# Interview with Daniel Gladiš

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1) **Can you tell us how you first discovered equity investing? Do you remember your first investment? How did it turn out?**

   I discovered equities investing in 1992 thanks to the Coupon Privatization. As someone who had grown up under the communist regime, I found the idea simply amazing that through shares I could own stakes in various companies which create value through their businesses. I fell for it right away. I acquired my first shares in 1993, when companies from the first wave of the Coupon Privatization were introduced to the Prague Stock Exchange.

   It sounds almost unbelievable today, but back then, in the mid-1990s, we had around 1,500 Czech listed stocks, of which maybe 100 were traded very actively. I really felt like I was in my element.

   Concerning my first specific investment, I vaguely recall it was the Radegast brewery and the chocolate producer Čokoládovny. Of course, these were stocks that were part of the first wave of the Coupon Privatization. Those who participated in what was happening back then may remember that at the turn of 1993 and 1994 we saw explosive growth in the prices of Czech stocks. Whatever a person could get one's hands on soared upwards. Growth of 15–20% per week, week after week, was no exception. In hindsight, I can see we had more luck than understanding. I made my first foreign investment some time in 1994.

2) **When did you first discover value investing? And what was your investment approach before that?**

   It was a long and winding road that led to value investing. In 1993, we established the stock brokerage Atlantik finanční trhy. We were focusing on institutional investors, and very quickly we became the Czech Republic's largest brokerage firm in this segment.

   My responsibility was to take care of foreign clients. Most of them were from the UK and the US. Back then, the Czech equity market was the only larger such market in Eastern Europe, and for a time we were the foreign investors' favourite. Thanks to this, doors were open to us everywhere.

I made more than 200 visits to our foreign clients and had the unique opportunity to listen to them tell about how they invest. Among my clients there were even such legends as Seth Klarman and Jeremy Grantham. I quickly realized that I wanted to be on the other side of the phone – not to be the broker who makes trades for investors but the one who makes the decisions on investments.

My own investment approach at that time could have been described as amateur even though I didn't realize that myself. The breakthrough came when I got my hands on Graham's book *The Intelligent Investor*. It hit me like a bolt of lightning, and to this day I precisely remember where I read it. That was more than 20 years ago. There and then, I became a proponent and life-long student of value investing.

**3) Can you briefly describe your current investment approach?**

The whole of my investing is based on two basic ideas. The first one is this: If an investor wants to have high returns over the long term, his or her portfolio must be dominated by stocks. History clearly shows that stocks bring the highest long-term return. Their predominance over the other classes of assets is completely overwhelming. In terms of relative returns, the future will probably look the same.

In addition, stocks bear lower long-term risk than do bonds and cash. This idea is surprising to a lot of people, because they are conditioned to an incorrect definition of risk and to thinking just the opposite. Stocks are also highly liquid, there is literally an inexhaustibly wide range on offer, and they are tax-advantageous for individuals.

The second idea concerns the selection of specific stocks. In my opinion, there is only one rational and reliable method of investing (regardless of the class of assets), and that is to pay a price that is lower than the value we get in return. Our selection of stocks focuses on seeking opportunities where the share price is substantially lower than is the stock's value. There are relatively many such opportunities on the market because most investors are not willing to expend the effort to seek them out and moreover they have investment horizons that are too short.

History also shows that if there is anything in the stock markets that one can rely on it is the fact that, over the long term, a stock's price follows the development of its value.

**4) How has your investment philosophy developed over time? Did you, like Warren Buffett, go through a conversion from a deep value investor who buys deeply undervalued companies of average to below-average quality to one focused on high-quality companies at reasonable prices?**

There were more phases of development in my case. In the very beginnings – and that means during the first half of the 1990s – I knew barely anything about investing. My choice of stocks was, from today's point of view, entirely amateurish. The interesting thing is that in those years I was achieving my greatest returns by far. Since that time, I haven't even come close. Today I know that it had been largely a matter of luck. This period was very important, though, because I started to quickly gather experience and, due to my work as a broker, I began to know how markets work and also how large institutional investors think.

I remember the start of the second period exactly to the day, and it relates to when I read *The Intelligent Investor*. For the next few years, let's say until 2004, I was almost orthodox in applying Graham's approach. It was based on quantitative screening of stocks and a broader portfolio. It yielded good results, but, with markets becoming more expensive, the possibility for using this approach was gradually shrinking. There simply was nothing left to buy, and I had to adjust to that.

