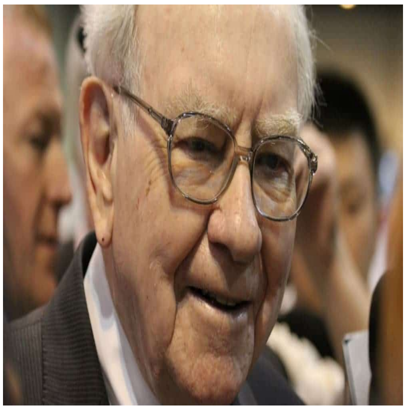

3 Investment Secrets Warren Buffett Won't Tell You

Description

Warren Buffett's unparalleled investment performance and his willingness to share his secrets have made him a global celebrity. His annual letters to shareholders are eagerly awaited by everyone, from investment professionals to young savers across the world.

Over the years, Buffett has been surprisingly open about his investment technique, business philosophy, failures, and shortcomings. However, there are some aspects of the investment world he doesn't touch on too often. Here are three investment truisms that Buffett or any financial professional won't readily admit.

Cheap stocks are cheap for a reason

Buffett's mentor Ben Graham pioneered the "cigarette butt" strategy of investing in stocks that were worth less than their book value. According to this early cohort of investors, some companies were worth more dead than alive, which made them irresistible opportunities for the value-oriented punter.

However, this conventional wisdom doesn't always work out as expected. Some companies are unbelievably cheap only because they're on their way to becoming even cheaper and ultimately worthless.

Nortel Networks, once the largest telecommunications company in Canada, was probably trading for less than its book value just before the company declared bankruptcy in 2009. It turns out the underlying business assets and patents were worth a total of US$7.2 billion, but creditors took eight years to recover these assets.

Similarly, other seemingly *cheap* stocks like **First Quantum Minerals** and **Trican Well Service** could be value traps that destroy shareholder wealth over time.

Great stocks are rarely undervalued

On the flip side, it's extremely difficult to get a good price on a great stock. With interest rates at a record low and the number of good investment opportunities for stock pickers dwindling, the few remaining growth drivers are egregiously overvalued and are likely to remain so.

Shopify, for example, has always been “overvalued” by conventional metrics. The company hasn’t turned a profit yet and is still deploying hundreds of millions in expanding operations. The stock currently trades at a price-to-sales ratio of 35.5, which is insane, even for an innovative tech stock.

However, the company has delivered excellent shareholder performance over the course of its history as a public company. Similarly, **Constellation Software** or **Lightspeed POS** may never be undervalued, but that doesn’t mean they won’t deliver phenomenal results for investors over time.

Sometimes it’s better to overpay for a great company than to underpay for a mediocre one. Buffett seems to realize this, which is why **Amazon** is part of his portfolio now.

Debt isn’t always bad

Warren Buffett has always been famously critical of leverage. He tends to focus on companies with low debt and substantial earning power. However, even he relies on some leverage to boost returns. The premiums generated from his various insurance companies effectively give him “free leverage” to bet on stocks.

Of course, the average investors cannot hope for free leverage, but that doesn’t mean they should shy away from *all* debt. A robust business with a disciplined management team should certainly borrow money at cheap rates if they can hope for better returns from their operations. Even the most profitable and capital-light companies like **CGI** have at least some debt on the books.

As long as the debt-to-equity ratio is low and the interest payment coverage ratio is high, investors shouldn’t be too worried about a company’s overall debt.

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