



With
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Inside

**Exclusive Interview
with Tim McElvaine, President,
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About Downside Protection Report

Our mission is to uncover stocks with a large margin of safety and bring them to you once a month.

John Mihaljevic, editor, is a fund manager, former banker and analyst. He is a member of Value Investors Club, an exclusive community of top money managers, and has won the Club's prize for best investment idea. John is a trained capital allocator, having studied under Yale chief investment officer David Swensen and served as research assistant to Nobel laureate James Tobin. John holds a BA in Economics, *summa cum laude*, from Yale and is a CFA charterholder. He resides in New York City with his wife and two kids.



About Tim McElvaine:

[Website](#)

[In-depth profile](#)

[OID interview, 1996](#)

Dear Fellow Idea Seekers,

In this special edition of *Downside Protection Report*, we are pleased to bring you an exclusive interview with one of Canada's foremost value investors—Tim McElvaine. Tim is founder and president of McElvaine Investment Management, with roots dating back to the establishment of The McElvaine Investment Trust in 1996. Tim developed his value-oriented investment philosophy during his twelve-year career with Peter Cundill & Associates where he served as manager of the Cundill Security Fund from 1992-99, co-manager of the Cundill Value Fund from 1998-2003 and chief investment officer from 1998-2003. He graduated from Queen's University in 1986.

We'll be back with a new issue of *Downside Protection Report* later this month. As always, we will bring you our top two monthly stock picks, each of which must meet our criteria for strong downside protection and above-average upside potential.

Sincerely,

EXCLUSIVE INTERVIEW

Tim McElvaine, McElvaine Investment Management

***The Manual of Ideas:* Tell us a little about the genesis of your firm. What goals did you have at the outset, and what operating principles have guided you since then?**

Tim McElvaine: I think you must have conviction in your own work. Especially as a value investor, the market can go against you. If you are confident and correct in your reasoning, all will end well. A couple of years can seem like a lifetime when you are long a position but I have found the best ideas work out after a year or two. The returns tend to more than make up for the time.

***MOI:* U.S.-based investors may not be as familiar as they should with your long-time mentor Peter Cundill, one of Canada's most highly regarded investors. What makes Cundill special, and can you share with us some "Cundillisms" that continue to guide you today?**

McElvaine: I think following off what I said before, it would be to have conviction and be patient. Peter was very good at differentiating between noise and substance when things were not going well. If he felt it was just noise and there was underlying fundamental value, he was happy to wait even if the process took many years.

MOI: You have stated that your investment philosophy is “to make all the money on the purchase.” What makes the purchase decision easier or more profitable for you than the sell decision?

McElvaine: I have a tougher time calculating the margin of safety when things are going well. Having lived through the bad times with a stock, I guess I am a little suspicious when things start going well. I suspect my returns would have been better if I had been a little more willing to hang around once the recovery in a stock begins.

MOI: Our readers will be interested to learn that ABBA is not just a Swedish pop music group, but also an acronym that value investors everywhere should learn about. Please elaborate on your “ABBA approach” and how it helps you make better investment decisions.

McElvaine: Well, I figured ABBA was better than BaBa! The gist of my approach is as follows:

A — My focus is on accidents. In other words, where there is a problem and the sellers want out. I also loosely include special situations such as spin-offs in this definition.

B — Bird in hand. I want to have some concept of margin of safety in the price at the moment of purchase. I also think about the bird in the bush or what values might be like in a couple of years.

B — Brick house. Like the story of the three little pigs, there will always be a wolf that comes to the door. In other words, I like the company to have a solid foundation and not be a straw hut. As a value person, there will always be problems at the time of purchase but you like to have confidence that there is a good foundation.

A — Avoid Lola. The Kinks had a song called LOLA where a boy meets a nice girl in a bar and finds out a little too late that the girl was in fact a man. Not a great outcome in dating! Similarly in investing, I want to know going in where management and the board are coming from. I don't want to find out in “the final act”!

MOI: When assessing a company's discount to intrinsic value, do you find discounted cash flow analysis helpful or do you rely primarily on values that are readily ascertainable on a company's balance sheet? What kind of discount to intrinsic value do you typically look for?

McElvaine: I am not a big discounted cash flow fan. I agree completely that in theory a DCF should capture the value of a firm. I am, however, suspicious over the inputs at any point in time. Ideally, I am looking for some idea of private market value or liquidation/breakup value at the time of purchase.

MOI: How do you generate investment ideas?

McElvaine: I think the bulk of ideas come from the new low list or some type of special situation. When I see this combined with insider purchasing, it usually is worth a look.

MOI: Those who have moved from analyst to portfolio manager often point out that good ideas are only one piece of the success equation. Skilled portfolio management is indispensable. How concentrated is your investment portfolio, do you use leverage, and what is your view of short selling?

McElvaine: The Trust is pretty concentrated, meaning the top five ideas account for about 50% of assets. I think I got a little too concentrated over the last couple of years and would expect this to broaden out a little. I don't use leverage nor do I do any short selling.

MOI: Last year presented many challenges for value-oriented investors, but it also threw up some of the best opportunities in a long time. How did the volatility affect your investment process, and have you tweaked your approach in any way as a result of last year's experience?

McElvaine: I was surprised by the volatility having expected 2008 would be more like 2000 where the value investor did reasonably okay. As mentioned, be a little less concentrated and be careful with the balance sheet would be my "lessons learned."

MOI: What is the single biggest mistake that keeps investors from reaching their goals?

McElvaine: I am not really one to comment on that but I suspect it is being a little too emotional in investment decisions.

MOI: What books have you read in recent years that have stood out as valuable additions to your investment library?

McElvaine: The book that I found best summed up 2008 was [*The Emperor's New Clothes*](#) by Hans Christian Anderson!

MOI: Tim, thank you very much for your insights.