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# **PARADIGM CAPITAL**

**„VALUE INVESTING WITH A PORTFOLIO RISK MANAGEMENT APPROACH”**

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**THE BEN GRAHAM CENTRE'S 2ND  
EUROPEAN VALUE INVESTING CONFERENCE  
ATHENS**

## RISK MANAGEMENT IN PRACTICE...

### Proper definition of risk

- Permanent (long-term) impairment of capital

### Practical risk management

- At purchase/sale – margin of safety
- No excessive leverage at firm or portfolio level
- Diversification - especially important

### Macro risks – inflation/boom – deflation/bust

- Equities/franchise businesses
- Build portfolio from bottom-up – assess boom/bust exposure
- Insure net exposure – cash, shorts, options

## WHAT IS THE DEFINITION OF RISK?

- Exposure to the chance of injury or loss
- The volatility of returns

## HOW DO WE INSURE AGAINST RISK?

- Unsystematic risk insurance
- Systematic risk insurance

## RISK MANAGEMENT IN PRACTICE FOR VALUE INVESTORS FOCUSES ON ESTIMATING AND LIMITING DOWNSIDE EXPOSURES, IRRESPECTIVE OF EXPECTED RETURNS...

### Investment Level

*Bottom up*

#### Company specific risk

- **Wide range of investment outcomes are considered:**
  - Eliminate Investment candidates with a possibility of **total loss** (e.g. high leverage)
  - Eliminate **specific risks** (e.g. FX hedging) EUR based fund all FX principal hedged
  - Reduce **investment losses** even in worst business environment (margin of safety in price)
  - Position sizing to **limit portfolio impact**
- Investments established over a period of time; averaging out market movements

