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CHRISTOPHER TSAI REFLECTS ON TIMELESS VALUES IN INVESTING AND LIFE
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Ezra Crangle, Editor-in-Chief of MOI Global en Español, had the distinct pleasure of speaking with Christopher Tsai, President and Chief Investment Officer of Tsai Capital Corporation. Christopher's investment approach has been influenced by Warren Buffett, Phil Fisher, and Charlie Munger, among others, as well as his own family's long and storied financial history. Christopher's grandmother was the first woman to trade shares on the floor of the Shanghai Stock Exchange, while his father, Gerald Tsai Jr., was a prominent investor and the first Chinese-American to lead a Dow Jones Industrials company.

Ezra Crangle, MOI Global en Español: Your career began influenced by your father, Gerald Tsai, who was a pioneer in momentum investing. What led you to move away from that philosophy and adopt a more value-oriented approach to investing?

Christopher Tsai: In life, you will have an advantage, and a lot more fun, if you leverage a personal trait and remain true to yourself. Think about it this way: a career as a professional swimmer is just not going to work out well if you are built to be a boxer. My father was superb at timing his investments, both in public and private companies. He had a natural gift. But I would argue that there was a lot of luck to his career, and market timing generally does not work.

I certainly didn't want my approach to rely on luck. I learned early on in life that I was terrible at timing the markets but enjoyed a good market sell-off. I love buying on sale and don't seem to be bothered by drawdowns. But more importantly, I want to sleep well at night. Focusing on underlying values and allowing the power of time and compounding to work for me was appealing when I was in my teens, and it's even more appealing now.

MOI: You mentioned that your father taught you important lessons about investing, such as the importance of assuming the market is right before making an investment. What do you consider to be the most valuable lesson you've learned in your career, and how do you apply it in your current investment decisions?

Tsai: I've been fortunate to learn so much from so many investors who are just way smarter than I am. It's hard to say what the most valuable lesson was. But when I was interning for my father, he told me never to dismiss a company because it looked expensive. He said you have to do the deep work to understand what a company is worth. Too many people, especially in the value investing community, seek out companies with a low P/E ratio. But what is a P/E ratio other than just price over a 12-month period of earnings? Sure, it can be a good rule of thumb, but it can also be so misleading, particularly with respect to rapidly-growing businesses.

If a company decides to invest more now, it's going to depress earnings. The P/E ratio will consequently be higher. But that investment might actually increase the intrinsic value of the company. In other words, a purchase at $20 a share with a P/E ratio of 40 may be a better buy than a purchase at $20 a share with a P/E ratio of 10. You have to understand what's going on under the hood. You have to think about all the future cash flows and what those cash flows are worth in present value terms. Buffett has said that over and over again. Yet investors, especially value investors, seem to forget that. They love to screen for companies that look cheap. This is so important to understand because the truly great growth companies almost always look expensive.

MOI: In your investment approach, you focus on high-quality companies that can offer a margin of safety. What characteristics do you look for in a company to consider it a long-term “compounder”?

Tsai: We look for businesses that we think can reinvest capital at high rates of return over a long duration. That’s primarily where the compounding comes from. But what creates that foundation? You need a management team that is skilled at capital allocation. You need markets that are large enough to support the deployment of an increasing amount of capital over a long period of time. And you need a business model and economic moat that allow for an outsized return on investment. We therefore avoid investing in companies that don’t have some sort of competitive advantage.

MOI: Nearly 30 years of Tsai Capital. Congratulations! How has Tsai’s investment philosophy evolved over these nearly three decades?

Tsai: Thanks! We focused on high-quality, growth companies back then, and we focus on high-quality, growth companies today. What’s changed, however, is our appreciation for diversification. I’m not talking about having a hundred companies in the portfolio. I’m talking about having 23 or so today versus a smaller number in the past. I’ve come to the conclusion that having more companies in the portfolio, to a point, of course, can be extremely beneficial in achieving the goal of compounding capital over the long term. That’s because it’s a lot easier to manage through drawdowns, which are inevitable, and to hold onto our compounding machines when the news is bad, which is also inevitable.

MOI: We know that many traditional value investors find it difficult to understand how Tesla can fit into a value investing approach. Could you help our readers understand more about Tesla? What elements do you believe make Tesla an attractive investment from a long-term value perspective?

Tsai: I’ll reiterate that too many investors are focused on P/E ratios. How many people missed out on Costco because they thought that a 30 or 40 multiple was too expensive? How many missed out on Amazon for the same reason?

