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Q&A WITH ELLIOT TREXLER, CIO OF GLOBAL RETURN ASSET MANAGEMENT

Elliot Trexler is the Chief Investment Officer and President of Global Return Asset Management. He was awarded in 2016 "Best Fundamental Growth Investor" and "Award for Excellence in Risk Analysis" by BarclayHedge. He also received the 2016 and 2018 "Hedge Fund Manager of the Year" awards by Wealth & Finance International. In this interview, Elliot shares his views on investing, risk, ESG, and the importance of the 10-K.

How did you get started in the investment profession?

When I was nine years old, I was in my Uncle Sal's office watching him work. On his desk were several computer monitors, lots of books and stacks of papers. I saw him punch a few keys on his keyboard, so I asked what he was doing, and he replied, "I just bought an ownership interest in a company." That's when I knew I wanted my career to be investing. I bought my first stock shortly thereafter.

Why did you open your own fund?

I wanted to craft my own culture and work with people I like. Many people complain on Sunday night about going to work the next day, I don't ever want to be in a position where I'm complaining about work. Sixty percent of my waking hours are at work, life is too short to agonize about where and with whom I'm going to spend that time.

How would you define your investment style and philosophy?

We're value investors focused on risk management.

My strategy is unlike Wall Street, which looks for all the reasons a stock could rise in value and how much they can make. I do the opposite. I'm looking for risk and for all the reasons a stock could decline in value. I then assess whether those risks are compensated by the upside potential.

As for investment style, I'm long-only and hedge with index options and cash.

What led you to that particular style?

My personality, which is risk averse, methodical and analytical.

How do you define and measure risk?

Risk is the probability of an impairment to the corpus, which I define as the initial capital invested in the fund, such that if an impairment occurs, additional investments won't restore the corpus back to its original purchasing power.

How do you manage risk?

I have a lot of ways I manage risk, but most of my focus is on trying to understand a company's actual and potential sources of risk and how these could impact the company's valuation. I do this because each holding is a source of risk and return to the portfolio, and I want a low-risk, high-return portfolio. And I'm adamant about waiting for my buy price, you can reduce a lot of risk by waiting for good prices.

The *purpose* of my risk management strategy is to quantify the risks within an investment and then determine whether the potential return compensates for these risks. The *goal* of my risk management strategy is to eliminate prospective investments that possess uncompensated risk. Ideally, the remaining investments create a portfolio with the greatest return possible and the least amount of risk.

In an article in Guru Focus, one of the questions asked, "What drew you to that specific strategy?" and you said risk management. Can you elaborate on that and talk about your views on risk management and how it is incorporated in your investment process?

I've never understood why our industry separates investment management and risk management. Or separates investment analysis and risk analysis.

Investment analysis must begin with identifying risk because risk is the source of all returns. If returns didn't come from risk, then investors would never lose money. Therefore, above all else, successful investing comes from successful risk management.

Risk management is the core of my investing: how I research a company, analyze its financials, buy and sell its stock – everything – begins with risk management. I'm really in the business of risk management, not investment management.

Can you describe why you incorporate ESG analysis in your investment process?

We think it's important because analyzing a company's ESG factors helps us identify risk in a company's operations. I've never seen a company list "Risk" on its financial statements. You have to look beyond the financial statements to find risk and ESG is one method we use.

Understanding a company's ESG factors gives us a better understanding of the company's operations, potential risks, how management thinks and the investment's risk/reward ratio.

Do you screen using an ESG framework or analyze the companies' policies when you evaluate a potential investment? How do you incorporate ESG into your evaluation process?

I don't use screens because ESG is subjective. I've created my own checklists and decisions trees that I use.

For example, one of the things I look for are changes to a company's accounting policies. If I see a company changing its policies every other quarter, it tells me management is finessing their financials to meet Wall Street's estimates or their compensation hurdles, or both. It could also indicate the company's fundamentals are deteriorating.

