



Q&A with Jeff Auxier of The Auxier Focus Fund

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1. How many positions are there in the fund usually? I don't think it's very concentrated by looking at the % invested in the top 10 holdings?

The Auxier Focus Fund has a number of "tracking" positions that I like to follow before taking a larger commitment. Therefore the number of positions is a little overstated. Generally, position sizes are a function of the compelling nature of the investment and the margin of safety. Given the easy money Fed policies over the past eleven years and the competitive nature of the global economy, it has been harder to find impregnable franchises. In the early 1980's it was much easier to find strong businesses at bargain prices and therefore easier to justify larger position sizes. If we get to bear market washout prices, I would be more comfortable buying bigger positions. When the corporate bond market hit depression lows I was much more aggressive in that space, taking larger positions in senior debt securities. When a highly predictable business with superior management goes on sale, I will go higher in the weighting, but it has to be compelling. The "easy money" backdrop has meant the market has not been allowed to clear to price points that provide an adequate margin of safety. Due to the potential "torpedo effect" of large positions on the portfolio, the macro conditions have made it more risky. Compounding is our focus and to win we must first not lose.

The Fund is named Auxier Focus due to the attention it garners from the firm and the manager—not based on concentration. As manager and a major shareholder, my shares are locked up—I can't sell. This, together with the name on the door, helps to protect on the downside and endure through the most difficult markets.

2. What does risk management mean to Jeff?

I take the stewardship aspect very seriously. We start with humility and the understanding that emotions and ego need to be under control at all times. Next, the concept of compounding and how it is so important to always look first at the downside. In order to keep compounding, you need to avoid permanent capital loss. There are no easy formulas. A daily dedicated, tenacious research effort is required to protect the portfolio. I have studied human behavior and different markets over the past 200 years to prepare for crisis situations. A careful study of the balance sheet of each security is a must, especially during difficult economic challenges. We believe in the Buffett definition that risk is not knowing what you're doing. Volatility offers tremendous opportunity to the business analyst—it is not risk. Another Buffett saying that has served us well—when money is easy, grab your wallet and run the other way. These philosophies have helped us focus on the dangers of bubble conditions that follow "easy money" and lax standards. Investing is the craft of the specific. People have confused the definitions of *investing* versus *speculating*. Today, nearly 70% of trading on the exchanges is based on mathematical algorithms. This type of misdirected focus can be good for the long-term buyer of business values looking to allocate based on compelling price points.

Risk management also means looking at the entire capital structure. Wall Street tends to focus too much on earnings and not enough on the balance sheet. It is difficult to survive tough times with a weak balance sheet. A careful study of "off balance sheet" shenanigans is important. The management's capital allocation record—do they love the business or are they in it for the stock options? Do they overpay? Do they pay attention to the details? Like Costco's Jim Sinegal says: "retail is detail." Is the top management working off their ledger daily? John D. Rockefeller stressed the importance of the ledger—his "Ledger A." Are they diligent and humble?

3. Cash was only at 2.5% as of March 2010. What is it currently? And does he usually have a large balance?

The current cash position is 7% with corporate debt approximately 22%. I am using the debt as a source of liquidity, as the lower risk "double plays" have been achieved for the most part. I want compelling investments based on price, value and a healthy margin of safety. As markets get frothy and greedy I will always pull back to cash or other "workouts"—market agnostic positions. Then as the market corrects I will shift back to quality common stocks. The entire capital structure of each company is analyzed to come up with the most compelling opportunity. The allocation is based primarily on that attractive purchase price. We have been able to outperform the market (as measured by S&P 500 Index) by over 88 percentage points since inception, 7/9/99 (cumulative, as of 7/31/2010) without full exposure, due to well researched investment selection.

4. if you had to invest in BP stock or BP Debt, which would you choose and why?

