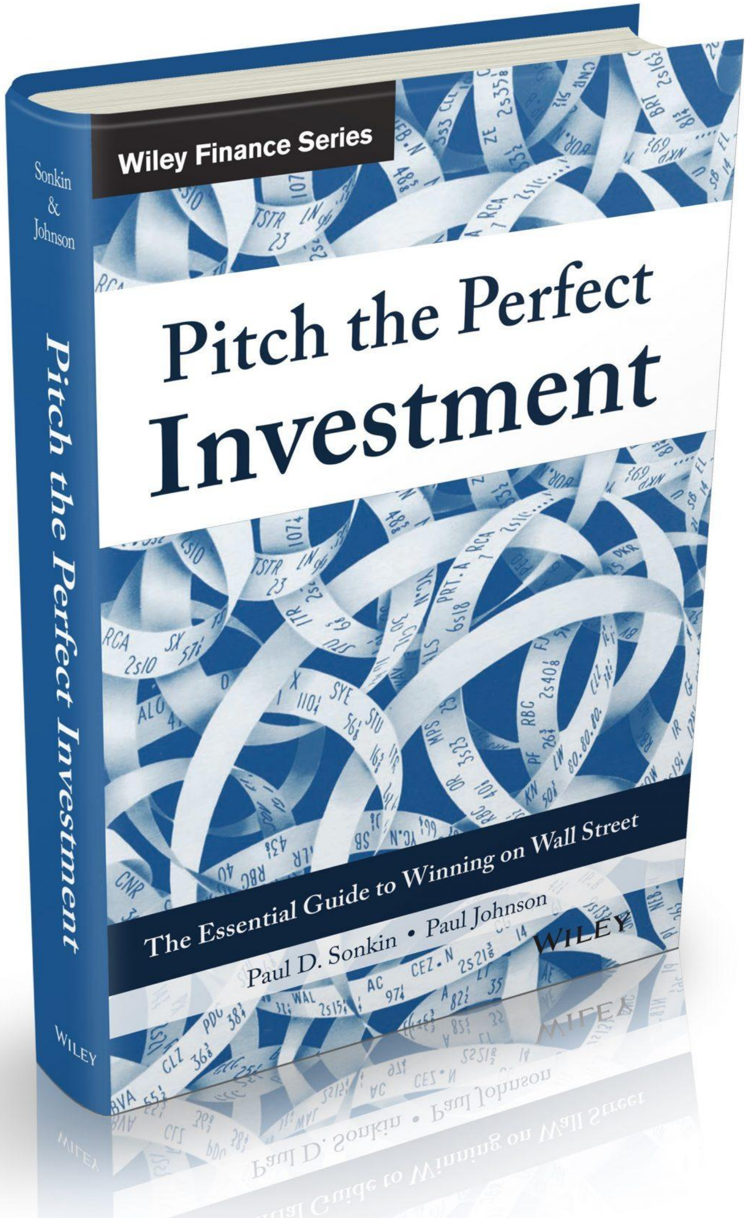
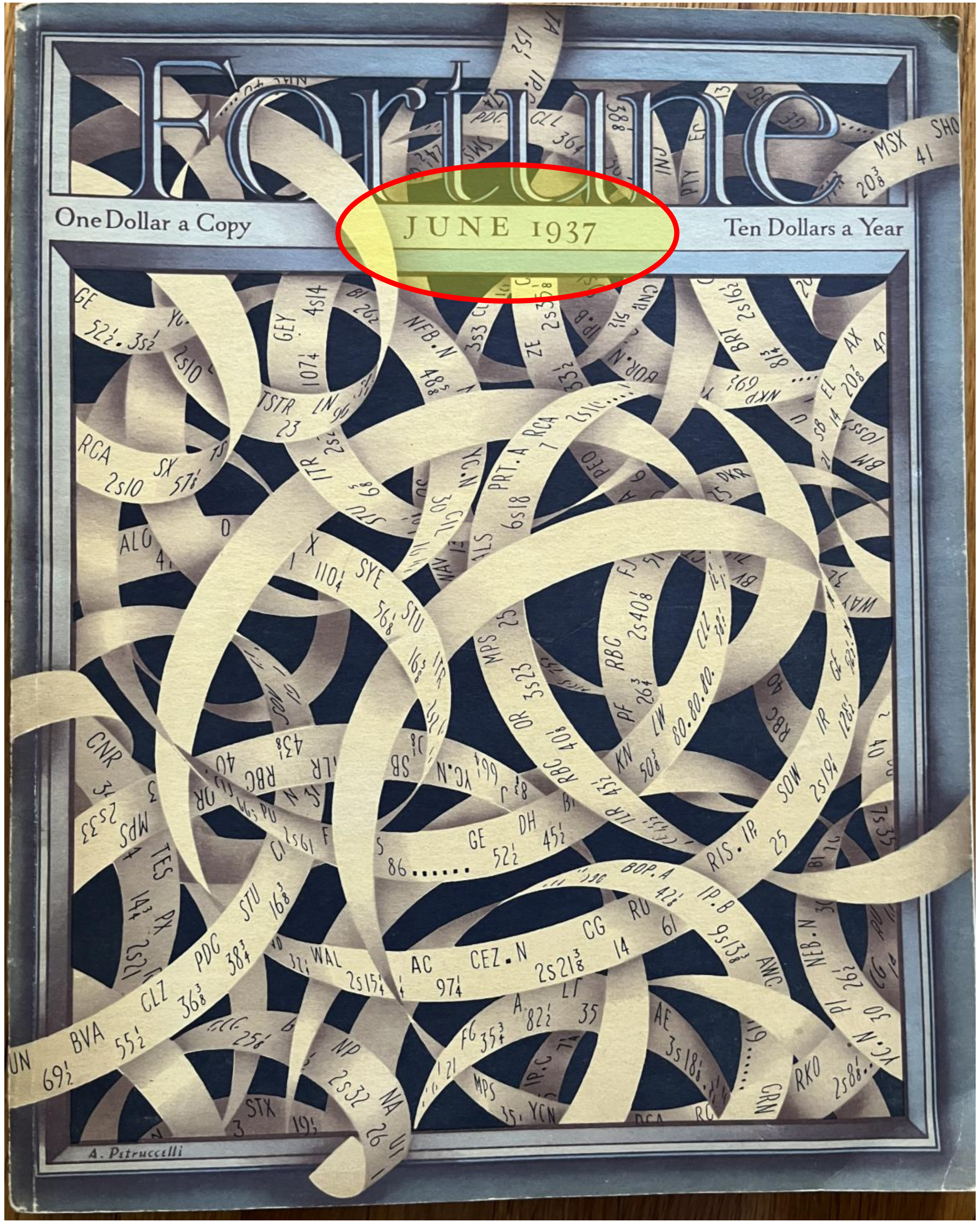
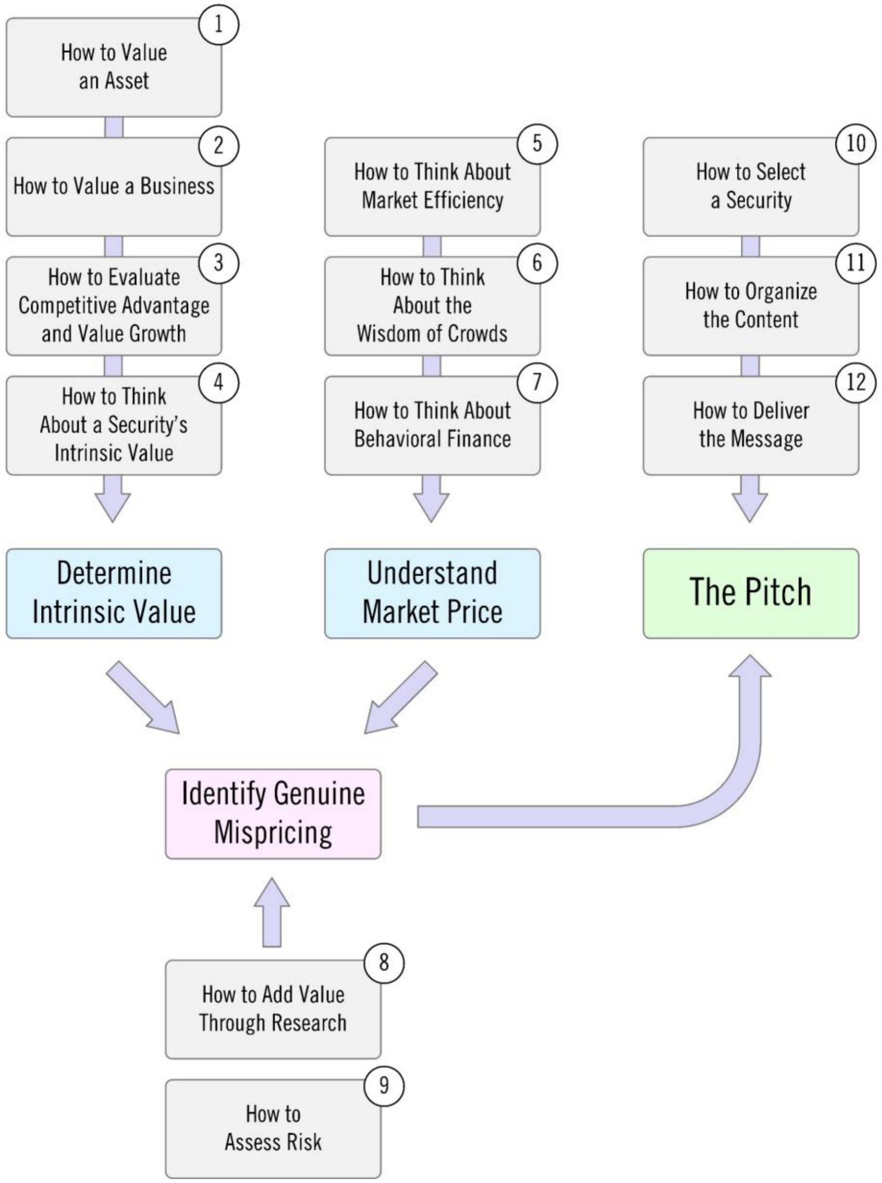