This was followed by a third period when my picking of stocks was supported by very sophisticated and intricate models involving enormous amounts of work. I believed this would be the right path which would bring the greatest added value. After several years, we evaluated this approach and concluded that, even though the results are good on average, their reliability is low in the individual cases. Some investments worked out great, while others were disappointing.

The lesson we learned from this is that trying to be too sophisticated is not beneficial. Once an investor starts to drown himself or herself in complicated models, he or she loses detachment and objectivity. If it's necessary to craft a sophisticated model to demonstrate that a stock is cheap, it usually isn't cheap. The cheapness of a stock must hit one right between the eyes at first view without requiring complex calculations. This was the conclusion we reached during this phase, some 9 years ago. Since then, we've been trying to simplify our investment ideas as much as possible, and so far this has been working out very well.

In a letter to shareholders at the end of 2017 I wrote this:

"Over those long nine years, we bought shares in 71 different titles. The portfolio's turnover was higher during 2009–2011 because it was necessary to respond quickly to rapidly changing equity prices. In the following years, the turnover gradually came down. Out of the 71 stocks acquired, we have already sold 49 and are currently holding 22. Of the 49 stocks sold, we realised gains from 44 stocks and lost money on 5 stocks. Of the 22 stocks we are still holding, we are in positive-returns territory in 20 cases and in negative returns in 2 cases. Our history to date thus shows that we are making money on approximately 9 stocks out of every 10 we buy. We presume this will be similar also in future."

So far, it seems that simplicity beats complexity. We have a minimum of losing investments and the spread of returns between the best and worst investments is relatively small.

When I look back to the individual phases of my development as an investor, I can see a certain logical progression. I think it can objectively be said that each phase has been a step forward. It is very probable that in a few years I will look back at the current phase very critically, and I believe I will manage progressively to move on and on. What I like about investing is that a person can constantly improve regardless of how much experience one has and in which phase one is presently. I try to learn something new every day and add piece by little piece to my cache of knowledge.

**5) Can you describe for us in a little more detail the sequence of the individual steps within your investment process?**

When we analyse a company, we always ask these four questions:

1. Do I understand what the company does?
2. Does the company have some sustainable competitive advantage?
3. Is the company managed in the best interests of the shareholders?
4. Are its shares attractively priced?

Only when these four questions can be answered in the affirmative will we consider to include the stock into our portfolio. This is then decided based on whether the combination of its return and risk is sufficient in absolute terms and also better than what we currently have in the portfolio.

**6) How do you seek out investment opportunities?**

There's no magic wand that could find investment opportunities on its own or any fool-proof recipe. One has to look and turn over every stone. There are several possibilities. For example, studying individual companies from A to Z, analyses from brokers and investment banks, analytical journals, monitoring old well-known companies, keeping an eye on other investors, investment-focused media, screening, tips, conferences and seminars, following the markets, and generally getting to know the world around you.

**7) What kinds of companies do you prefer? What basic criteria must they fulfil?**

This was partially indicated by the previous answer. I have to feel that I understand what a company does, what its business model is based upon. Because my horizon for investments is usually five or more years, I want a company not only to exist in 10 years' time but also to have prospered. That means I'm looking for the existence of some sustainable advantages that increase this chance.

This long investment horizon also requires that the company's management efficiently allocate its capital. This is something people frequently forget about, but it has an immense impact on the development of a company's value.

8) **What do you primarily focus on in your analysis?**

The most important indicator is "owners earnings" (Buffett's term). This is essentially cash that shareholders can carry home at the end of the year without endangering the company's operation in its current form and size. Essentially, it's free cash flow. I'm also interested in the level of returns that a company can achieve in reinvesting the capital it has earned. Strong free cash flow and high rates of return that it can repeatedly earn from reinvesting that cash year after year – that makes for an ideal investment. At least in my eyes.

9) **What valuation models do you most frequently use for establishing the intrinsic value of a company?**

I do not use any complicated models. Cheapness must be apparent at first sight, and then all necessary calculations can be done in one's head.

10) **What is your position on risk? How do you evaluate and measure it within your investments?**

Risk is one of my favourite themes. Every investment has two sides – return and risk. Return can be measured, and everyone can imagine what it means to earn 50% on something. Concerning risk, it's more difficult. As soon as we start thinking about risk, we encounter three problems: There exists no objectively valid definition of risk, risk is not measurable (either ex ante or ex post), and it is very subjective.