We have both BP stock and debt. The first step as the crisis unfolded was to quantify the strength of the balance sheet. Unlike the banks, BP had a much stronger balance sheet with a fraction of the overall debt load carried by major financial institutions. We want the tennis ball, not the chicken egg—the one that bounces back. Often in crisis I buy both the debt and stock to track the balance sheet. We were paying less than \$10 per barrel for reserves with even double the worst case scenario in terms of losses. Next, I looked at the end demand for the product. Is it big ticket or small, necessity or luxury? Also, the supply/demand make up. So much of the oil business has been nationalized, which helps limit supply. By comparison, natural gas extraction with the new shale technology points to floods of entrants, supply and greater risk. I have tried to study the great oil investors in this country over the past 150 years: John D. Rockefeller, J. Paul Getty, along with the big four oil families in Texas—Murchison, Hunt, Cullen, and Richardson. J. Paul Getty set up a holding company named Tidewater in 1930 just to buy oil stocks cheap. He never paid over book value. The four dominant Texas oil families made their fortunes on the buy side as well, over a 60-month period from 1930-1935, when oil dropped down to 3 cents a barrel. Great fortunes are made in crisis situations, buying enduring businesses at fire sale prices. Carlos Slim came alive after Mexico defaulted on their sovereign debt in 1982. Like Shelby Cullom Davis used to say, "you make most of your money in bear markets, you just don't realize it at the time."

5. What are your biggest mistakes you had made with your investment? What did you learn from it?

We correctly identified the causes of the 2008 market meltdown but failed to act in a more aggressive manner on pruning positions that were fairly valued. Even though much of the leverage in the system was not disclosed, we should have followed that basic Buffett rule: "when money is easy, grab your wallet and run the other way."

6. With the abundance of stocks and companies out there I was wondering if you could discuss the process you use to narrow it down in search of a value investment.

I first want to quantify the potential downside of each individual security. That means understanding the predictability of operations; the strength of the franchise and the heart of the management. To compound returns I want to be able to identify and reduce the risk of each transaction. I am attracted to the more mundane companies, those that sell necessities and have smaller tickets. To win we first must not lose. Like Peter Lynch used to say, "you want the inspired management in the uninspiring industry." Exciting, fast growing companies and industries are magnets for all kinds of capital and competition. I am mindful of the "torpedo stock" – where high expectations are priced in and the company falls short, and thus can torpedo the entire portfolio. Very few companies can consistently grow over 12% so we tend to try to buy great businesses at very low multiples of earnings, cash flow and sales in order to achieve a "double play" or "triple play" return. I am constantly monitoring the operating realities of the business and looking for the turn up in fundamentals with a price that is not reflective of the improved fundamentals. We like the horrible-to-bad trade, where the companies are priced for horrible outcomes but it turns out to be merely bad. We like the Jim Grant saying that there is no such thing as a bad bond, just a bad price. I also like to buy managerial "drive" cheap. With all the mathematical trading, ETFs, etc., there has never been a better time to be a business analyst to take advantage of the folly and material misappraisals that results from a plethora of faulty approaches to capital allocation.

7. What are your guiding principles to decide when to sell a stock?

Price, value and margin of safety guide the capital allocation process both on the buy and sell side. We are mindful of bubbles and will sell any holding if it is deemed materially overpriced. We monitor the operating reality of each business and industry. When money is "easy," accounting lax, we lighten up. We watch the ego and ethics of the

management. Are they in it for the love of the business or love of a fast buck? Do they overpay and overborrow? Do they overpay on stock buybacks? Do they keep their emotions in check when allocating capital? Are they driven to master the game with high ethics? Do they think and act with a long-term, shareholder-friendly outlook?

8. What is your outlook for today's stock market? How much weight does the macro economy play in your investment decision?

I love to study great businesses, great business leaders and great investors throughout history. I strive to be a great business analyst. The top 25 businesses over the past 25 years have appreciated between 18,000% and 63,000%. That is exciting. So much time is spent on the "unknowable"—the market, economy etc. Wal-Mart from 1970-2000 appreciated over 80,000%. Costco has appreciated from 20 cents in 1985 to \$57 today, largely because of Jim Sinegal. His saying, "retail is detail" is so critical. I like to go back 200 years to study both great successes and failures. As [Warren Buffett](#) says, you can count on three recurring things in the market—fear, greed and folly. Utilizing a rational approach at all times is key. As Ben Graham has taught, the market is there to serve you, not guide you. We look to the market for material misappraisals. Investing is the craft of the specific: we need to know more than the market about each individual investment. The market is just there to occasionally offer up mouthwatering opportunities with terrific odds and the chance for the double or triple play. We identify first what we want to own and then wait for the emotionally driven selling, to buy at a fraction of the underlying intrinsic value.