Wiley Finance Series
Pitch the Perfect
Investment
The Essential Guide to Winning on Wall Street
Paul D. Sonkin • Paul Johnson
WILEY
Sonkin & Johnson
Pitch the Perfect Investment
WILEY



Fortune
One Dollar a Copy
JUNE 1937
Ten Dollars a Year
A. Petruccelli

Book Overview

- Determine intrinsic value
- Understand market price
- Identify genuine mispricing
- Add value through research
- Assess risk
- Craft the perfect pitch



Stocks as narratives

Estimate of intrinsic value (IV) = a narrative

(can be modeled as a DCF)

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Estimate of intrinsic value (IV) = a narrative

(can be modeled as a DCF)

Price = consensus of all narratives

Expectations (how stock prices are set)

$$\text{Value of asset } = \sum_{t=0}^{T} \frac{\mathrm{FCF_t}}{(1+r)^{\mathrm{t}}}$$

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Expectations (how stock prices are set)

$$\text{Value of asset } = \sum_{t=0}^{T} \frac{\mathrm{FCF_t}}{(1+r)^{\mathrm{t}}}$$

$$\text{Stock price (estimate of the value)} = \quad \left[\, \sum_{t=0}^{T} \frac{\mathrm{FCF_t}}{(1+r)^{\mathrm{t}}} \,\right]$$

Expectations (how stock prices are set)

$$\text{Value of asset } = \sum_{t=0}^{T} \frac{\mathrm{FCF_t}}{(1+r)^{\mathrm{t}}}$$

$$\text{Stock price} = \left[\sum_{t=0}^{T} \frac{\mathrm{FCF_t}}{(1+r)^{\mathrm{t}}} \right]$$

