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1 Jun 2015

Price & Value

"That's a nice car! How much did you pay for it? I'm sure it's expensive!"

"I can see you spent quite a bit on that new watch of yours, are you sure it's worth the price?"

How often do we get into conversations like these with regards to our purchases? More often than not, the focus of the conversation will be on the **price** of the object. So then, what does **value** mean? To answer this question, let us look at what Warren Buffet has to say.

"Price is what you pay. Value is what you get"

Let's take a minute to digest the phrase. Has it helped in your understanding between **price** and **value** already? In our consumer and credit society, we are constantly bogged down by prices in our daily life. Every physical and material aspect of our daily life has a price attached to it -- food, transport, entertainment, etc -- and it is no wonder that most people don't see beyond the price of things other than just coming up with the money required to pay for it.

Simply stated, price does not necessarily equate to value. Something which is purchased cheaply doesn't mean it has good value and something which has been bought expensively doesn't mean it has bad value. It all boils down to what value means to us.

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For example, collectors of luxury timepieces would gladly pay the price of these items if they are ever discounted. Even if it amounts up to tens of thousands of dollars, they would still consider it cheap compared to its original selling price. This is because they see the value in them. Likewise, people who are only looking at purchasing a watch for the basic purpose of telling the time would think that this category of watches is crazily expensive!

How then have we been able to leverage on the concept of **price** and **value** in our investment planning strategies? Let's refer to some of our past investment calls we've made. (Refer to Unicorn 1200 30th July 2013)

In January 2007, our Investment Committee added gold as an asset class to our portfolio. At the time when we made the call, gold was about US$640 per ounce.

Past performance is not necessary indicative of future performance.
http://www.kitco.com/charts/livegold.html

Despite the price of gold rising from 2001 till 2007, why did we still include it as part of our asset class? Was it because of the cheap price? Definitely not because the price shows that it's more expensive compared to a few years back. Rather, it was the value of using gold as a safe haven during a crisis that resulted in the purchase. As of end-May 2015, gold price is now around US$1,190per ounce.

Another similar example would be in September 2008 when we allocated 30% of our clients' investment portfolio to China equities. The Shanghai Composite Index was about 2,293 points.

Past performance is not necessary indicative of future performance.
https://sg.finance.yahoo.com/echarts?s=000001.SS#symbol=000001.SS;range=1d

As we can see, the index has fallen by almost 65% then! When a person uses price as the arbiter, economic sentiments coupled with the rapidly falling price was more than enough to scare most investors away from China. However, the value again was in China's long-term growth story, which we felt were intact and attractive, therefore we went about with the allocation. As of end May 2015, the Shanghai Composite Index is around 4,611 points.

Very often, the value of a good asset is very stable and appreciates consistently over time. However, the price of the same asset could be fluctuating wildly day to day, even second to second. When a person uses price as the determinant of value, he will make decisions based on an illusion, thinking that he has got richer or poorer because the price has moved. He will have no yardstick to make a decision, but rather, he has allowed his emotions (and consequently wealth) to sway wildly with the prices of his assets. However, when one can see the value of what he has invested in, he will have a very clear yardstick to make a decision and hence consistently profit from his investments.

Price has no meaning on its own. It only gets its meaning when measured against value. This concept is simple but not easy. When you can truly grasp it, it can make you very wealthy.

Reflections

What are some of the purchases you have made recently which you felt was bought at an attractive price but others felt was expensive?

What value did you see in these purchases that caused you to feel that it was bought cheaply?

Have others opinion that your purchase was expensive caused you to start doubting the value of your purchase?

How can you apply your understanding of the first 3 questions to your own investment planning?

Since value is such a critical success factor in investing, how do you go about deciding the value of your investment?

Prelude to next article: *Differently Different*

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[1] "I'm leaving you because you know the price of everything and the value of nothing."
https://www.cartoonstock.com/directory/t/tightfisted.asp

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