Every investor should try to clarify his or her own definition of risk as early as possible. This will then shape the character of his or her investments. We view risk as the probability of not reaching our investment goal. For us, risk is the probability for permanent loss of capital, and in individual companies we understand risk to be the risk that relates to the company's business activities.

11) **Total investment return is given (if we ignore dividends) not only by the price for which we buy a share but also by the price at which we sell it. For most value investors, it's not that difficult to identify when a share is underpriced, but selling it is usually substantially more complicated for them. What about you? When do you sell?**

Generally, there can be two reasons for selling. The first is absolute, the second relative. An absolute reason for selling occurs in a situation where expected return from an investment falls below a minimal acceptable level relative to investment risk. The relative reason for selling is a situation wherein another, substantially better investment is available to me.

12) **How much time do you dedicate to analysing an individual company? Do you use external research? If you do, what would you recommend?**

If it's a company that I truly am seeing for the first time and want to formulate an in-depth view, it takes one or two days. This is partially influenced, though, by the fact that I will have some knowledge in the field in which the company does business and almost always will already have studied several similar or competing companies. There are very few things that are absolutely new.

We do use external analyses. These are very helpful, because they bring together and present the data in a clear and structured form, which saves us work. But we draw our own conclusions from them. We don't pay too much attention to brokers' and investment banks' recommendations.

**13) Once you have chosen sufficiently attractive investment opportunities, how do you compile a portfolio with them? Do you prefer a diversified or concentrated portfolio? And how do you determine the weights of the individual positions?**

We have 20 stocks in our portfolio, and this seems to me even a little too broad rather than too narrow. If I managed only my own money, I would have about 5 to 7 stocks. There are several reasons, however, why the number of stocks in the fund's portfolio must be greater. We give above-average weighting to the best investments, upwards of 10% and exceptionally even more. I believe that excessive diversification eats away at the returns and that there are so few really attractive investment opportunities that it would be a shame not to give them more space. Such a portfolio has higher volatility and frequently behaves completely differently in comparison to the rest of the market, but that's not a fundamental concern.

**14) Does it make sense at all to hold a broadly diversified portfolio?**

No. A broad portfolio just shows that an investor does not believe in himself or herself and is looking to diversification as a sort of alibi.

**15) What's your opinion on the growing popularity of passive index investing (note: purchasing a low-cost ETF or index fund that copies the performance of a selected stock index as closely as possible)?**

This is a good route to take for a large part of small investors on the condition that they are patient, persistent, systematic, long-term oriented, and that they stand firm in what they are doing. Such a combination of human qualities is very rare in the real world, however, and therefore the returns of investors buying the indices are substantially lower than the returns of the indices themselves.

As far as I'm concerned, I prefer active investing because it gives me the chance to achieve a return greater than that of an index over the long term – and with lower risk to boot. What's more, passive investing takes away the best part about investing – seeking out good investments and the joy of success in finding them. That's something I wouldn't want to give up.

16) **And what about current "investment trends" in the form of robo-advisors and use of artificial intelligence in investing?**

I wrote a letter to our shareholders on this topic in the spring. I suggest people might want to take a look at that (see http://www.vltavafund.com/dopisy-akcionarum/robotialide).

17) **Let's go back for a moment to your fund. In contrast to most other portfolio managers, you have the advantage of being able to choose your clients. Can you explain your reason for why you do so?**

When someone entrusts us with their money, they are expressing a certain faith in us. We, in return, take on a certain responsibility. For me, this is a personal relationship. I want to know with whom and for whom I'm working. We did not establish the fund in order to hoard assets. Our objective is to work with pleasant and cultivated people and thereby to enjoy what we are doing. We assist our investors by taking over a part of their worries with their financial assets, helping them to better enjoy their lives. We know each other and know that we can rely upon one another. I wouldn't want to manage a fund where I wouldn't know the investors and had no influence on who has money in the fund. For me, our fund is something like a big family.

18) **What would your ideal client look like?**

Mick Jagger. He's got a good bit of money, and, considering how many children he has, he also has a very long investment horizon. He'd also be fun to work with.

