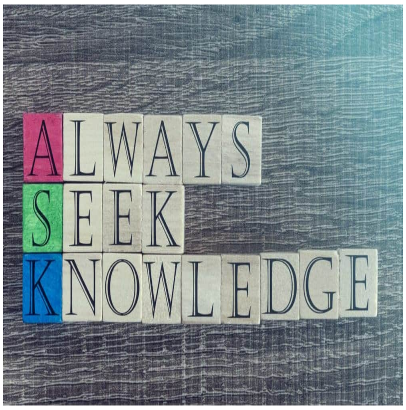

Charlie Munger’s Investment Style Could Pay Big Dividends in Today’s Frothy Market

Description

Warren Buffett gets most of the attention from the financial media, but investors should also learn from his long-time friend and business partner Charlie Munger when going on the hunt for value investments.

Charlie Munger, Warren Buffett’s right-hand man, is all about buying shares of wonderful businesses at discounts to their estimate of intrinsic value and holding onto them for the long term. The man played a major role in shaping Warren Buffett’s investment style, pushing him from “cigar-butt investing” to only owning shares of “wonderful” businesses.

These days, it’s much harder to find “wonderful businesses” at sizeable discounts to their intrinsic value. Price-to-earnings (P/E) multiples are on the higher end, and even Charlie Munger himself hinted at a lack of bargains to be had in today’s frothy market. Like it or not, Munger and Buffett will continue investing, even though they think market returns over the decade ahead will be lower than that of the past decade.

Don’t neglect the valuation process

Value has never been more important. While it may not seem this way, given the speculative frenzy in Bitcoin and all the sort, investors must continue to weigh the risk with reward to ensure they’re not at risk of skating offside come the next correction. The next pullback is always waiting around the corner, and it’s the names that have climbed the highest in a market rally that tend to face a proportional magnitude of volatility in the opposite direction. As someone wise once put it, the higher you climb, the farther you have to fall.

That’s not to say you should shun growth and frothy momentum stocks, though. If a firm’s growth profile justifies its premium price tag, an unprofitable but growth business’s stock could very well trade at north of 20 times and still be considered a great value.

Shopify: It's too expensive to be a value stock … right?

Look no further than shares of **Shopify** (TSX:SHOP)(NYSE:SHOP), a stock that's never traded at a valuation multiple that's anything short of stupidly expensive. Even during the depths of the February-March market crash, SHOP shares were still not cheap through the eyes of value investors who failed to grasp the full understanding of Shopify's incredible growth story. Indeed, Shopify trading at 20 times sales turned out to be a bargain when you weigh how much shares cost today (shares of Shopify currently command a staggering 60 times sales)!

Of course, Shopify deserved to be re-valued to the upside, because of its pandemic tailwinds and because the low-rate environment calls for slightly higher-than-average multiples. Bonds are the most unrewarding and the "expensive" they've been in recent memory, after all.

Back to Charlie Munger. He's a value man. But it's not just the discovery and purchase of bargains that he should be known for. I think the man's patience is admirable. In an era of commission-free trading (it's not yet in Canada), the definition of *long term* has undoubtedly shrunk from the time when Charlie Munger began his investment career.

What is long term these days?

Depending on who you ask, long term could be anywhere from six months to a year and a half. That's not Charlie Munger's definition of long term, though!

He'll gladly sit on a stock for years, if not decades at a time, as shares correct upwards towards his estimate of its intrinsic value. Moreover, Charlie Munger's insistence on "wonderful businesses" over cigar butts also pays massive dividends over the long haul, because once a mispriced stock has corrected to reflect its true intrinsic value, it can still keep building upon its intrinsic value over time. That means the said stock can be held for decades at a time.

Charlie Munger is all about sit-on-your-bum investing, a strategy that I believe can help everyday investors do far *better* than the market averages over time.

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