We do not know the future cash flows (FCF)

Expectations (how stock prices are set)

$$\text{Value of asset } = \sum_{t=0}^{T} \frac{\mathrm{FCF_t}}{(1+r)^{\mathrm{t}}}$$

$$\text{Stock price} = E\left[\sum_{t=0}^{T} \frac{\mathrm{FCF_t}}{(1+r)^{\mathrm{t}}}\right]$$

Represents consensus expectations

Expectations (how stock prices are set)

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Expected future cash flows

Expectations (how stock prices are set)

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Price = consensus estimate of value

Expectations (how stock prices are set)

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Changes in the stock price =

$$\Delta\ \text{SP} = \Delta\ E\left[\sum_{t=0}^{T} \frac{\mathrm{FCF_t}}{(1+r)^{\mathrm{t}}}\right]$$

Expectations (how stock prices are set)

$$\text{Value of asset} = \sum_{t=0}^{T} \frac{\mathrm{FCF_t}}{(1+r)^{\mathrm{t}}}$$

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Changes in investor expectations

$$\Delta\ \text{SP} = \Delta\ E\left[\sum_{t=0}^{T} \frac{\mathrm{FCF_t}}{(1+r)^{\mathrm{t}}}\right]$$

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$$\text{Stock price} = E\left[\sum_{t=0}^{T} \frac{\mathrm{FCF_t}}{(1+r)^{\mathrm{t}}}\right]$$

Stock price changes because consensus expectations change

$$\Delta\ \text{SP} = \Delta\ E\left[\sum_{t=0}^{T} \frac{\mathrm{FCF_t}}{(1+r)^{\mathrm{t}}}\right]$$

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Consensus expectations change because new narratives emerge

$$\Delta\ \text{SP} = \Delta\ E\left[\sum_{t=0}^{T} \frac{\mathrm{FCF_t}}{(1+r)^{\mathrm{t}}}\right]$$

Fundamental value vs speculative asset

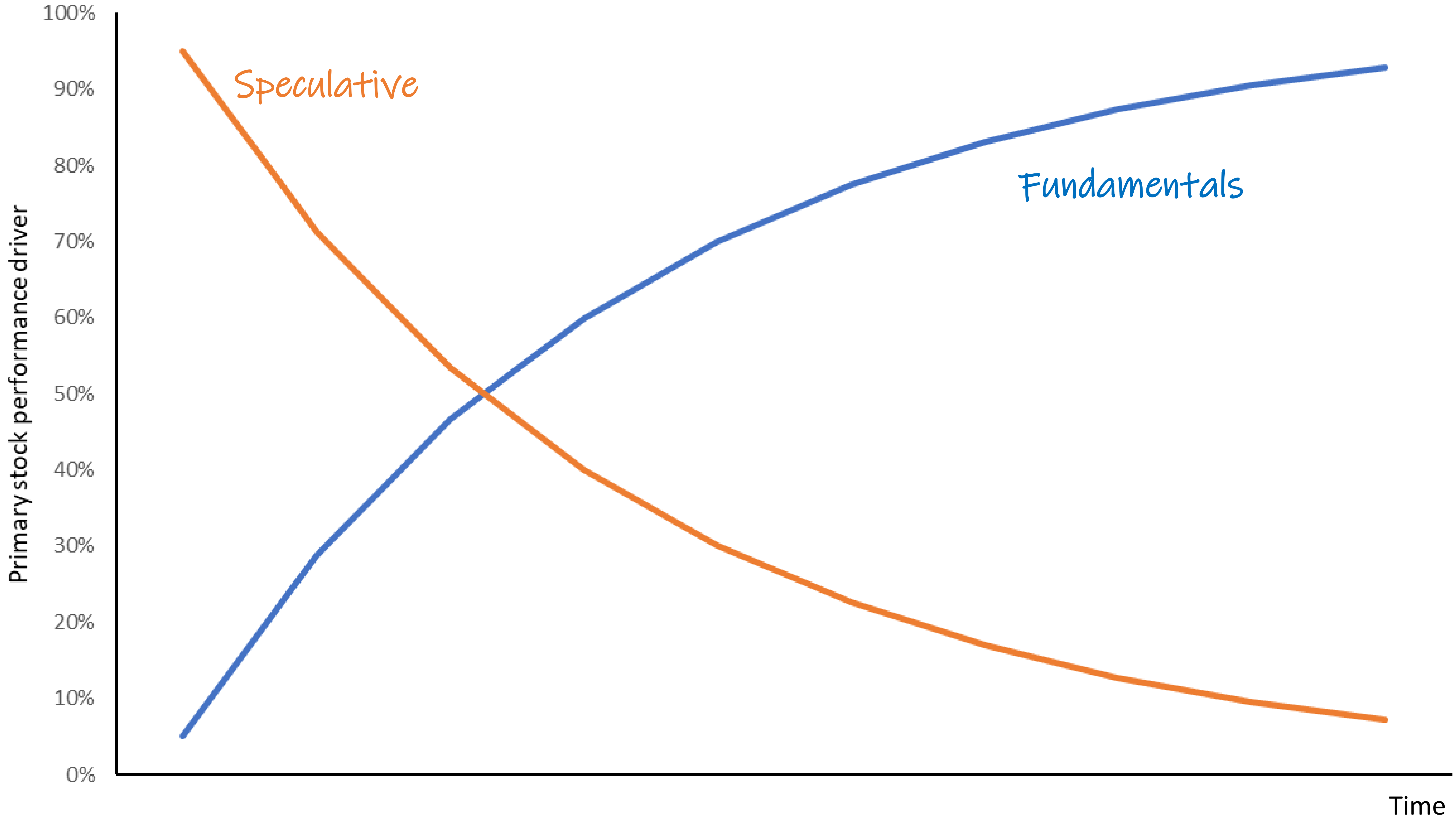
Fundamental

- Asset has a fundamental (intrinsic) value, usually based on future cash flow
- Fundamental value (V) determines investment strategy
  - Buy when Price (P) < Value (V)
  - Sell when Price (P) > Value (V)

