inflation out of despair. Out of the hatred towards losing a little bit of money in the case, they've been willing to pay up and I believe not realizing at all the risk they've been taking, even though '08, '09 was not that long ago. Even though the tech bubble was busting in 2001 was not that long ago. So I hear people say, "Well, it cannot be a market top." Who cares if it's a market top because there's no euphoria? In fact there's no massive retail participation, but I believe that markets can get ahead of themselves not always in a mania but out of necessity, out of the fact that you lose money holding cash. Who wants to lose money holding cash?

CONSUELO MACK: So the TINA, there is no alternative, school of investing.

CHARLES DE VAULX: We're holding cash. We don't mind losing a little bit of money on cash which is a strange statement to hear from me. I'm not known to like to lose money, because what's unique about cash and only cash has that attribute, cash is not only a buffer. It's not only something that does not go down in price when other things may go down in price. Cash is what you actually need to buy low so that you can then sell high. When people say – maybe the Rothschilds – you're supposed to pounce when there's blood in the street, you actually need cash to pounce.

CONSUELO MACK: Cash to do that.

CHARLES DE VAULX: So the cash on which we're losing a little bit of money today hopefully will allow us to pounce when the proper bargains will surface.

CONSUELO MACK: Two more quick questions. I mentioned earlier gold. You have holdings in gold bullion. What is the theory behind your gold holdings?

CHARLES DE VAULX: Well, I think I mentioned Warren Buffett earlier. We don't have his genius.

CONSUELO MACK: He does not own gold, and he doesn't like gold.

CHARLES DE VAULX: Doesn't like gold; pooh-poohs gold. Gold is not an investment. It does not generate free cash flow the way Farmland may or General Electric as a business, but then again he who at times worries about inflation, he has a knack for buying businesses that know how to cope with inflation. He has the ability to borrow money and lock in long-term rates for 40 years.

CONSUELO MACK: And demand very favorable terms when he lends a company money.

CHARLES DE VAULX: So now the reason why we care about gold is that we agree with Warren Buffett. It's not an investment. It has been money over a long time and money means not only an accepted medium of exchange. It's also something that's not supposed to lose its value over time. Fiat currency including dollars are known to have lost their value over time, and some more than the Zimbabwe dollar, but gold to us… what intrigues us is that more often than not, the performance of gold will be inversely correlated to the performance of stocks or bonds. So our funds are long only. We don't short securities. To have in our portfolio in our toolkit something gold which can go up when the rest of our portfolio may go down, is a very nice tool to have.

CONSUELO MACK: Final question which I ask every guest on WEALTHTRACK is if you had to choose one investment to put today in a long-term diversified portfolio, what would it be?

CHARLES DE VAULX: Well, it would be a stock which is one of the biggest positions in both of our funds. It's called Astellas Pharma. It's not a well-known name for your viewers, yet it's the second largest pharmaceutical company in Japan. Its market capitalization is $30 billion. Now it does have an ADR, so you could buy shares in the U.S., but most of the volume takes place on the Japanese exchanges. Interesting enough, we've held that stock for five years, and it's more than tripled for us, and even though it's tripled in price, we think it's as cheap as ever.

CONSUELO MACK: Why is that? Because it's just gotten better?

CHARLES DE VAULX: Because the intrinsic value of the company has grown a lot over time basically. Astellas Pharma has many products that are able to really help patients. Their latest product is Xtandi, which is for prostate cancer. They do not believe in price gouging. They believe in having a strong balance sheet. They want to finish first. In fact they hold net cash today. They've been willing to buy back their own shares for the right reasons when they felt the stock was unduly cheap. So it's a remarkable company. Eighty-five percent of their sales and earnings are outside Japan, 35 percent in the U.S., and for some reason the stock is I think misunderstood. I think most of the pharmaceutical companies are either European-based, followed by the Europeans, U.S.-based followed by the Americans. This one, because it's in Japan, because of certain accounting quirks, (Inaudible) goodwill, it's not well understood and followed by the market.

CONSUELO MACK: It's a perfect value choice for IVA.

CHARLES DE VAULX: Exactly. Thank you so much, Charles de Vaulx for joining us on WEALTHTRACK.

CONSUELO MACK: You're welcome, Consuelo.

CONSUELO MACK: At the close of every WEALTHTRACK we try to give you one suggestion to help you build and protect your wealth over the long term. This week's action point is: **Consider the valuable role cash can play in your portfolio**. It can be a defensive holding, to offset losses in market downturns. It can be "pounce money" as de Vaulx just said, to buy when stocks get cheap. Or it can be what Fairholme fund's Bruce Berkowitz calls it: "financial valium" so he can sleep at night. Cash can be all of those things which makes it a unique and valuable asset in investment portfolios.

Next week, prepare to be enlightened and entertained when financial thought leader, historian and must read editor of grant’s interest rate observer, the one and only Jim Grant joins us. And in the extra feature on our website this week, Charles de Vaulx will discuss how the rampant disruption he is seeing in so many industries is affecting how he runs his portfolios. Also feel free to reach out to us on Facebook and Twitter. Thanks for watching. Have a great weekend and make the week ahead a profitable and a productive one.