Any of these would cause the company's stock to decline. If I hadn't reviewed the company's accounting policies, which is a governance factor, I wouldn't have identified these risks.

In the Guru Focus interview, one of the questions was on stock screeners and ways to find undervalued investments besides screens. You said you read a lot of 10-K's. For beginning investors, reading a 10-K seems a bit daunting, do you have any tips on how to break it down?

Practice by reading a lot of 10-K's.

There's no easy shortcut to successful investing. If you want to be a fundamental investor you have to understand the companies you're investing in. That includes its operations, its industry and its risks, and the only way to do that is to read about it in a 10-K or 10-Q. Over time, a 10-K won't be daunting, reading 150 pages will become just another "to-do item" on your list for the day.

How should a beginning investor approach a 10-K? Do you start out with the financial statements first? Is there a certain pattern you follow when reading a 10-K?

I start on page 1. Then I go to page 2 and continue from there.

The financial statements are the last section I review. Most investors jump right to the financial statements because "that's where the money is" but those numbers only represent what's already happened, and they'll change in the future.

As an investor, I'm buying the future, and it's the text of a 10-K that helps answer what the future might look like. The financial statements mean very little if you don't understand the business.

How do you evaluate company's business models and competitive advantages? How do you evaluate consumer advantages?

Specifically, I use checklists and decision trees, just like you would use a road map to get where you want.

The best way to develop your evaluation process is to read as much as you can and then create your own checklists and decision trees. The more you read and continue to learn and refine your checklists and decision trees, the better you'll understand how to evaluate business models and competitive advantages. You must be a student of investing.

When you were creating your decision trees, can you talk about that process?

It's an iterative process. The more you read, the more you're able to identify critical information, understand the right questions to ask, and know what's relevant and what's not to your evaluation.

I regularly review and revise my checklists and decision trees. In fact, the day I stop doing this will be the day I begin losing. Accounting, technology and business models continually evolve, and new information is constantly being created, so it's imperative I improve my decision trees.

Was it the result of reading a bunch of 10-K's and seeing particular patterns?

Yes.

Was it the result of reading management books or publications for certain sectors or companies?

Yes.

For companies in general, are there core business characteristics that successful companies share?

Yes. And anyone can recite these but understanding a company's risks is what separates successful investing from everything else.

How do you calculate and determine intrinsic values?

This is the easiest part of investing. Everyone has the formulas and if you don't, there are countless resources available – software, excel downloads or add-ins, sell side research, etc.

Most people think calculating the intrinsic value of a company is the most important part of investing. But I disagree. I think the most important part of investing is understanding the risks imbedded in a company and understanding how these could impact the company's intrinsic value.

What books do you enjoy the most reading? What are some books you are reading now?

I'm obsessed with reading. I read about a book a week and will read several books at a time. If I'm not reading a book, I'm reading a whitepaper, research report, 10-K or 10-Q.

I've read all the investment classics, some of them multiple times. As for topics, I read books and whitepapers on accounting, business, psychology, neuroscience, quantum physics and new technologies. I'll read anything I can learn from that's applicable to my work.

I read with a pen and highlighter and much of what's highlighted is put into a document I call my "Investment Book." This is several hundred pages of notes on investment principles, philosophy, risk management, different calculations, etc.

Who are your mentors?

I have multiple mentors who help with different aspects of my business. For example, I have one mentor who's been incredibly helpful on business development practices. Another mentor has coached me on how to establish a culture of compliance. And I have two mentors who are great sounding boards for ideas I'm batting around.

But learning shouldn't stop with mentors. Everyone we interact with – at work, in social circles, our family, clients, authors, etc. – can be a teacher if we're willing to listen.

I've actually learned a lot from people I've never met. Just by watching what they do and say, as well as what they don't do and don't say, you can learn a lot. And the reverse is true too; there are many teachers who are great examples of what *not* to do.

Closing thoughts

Focus on risk management and investment returns will follow.

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