Speculative

- Asset does not have a fundamental (intrinsic) value
- Speculating (solely) on price changes, which is a function of supply and demand
  - However, there is no systematic way to determine an investment strategy based on changes in price

"In the short run, the market is a voting machine but in the long run it is a weighing machine."
- Ben Graham



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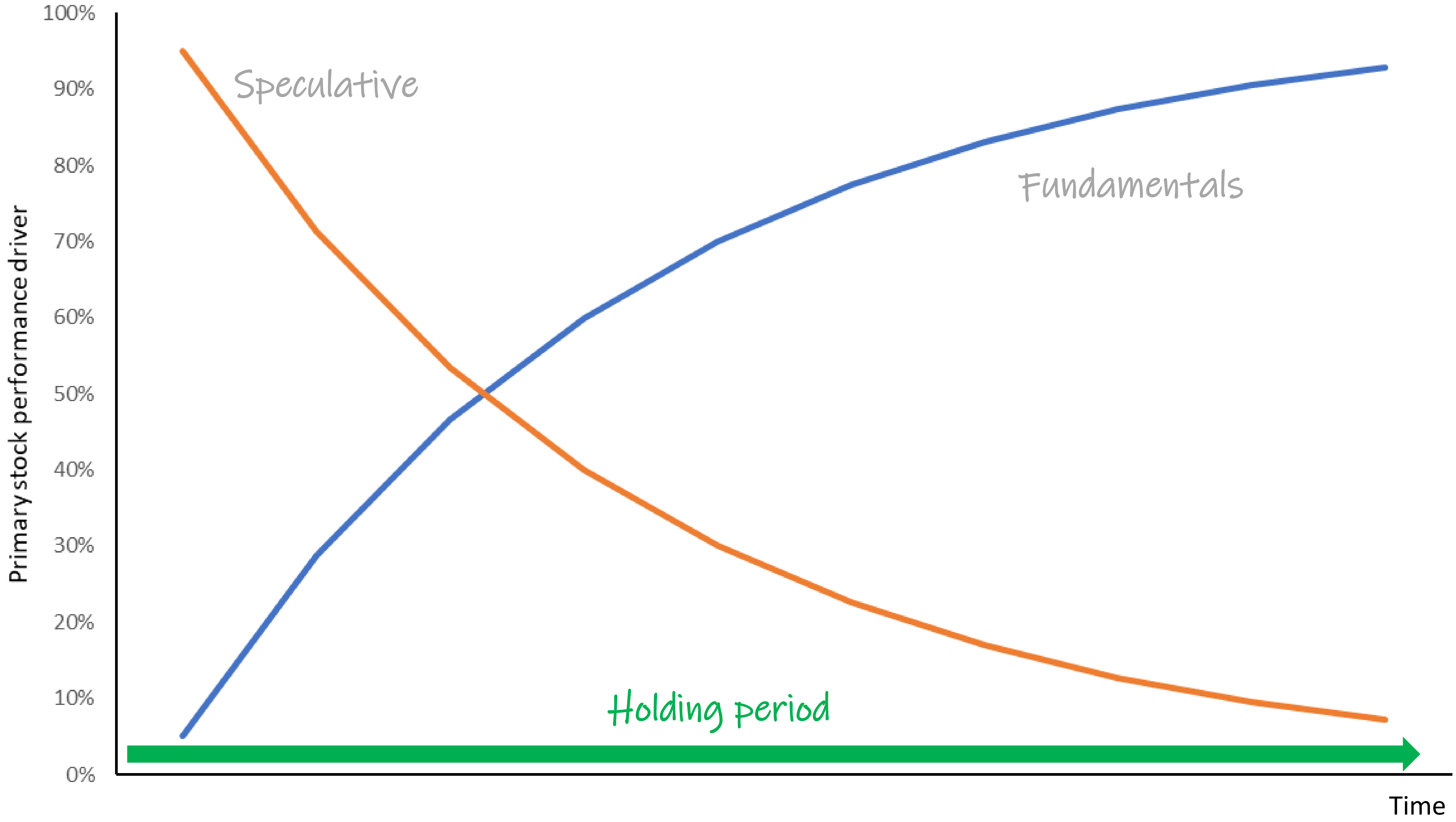
Primary stock performance driver
Speculative
Fundamentals
Time



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Investing is a supreme act of arrogance…

Every time someone buys a security thinking it will outperform someone else is selling that security because they believe it will underperform

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One of these investors will be wrong!

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One of these investors will be wrong!

Why do you believe you are on the right side of the trade?