9. How do you use GuruFocus? What features do you like the most? Any suggestions for us to improve?

You have a terrific site. You educate investors on the fundamentals of investing as contrasted with speculation. As the markets are increasingly dominated by mathematical trading formulas and blind pools—this is a great time to be a fundamental business analyst. Keep up the great service!

10. What are the reasons that you are holding a lot of large cap household names like Wal-Mart Stores (WMT), Dr. Pepper Snapple Group (DPS), Coca-Cola Company (KO)?

From the beginning I have always wanted to master the art of capital allocation. My first call back in late 1982 was to [Warren Buffett](#) on a Saturday at his office. He was very generous with recommendations on books and investors. I was hooked back then on his philosophy because it stressed a margin of safety, a rational approach and it was ENDURING. I wanted to find out what types of investments survived in the most challenging markets and economics. Dr. Pepper has been around since 1885, Schweppes since the late 1700's. When Dr. Pepper was spun out of Cadbury it traded down as low as 9 times earnings so we took it up and it became our largest holding. We were able to buy Coke for 13 times. One share of Coke purchased in 1919 is worth over \$6,000 today. Contrast that with one U.S. dollar purchased in 1930 which is worth less than 10 cents today. Wal-Mart, like Tesco, represents a play on the grocery business and the potential threat of food inflation globally. We own a number of supermarkets that are leveraged into the growing emerging middle class.

11. What does your daily schedule consist of?

My day usually starts about 5 am with research. I try to run 3-4 miles in the late morning and then ideally it is more research all day long and into the night. We set up the firm in 1998 with research as the main priority. I wanted a structure that would allow for an Olympic research effort. We rarely have any meetings at all. Back in 1982 when I called [Warren Buffett](#) and asked for advice as to getting an MBA, he said it was not as important as mastering accounting—the language of business. He also suggested to get as far away from Wall Street and basically build a database of companies, and strive to commit more time to original research, 10ks, trade journals etc. than anyone. My goal is to research at least 8 hours a day, every day. And I love it. I am a strong believer in reading, as it is the most efficient means of covering a mountain of data and uncovering facts. A daily dedicated, tenacious research effort is required to protect principal and insure the compounding process continues.

12. Do you believe in speaking to management of companies, or do you see them more as salespeople?

I believe in the John D. Rockefeller adage of going off the ledger first. I want to know how the business is doing with conservative accounting. Unfortunately, most CEOs are not trained in capital allocation. So that is the number one concern, together with ethics, when studying management. More destruction in shareholder value takes place with big egos, overpaying and overborrowing. Integrity is huge, as is the right heart.

13. What is your screening process for stocks, or how do you go about finding them?

I like trade journals, 10ks, newspapers, business biographies.

14. You have approximately \$200 million AUM, yet almost all your stocks can be considered medium cap, large cap, and several mega caps. Is there a reason you are underweight small cap stocks?

Actually, we have approximately \$400 million under management. We are able to take advantage of the 37,000 securities globally. In the past we have had large positions in small stocks, large stocks and debt. We try to be flexible and businesslike and there is no bias regarding size. We demand value and want to make sure we are paid sufficiently for the risk taken.

15. With the decline of the West and rise of the East, do you see any value in owning foreign equities particularly in the emerging markets? How do you think about the investment opportunities in BRICs?

In the 1980's I started investing in several stocks controlled by Carlos Slim in Mexico. When the Mexican Peso devaluation hit in 1993 we were able to take advantage of great bargains, but only because of watching the businesses for a long period. The cumulative benefit of a daily research effort after 27 years is helpful as I often will watch a company for several years before the price point is attractive. Regarding emerging market stocks, we like to buy along the food chain. If you go from making \$1 a day to \$2 a day you may not necessarily buy a new Mercedes, but you may upgrade the protein in your diet or buy some better shampoo. We like small ticket items where the product is used up and repurchased on a regular basis. Having lived on a farm since 1988, I also have some insights into agriculture, as we have exported to China for a number of years.