I’ve spoken a lot about Tesla in the past so I won’t go into too much detail here. But I’ll say that most investors have probably not done deep work and can’t get past the P/E ratio or their perceptions of Elon. Tesla has significant and sustainable competitive advantages. It’s investing heavily today and rapidly building intrinsic value. This company is one of the most capital-efficient businesses I am aware of. I could be wrong, of course, and I’ve said that before. But we think Tesla has all the characteristics of a high-quality, long-term compounder.

We’ve owned Tesla since February 2020. We initially paid an average of about $41.66 per share. So, the stock is up about six times since we first invested. But we think it’s still undervalued. I’m also convinced that you will increasingly see Tesla show up in the portfolios of those who characterize themselves as value investors. That’s starting to happen now.

MOI: In your talk on “Investing in an Age of Disruption”, you discussed how companies must adapt to technological and market changes. Could you share how you incorporate this mindset into your investment selection process? What sectors or types of companies do you consider best positioned to thrive in this age of disruption?

Tsai: It doesn't matter what industry you're in. Businesses are at risk of being disrupted, and the pace of disruption is accelerating. That's why culture is so important. And it can't be screened for. When we're thinking about investing in a business, we pay a lot of attention to the people and the culture of the business. We're looking for a management team that can pivot quickly and adapt to change and is willing to shelve a project after years of investment, for example, because that's the best thing to do. Elon pivots quickly. He's not worried about optics. Reed Hastings is another person who comes to mind. We prefer asset-light business models because they can usually pivot more quickly than asset-heavy businesses, though there are exceptions.

MOI: Although you mainly focus on U.S. companies, you've mentioned that you are willing to invest anywhere in the world with certain requirements for transparency and stability. What regions or international markets do you find most promising at the moment?

Tsai: Tsai Capital has a preference for investing in multinational businesses. Yes, these businesses tend to be headquartered in the United States, but they operate on a truly global scale. We estimate that about 60% of the revenue from our investees comes from outside of America. We favor the United States because of its transparency, innovation, and rule of law. And we are still finding plenty of opportunities here, though we have our eyes on Western Europe as well.

MOI: Which of the great investors do you admire the most, and what lessons have they taught you that have left a lasting impression on you, both in your investment approach and in your life in general?

Tsai: I've admired and learned from many great investors, but I'm going to single out Charlie Munger. I was fortunate to meet Charlie at his home in 2018, and I've learned so much from him. He has been an incredible teacher to me and to countless others.

He said that in life you want to choose your friends and clients wisely. You want to surround yourself with kind, intelligent, and reliable people. Unfortunately, there are many bad actors out there. Regarding toxic people, Charlie once said that the great lesson of life is to get them out of your life, and to do it fast. I think that is really excellent advice.

I keep a photo of us in my office to remind me of how to live a good life. I'm sure I get a lot wrong, but he has set the standards high and continues to serve as my north star. I believe I'm a happier and better person because of him.

MOI: Which books or readings that have shaped your investment approach or thinking would you recommend to our readers?

Tsai: It's a commitment, but I would highly recommend that investors read In Search of Lost Time by Marcel Proust. Proust captures the essence of why people behave the way they do with remarkable detail. It's astonishing to me how someone could understand humanity so well. And he said, "The real voyage of discovery consists not in seeking new landscapes, but in having new eyes." As investors, we have to remain open-minded.

I'd also suggest Poor Charlie's Almanack: The Wit and Wisdom of Charles T. Munger. This book is truly a treasure.

MOI: With your long career and experience, I'd like to end the interview with this: What recommendations or lessons can you share for those investors who are just starting their careers or are already experienced but want to improve as investors?

Tsai: I launched Tsai Capital when I was 22 years old. One of the benefits of launching early is that you have a lot more time to make mistakes! However, one of the disadvantages is that you likely will have a limited network of people who can assist you on your journey. This can make your journey more challenging and isolating. For those who are just starting out, and for those who are experienced, my recommendation is to compound your relationships and be helpful to others. Life is about people! And it's so much more fun when you can learn from others, fall down, and get back up together.

MOI: Thank you, Christopher.

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This interview makes reference to the average purchase price that Tsai Capital initially paid for shares of Tesla. The average purchase price is calculated on a dollar-weighted basis over the entire period of February 2020 through April 2020 and is inclusive of commissions.

For a copy of our most recent performance update, which includes annual performance comparisons after the deduction of advisory fees, visit: https://tsaicapital.com/files/Tsai-Capital-Annual-Investor-Letter-2023.pdf.