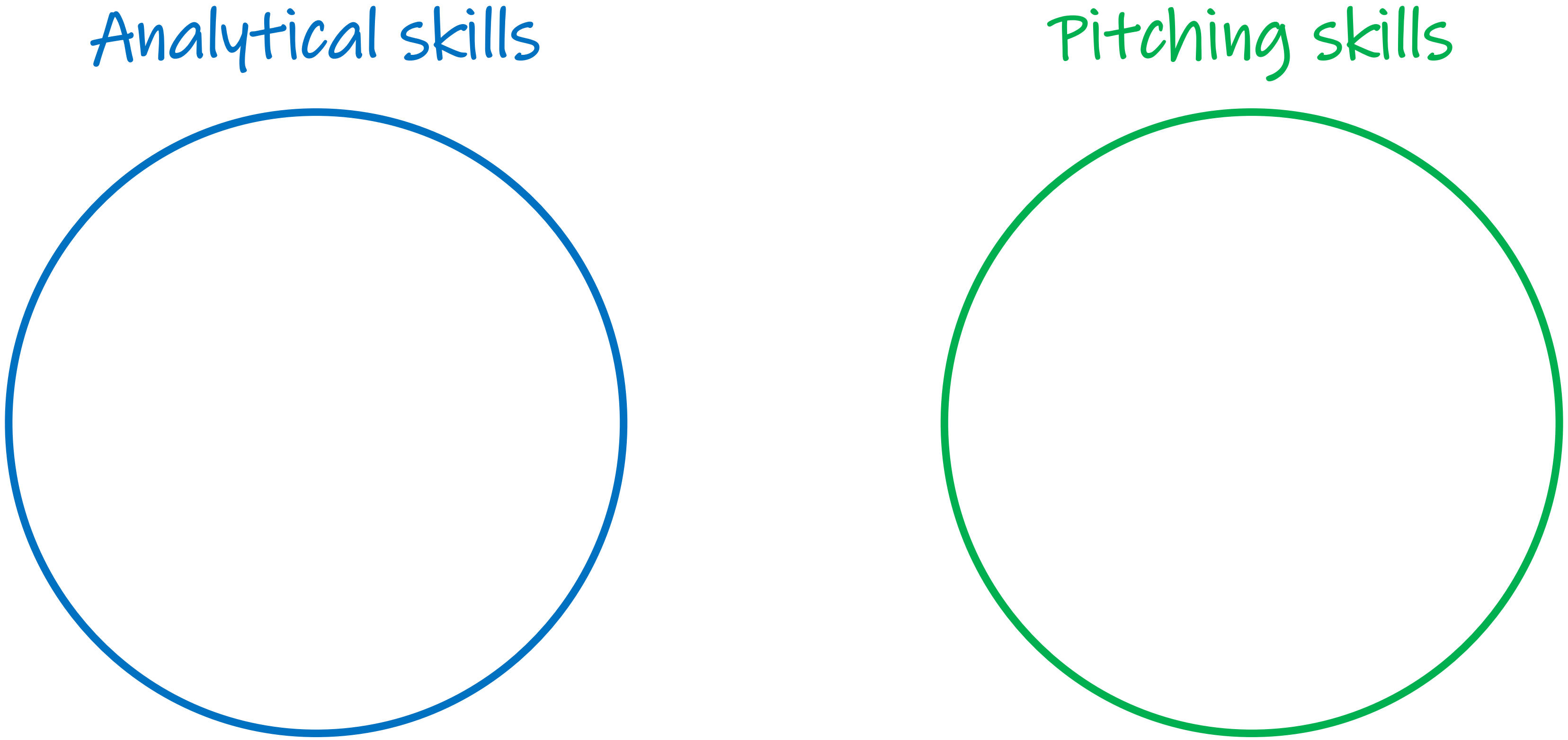
Charlie Munger – on investing

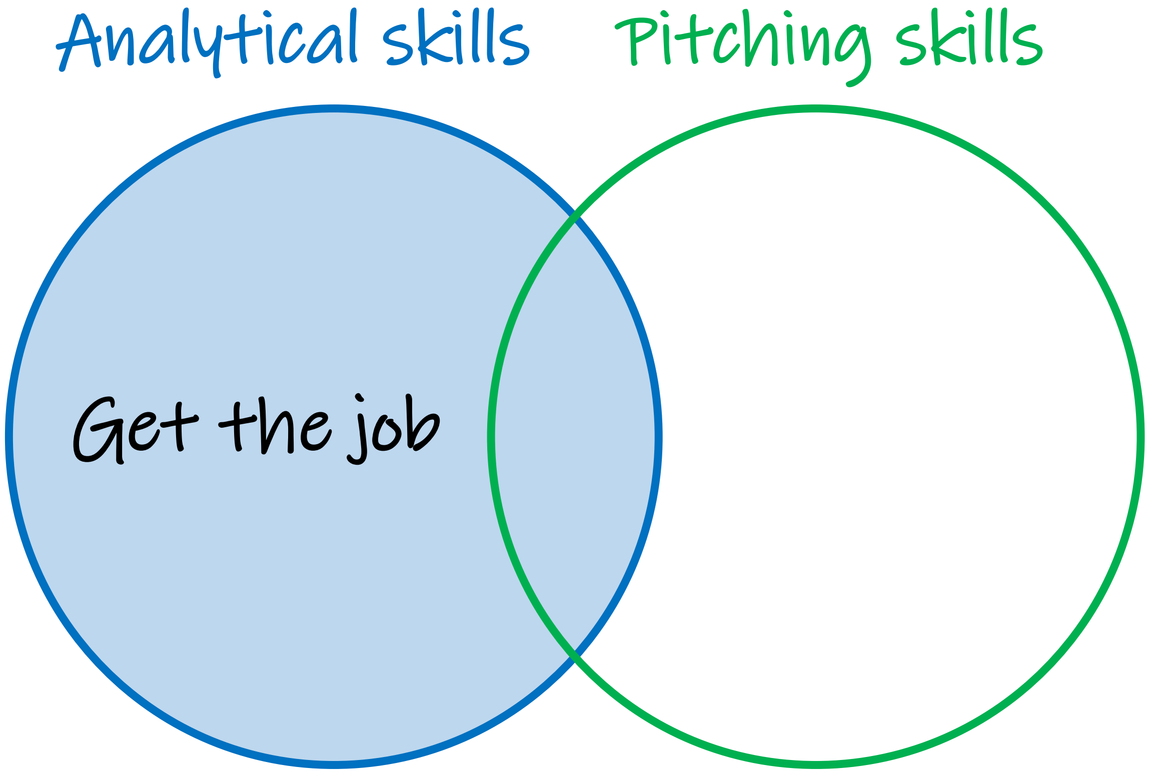
"It's not supposed to be easy. Anyone who finds it easy is stupid."

