Value Investing

Value investing is a philosophy of stock investing that makes the elementary but sensible deduction that favorably mispriced investments will tend to have low prices relative to earnings, sales, equity and other measures of financial performance. Value investing favors low-priced stocks. Its adherents regard it as one of the most simple but powerful and reliable axioms in all of finance.

There are different degrees of value investing. There are deep value investors who buy extremely beaten down investments. This version of value investing usually requires those who practice it to buy many investments because each investment tends to be very speculative.

Furthermore, since these firms are speculative, they tend to be very erratic. They can bounce upward dramatically (far past any reasonable estimate of their intrinsic value). If this should happen, it is foolish not to sell these stocks. Consequently, this form of value investing is usually characterized by rapid trading and a high turnover rate.

Value investing at the other extreme is what we call “quality value investing.” These value investors are very diligent about rooting out very good companies that may not be selling at rock-bottom rates but are still priced at bargain rates. This version of value investing usually requires the purchase of far fewer securities because the firms in question tend also to be high-quality and low-risk.

Also, since quality value investors take into consideration many more criteria than deep value investors, far fewer companies pass their higher standards and those companies do not change rapidly. Consequently, quality value investors tend to hold on to their companies for a long time and they tend to have low turnover rates.

In short, you can view deep value investing as sort of a shotgun approach to value investing; and you can view quality value investing as a sort of rifled approach to value investing. In practice, most value investors fall in between these two extremes.