19) **Does this mean that Vltava Fund (note: a qualified investors fund) will never become an open mutual fund?**

Yes, it does. It's more probable that the fund will someday close to new investors. Fund statistics the world over indicate that the larger a fund is, the lower are its returns. This is one of the main reasons why fund size is not our priority. Investors' returns come first for us. This is also why the fees in our fund are among the lowest in comparison with similar funds.

20) **What is or are your fund's competitive advantage or advantages? Why should an investor prefer Vltava Fund over a passive index ETF that guarantees market return for minimal costs?**

Putting aside the fact that even passive index ETFs have lower average returns than do the indices they copy, I can only restate what I have said above. Our active investing gives us the possibility to achieve higher average returns over the long term than those of the markets – and furthermore at much lower risk. By the way, and although it may seem strange to say so, the present upsurge in passive investing is a blessing for us. Because ever more investors have stopped thinking about what they buy and at what price, there are increasingly attractive investment opportunities on the market. It's water to our mill.

21) **If you were to select an actively managed fund for yourself, what parameters would it have to fulfil?**

In actively managed funds, the character of the portfolio manager comes first and foremost. From my perspective, I would want him or her to fulfil the following criteria:

1. He or she must live stocks. He or she needn't have some super talent and doesn't need to be a genius, but this person must be intelligent and have a passion for what he or she does. Passion and enthusiasm are necessary. A good investment manager must be – in the good sense of the word – a fanatic.

2. He or she must have a clear investment philosophy. This person must be able to explain that philosophy clearly, must be consistent, and it must be evident that he or she does as he or she says.

3. He or she must be of solid character. This person must be open and honest, admit a mistake when he or she makes one, and must be trustworthy, in the sense that one can rely on him or her to stick to his or her strategy over the long term and not to change it unexpectedly.

4. This person must have his or her own money invested in the product or fund he or she manages to such extent that its results have material impacts on him or her. One cannot expect correct decisions from someone who does not risk anything in making them.

22) **Managing money in a fund is always more complicated than managing one's own portfolio. What do you think are the greatest disadvantages institutional investors have over individual investors? What obstacles do you encounter most frequently in your fund?**

The main difference is that an investor thinks differently when taking care of other people's money than when caring for just his or her own money. The feeling of responsibility subconsciously leads towards lower risk. I have all my money in Vltava Fund, and when I look around I see no alternative that would be more attractive. If I managed my own money outside of the fund, however, I would be a substantially more aggressive investor.

The second difference is that regulation affects everything we do to a greater or lesser extent. The regulations are very strict, and to a certain extent they tie the hands of all institutional investors.

23) **If you were a small individual investor with a small amount of capital, would you invest differently than you currently do in your fund? And if so, how?**

That's not an easy question to answer. There's no general pattern for investing that exists for a particular type of investors. It doesn't much matter how much capital an investor has. More important are what are his or her investment horizon, investment philosophy, experience, abilities, and possibilities. If I were a small investor with a small amount of capital, I would clearly be also in a different phase of development as an investor and would necessarily have to invest in some other way. If, however, I were an individual investor with a small amount of capital and I knew everything I do today, I would invest the same way I do now.

**24) Do you think individual investors can, over the long-term horizon, "beat" the performance of professionals or the equity index? So far, the statistics are not in their favour.**

Everyone taken as a whole cannot be better than average, but each one individually can be. And many of them are better.

**25) What do you think are the biggest mistakes individual investors make? What is in fact the most common cause of your own losing investments, and what was the biggest investment mistake you ever made?**

The biggest losses occur when investors go into things they don't understand. This applies equally to investors at all levels. Another common error is lack of patience. This is probably the rarest trait among investors, even though it can by itself be the source of great competitive advantage.

My greatest mistake was that in the fund's early days we tried to make money too quickly, even though it was completely unnecessary to do so. Fortunately, this period is now far behind us.

**26) Could you briefly describe your typical work day? What does the work of a typical value portfolio manager entail?**

I get up most of the time between four and five. I look at what's new in the markets, read the daily financial journals, and then begin studying some company or another. That means reading annual reports, analyses, commentaries, presentations, conference calls, and so on. At noon, I have my first break for lunch. Then I have a short nap, I go work out, and then I go on working until about six o'clock in the evening.

**27) If someone were to put a gun to your head and make you choose another investment approach than value investing, what would you choose and why?**

I would put all my money into the fund of one of my favourite investors and then leave for a two-year vacation.