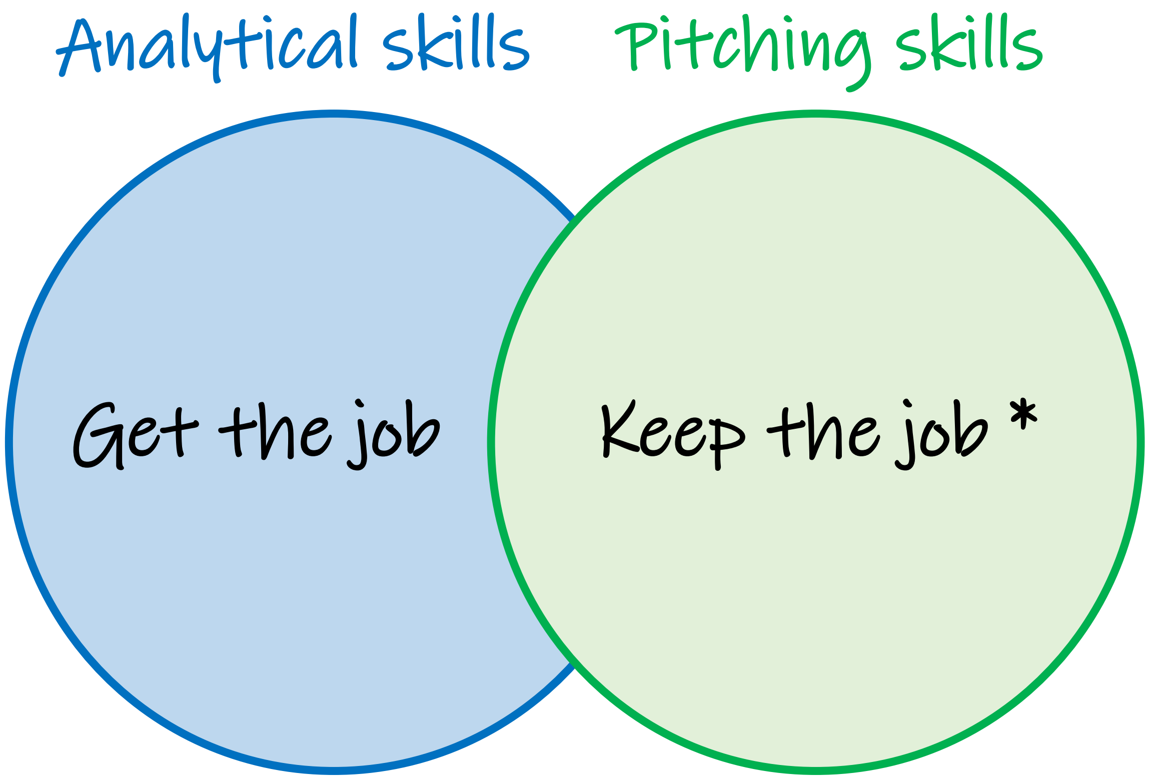
Failure to get ideas into the portfolio is no different than having

NO GOOD IDEAS

A successful pitch is key
to overcoming the challenge!


Analytical skills
Pitching skills


Analytical skills
Pitching skills
Get the job



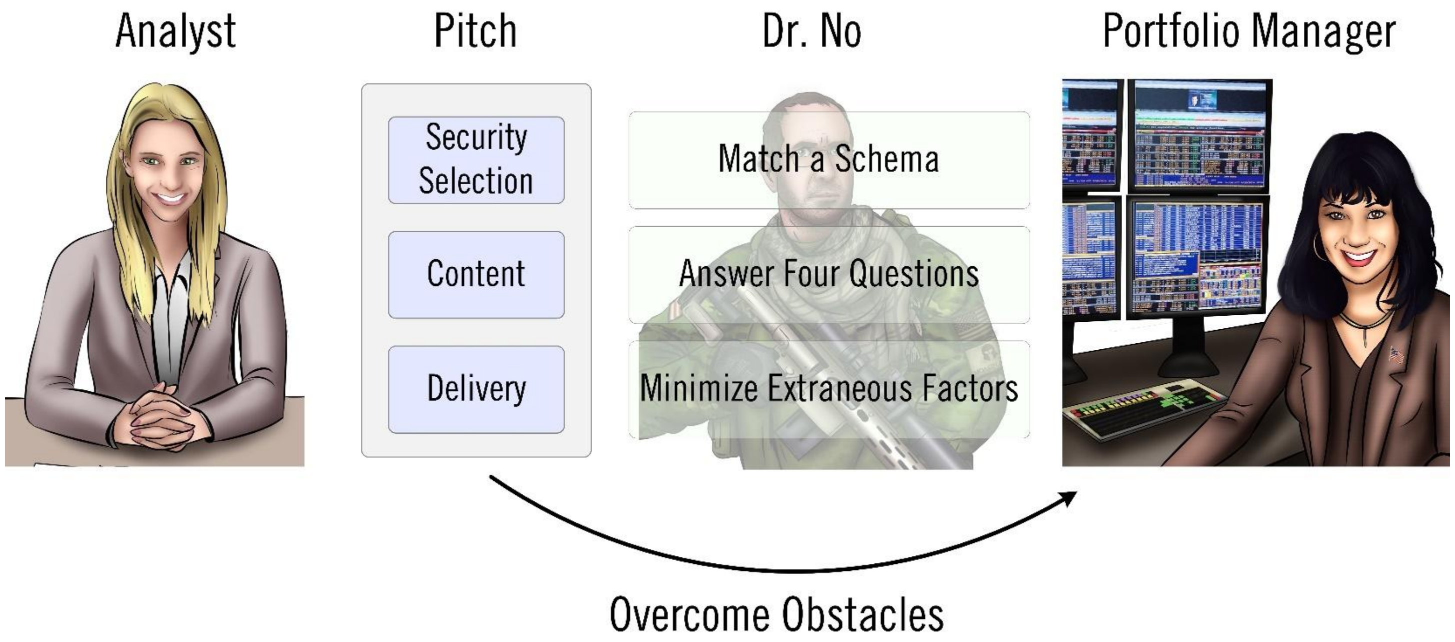
*Receive a bonus and get promoted

Pitching

Anatomy of a successful pitch

Elements in every pitch

- *Content* – why the idea is attractive
- *Audience* – how the idea matches PM's investment criteria and skill set
- *Delivery* – idea is conveyed clearly and succinctly



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CONTENT:
The perfect investment

- The analyst needs to answer four questions in her recommendation:

  - How much money will I make?
  - How much money could I lose?
  - Why the market is wrong?
  - And how the next person will figure it out?

CONTENT: The perfect investment

- The analyst needs to answer four questions in her recommendation:

  - How much money will I make? – upside
  - How much money could I lose?
  - Why the market is wrong?
  - And how the next person will figure it out?

CONTENT:
The perfect investment

- The analyst needs to answer four questions in her recommendation:

  - How much money will I make?
  - How much money could I lose? – downside / risk of being wrong
  - Why the market is wrong?
  - And how the next person will figure it out?

CONTENT:
The perfect investment

- The analyst needs to answer four questions in her recommendation:

  - How much money will I make?
  - How much money could I lose?
  - Why the market is wrong? – and how did *YOU* figure it out?
  - And how the next person will figure it out?

CONTENT:
The perfect investment

- The analyst needs to answer four questions in her recommendation:
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  - How much money could I lose?
  - Why the market is wrong?
  - And how the next person will figure it out? – catalyst

CONTENT:
The perfect investment

- The analyst needs to answer four questions in her recommendation:

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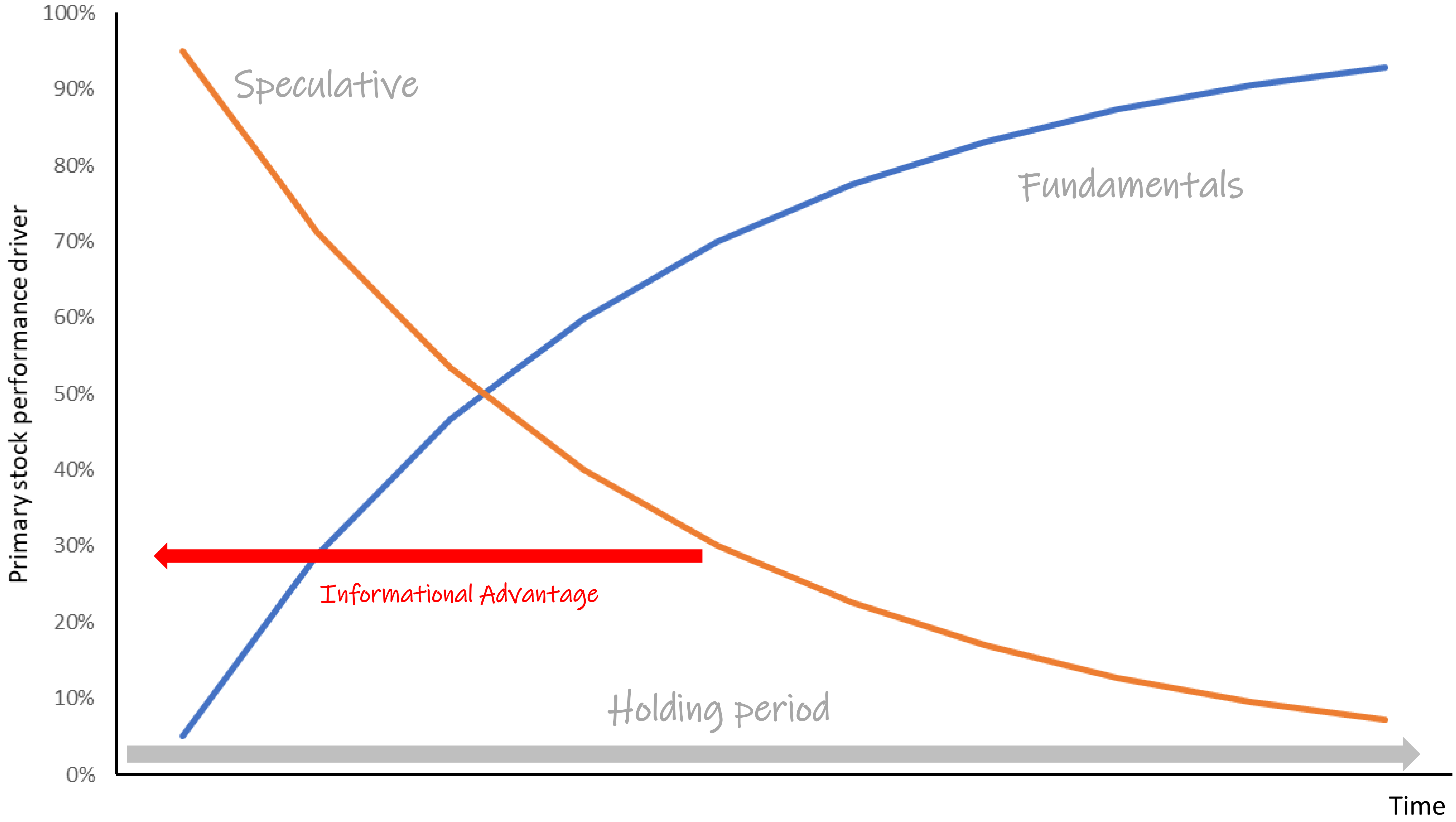
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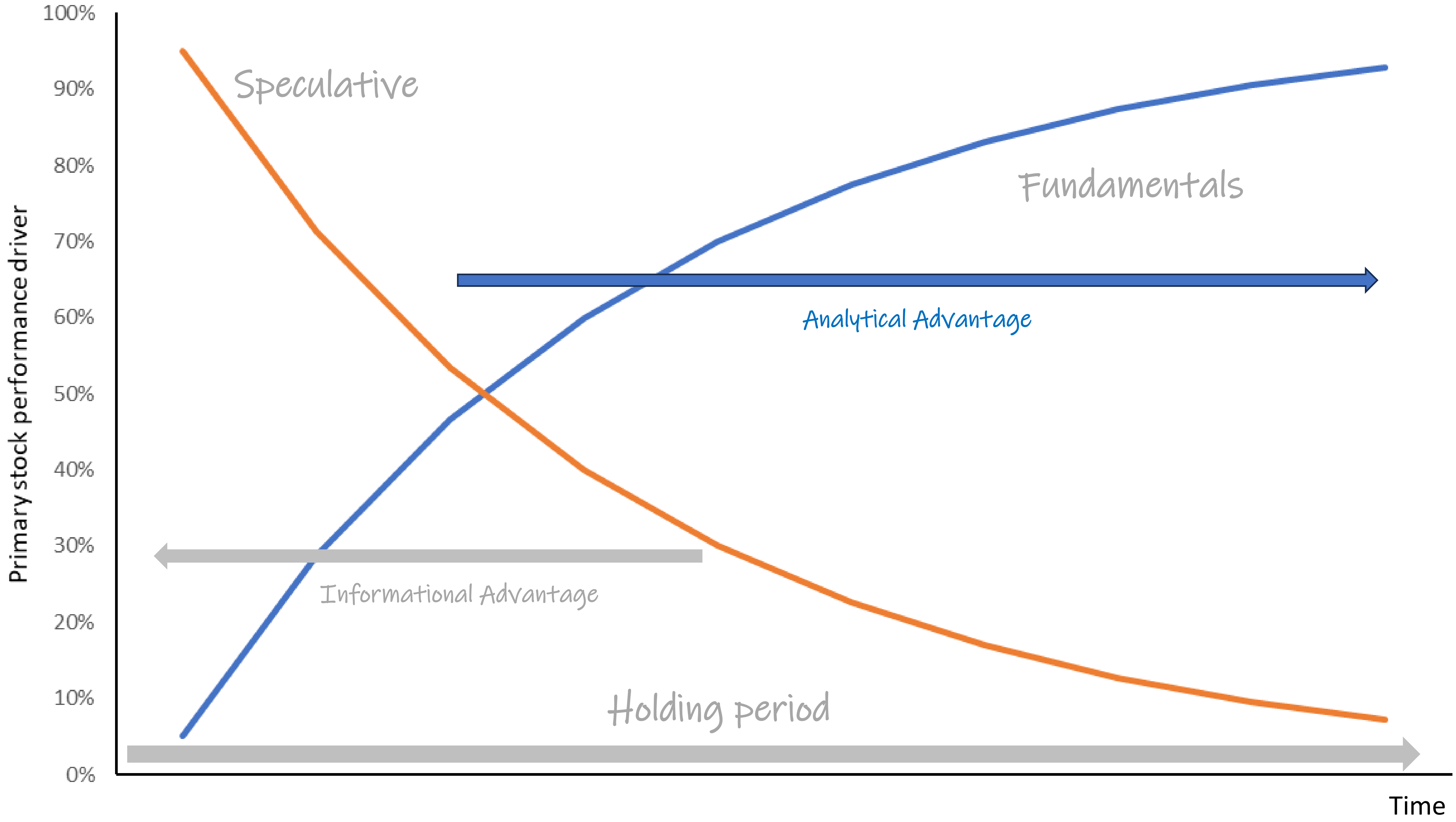
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PMs and Analysts want the same thing