**28) Let's look at the present situation in the financial markets. We've been in a bull market for 9 years. Are there any cheap stocks to be found? Where are you currently finding your interesting investment opportunities?**

Only one large market is at its historic high, and that is the US market. The European, Japanese, and a number of emerging markets are far from their all-time highs, and one cannot at all speak about 9 years of bull market there. There are relatively many attractive investment opportunities. I currently like the UK, Japanese, and Korean markets.

**29) What stock from your portfolio do you currently consider to be the most undervalued, and in percentage terms about how far is its price below your current estimate of intrinsic value? What do you think is the cause of its undervaluation and its being ignored by the markets?**

Taking into consideration the better known companies in our portfolio, then probably it's Samsung Electronics. With the preferred shares trading at five times earnings in a company that is the global leader in everything it touches, that has no debt and is drowning in cash – that is really an absurd valuation.

**30) Where do you currently see the greatest source of market inefficiencies that can be utilised in seeking interesting investment opportunities?**

The main source of inefficiency consists in the investors themselves and their nature. That doesn't change, and so inefficiency in the markets remains. New contributors to inefficiency are – and maybe paradoxically – passive investing and artificial intelligence. The longer an investor's investment horizon, the more he or she can exploit market inefficiency. Most investors have very short investment horizons, and that means competition on the markets decreases as one's horizon lengthens.

**31) In your opinion, is investing more difficult for an active investor now than in the past? Are markets more efficient?**

Investing remains the same. The trends, moods, and dynamics of the individual industries change, but the basic investment philosophy remains the same. Due to developments in technology, however, investing is now more convenient and less costly, and that makes it more accessible to a broader range of investors.

**32) What important lessons have you learnt during your investment career, and how did that change your current approach to investing?**

For me, every day of my work and of investing means acquiring another small piece for the mosaic of knowledge. I strive to learn constantly, and I believe I will continue to do so for still a long time. If I were to summarise my experience to date, I would say that the three most important conclusions that I have drawn from that experience so far are: 1. Simplicity beats complexity. 2. Patience is an investor's greatest weapon. 3. It is unnecessary and harmful to try and make money too quickly.

**33) What would you recommend to beginning investors? What should be their primary focus? What errors should one look out for?**

First, one should start by reading about investing, thereby absorbing a certain theoretical foundation. Next, a person should think about what one wants to achieve through one's investments, and then start to invest actively. Nothing takes the place of acquiring experience first-hand. One is probably going to make a lot of mistakes, but one's own mistakes are what moves a person forward the most. The sooner a person gets through this part of the journey, the longer the journey ahead will be.

**34) What books would you recommend to beginning investors, and what books have caught your interest lately? What book has influenced you the most?**

I recommend starting with the following books. I've divided them into several thematic areas:

Best classics

Benjamin Graham – *The Intelligent Investor*
Warren Buffett – *Berkshire Hathaway Letters to Shareholders 1965-2012*
Philip Fisher – *Common Stocks and Uncommon Profits*

On the psychology of investing

Robert Shiller – *Irrational Exuberance*
Charles MacKay – *Extraordinary Popular Delusions and the Madness of Crowds*

On risk in investing

Howard Marks – *The Most Important Thing*
Nassim Taleb – *Antifragile*

On long-term returns of markets and asset classes

Jeremy Siegel – *Stocks for the Long Run*

Investor biographies

Alice Schroeder – *The Snowball* (about Buffett)
Benjamin Graham – *The Memoirs of the Dean of Wall Street* (about Graham)

From life on Wall Street

Roger Lowenstein – *When Genius Failed*
Michael Lewis – *Liar's Poker*

Published in Czech

Benjamin Graham – *Inteligentní investor*
Robert Shiller – *Investiční horečka* (*Irrational Exuberance*)
Nassim Taleb – *Antifragilita*
Jeremy Siegel – *Investování do akcií* (*Stocks for the Long Run*)
Alice Schroeder – *Sněhová koule*
Daniel Gladiš – *Akciové investice*

This year, I probably enjoyed most the book by Francisco Paramés *Investing for the Long Term.*

**35) And our last question. What would you like to have known at the beginning of your investment career that you know now but did not back then?**

It would be nice to have known everything I do now 25 years ago when I started, including, for example, the three lessons mentioned earlier. At the same time, though, that would be to deprive me of one of the joys of investing: the road to knowledge that is lined by successes and failures. I don't know that I would really want to change a thing. It just makes me look forward to the next 25 years all that much more.


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