An analyst

- Wants to present ideas that the PM will *listen* to
- Wants the PM to *adopt* their idea
- Wants the PM to *scale* their idea

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A Portfolio Manager

- Wants new ideas they feel motivated to *listen* to
- Wants to *adopt* ideas that will outperform
- Wants to *scale* the best ideas

AUDIENCE:
Overcoming impediments

- Listening:
- Adopting:
- Scaling:

AUDIENCE:
Overcoming impediments

- **Listening:** Requires matching PM’s *objective* criteria
- **Adopting:**
- **Scaling:**

AUDIENCE:
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- **Scaling:**

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Overcoming impediments

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- **Scaling:** Requires *transfer of ownership* of the idea from the analyst to the PM

Keys to successful pitching

- **Tell a story**
  - Keep it simple
  - *Focus only on the four questions* – <u>almost everything else is unnecessary</u>
  - Show the PM how they will make money with the idea

Narratives

- We are wired to like stories!
- All stock recommendations are stories
- No one every says,
  - “My DCF value, using a 5-year explicit forecast, a 3% terminal growth rate, and an 8.5% discount rates, says the value of the stock is …”
- Find the narrative – essentially tell a story

Keys to successful pitching

- **Tell a story**
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  - *Focus only on the four questions* – almost everything else is unnecessary
  - Show the PM how they will make money with the idea
- **Co-opt the audience**
  - Force the PM to ask questions
  - Let the PM map their ***subjective*** criteria to your analysis
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- **Co-opt the audience**
  - Force the PM to ask questions
  - Let the PM map their subjective criteria to your analysis
  - Get them to take ownership of the idea
- **Separate what you *know* from what you *think***
  - Hard to argue with facts
  - Keep any debate centered on the conjectures – which is where it belongs

Pitch competitions – biggest mistakes

- Slides are too dense
  - judges can either listen or read, but not both – don't make them choose!
- Not answering the 4 questions
  - too much emphasis on the stock's "upside" without addressing "Why is the stock mispriced"
- Attempting to answer questions when you do not know the answer
- Poor time management

The interview

- All interviews in the investment business are stock pitches
- Be prepared!
- Will not know the investor's subjective criteria and you cannot have a different idea for each investor's objective criteria
- Therefore, start all pitches with, "I am pitching this idea to show you the work I am capable of doing, not as an idea for your fund/portfolio"

Credibility is critical to idea adoption

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But do not try to sell me!

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Thank you