### Portfolio Level

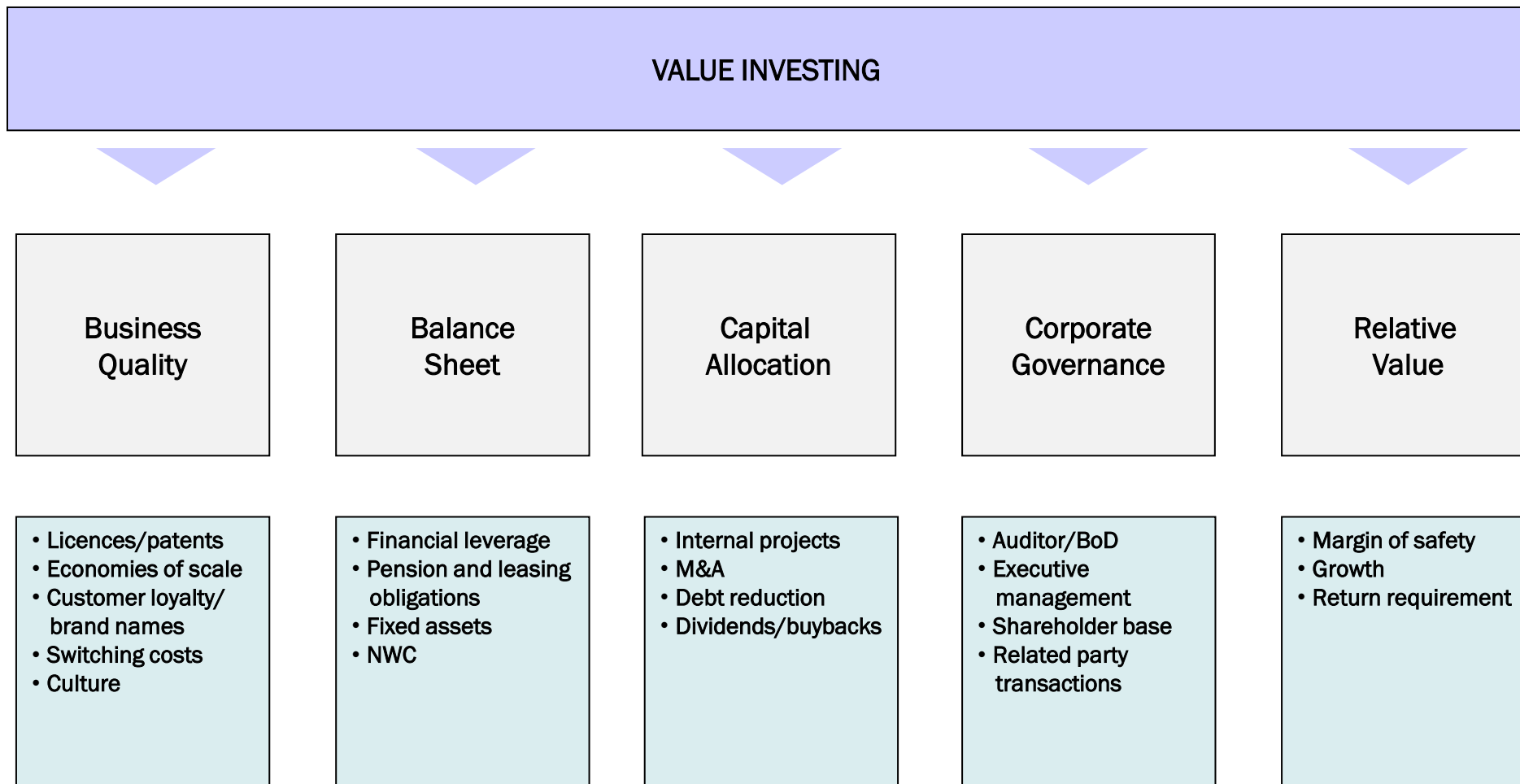
*Top down*

#### Market risk

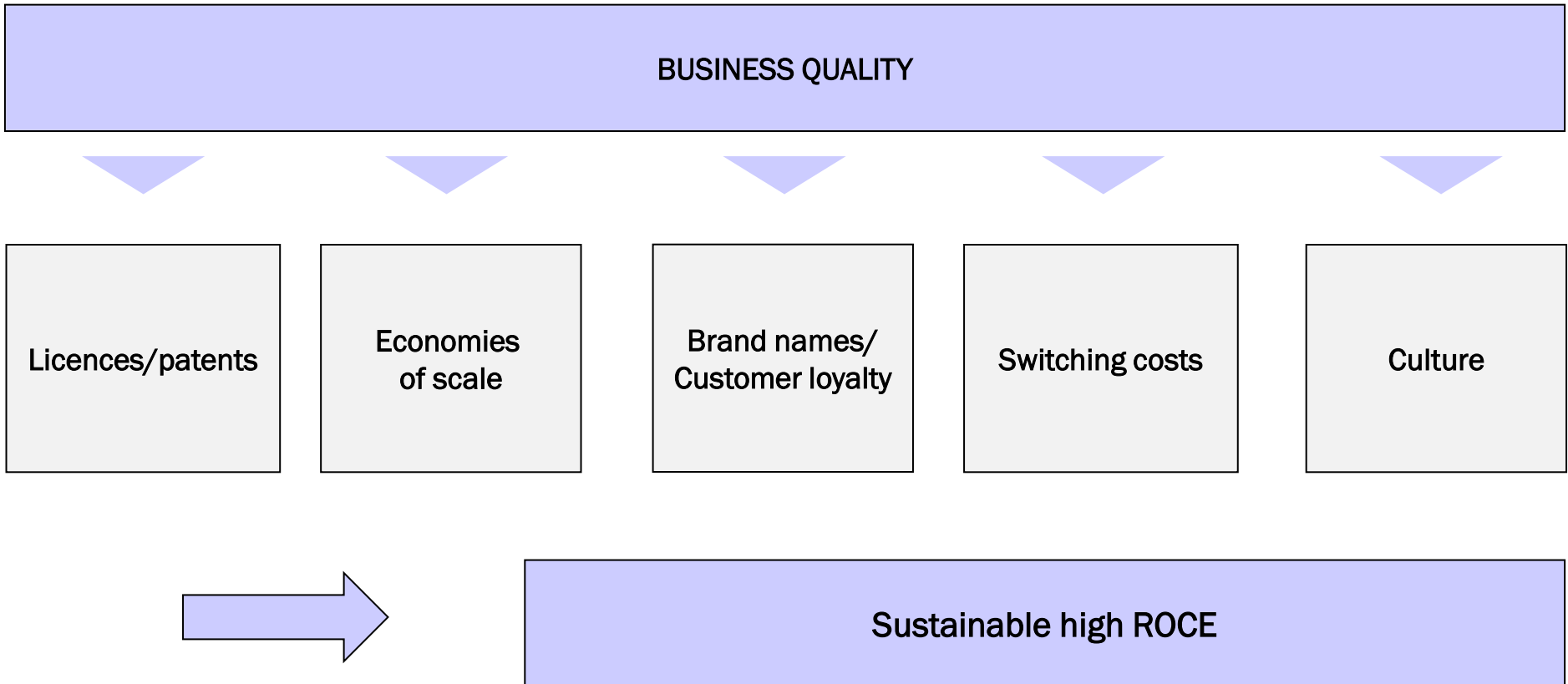
- Avoid industry and geographic **concentration risk** through niche market leadership
- **Equity market swings anchored through Special Investment Opportunities**, characterised by predictable estimates of realised value and short – catalyst driven – duration
- **Macro risks** monitored and, where practical, disaster insurance hedges purchased (e.g. deep out of the money index put options)
- **Liquidity balanced** to investor expectations and preferences

Avoiding permanent loss of capital is a key objective of the investment strategy

## OUR ANALYSIS AT THE INVESTMENT LEVEL IS DEDICATED TO VALUING SECURITIES...



**THE FIRST PILLAR IS TO UNDERSTAND BUSINESS QUALITY...**



## UNSYSTEMATIC RISK IS DIVERSIFIABLE...

- ❑ More than 15 portfolio names will diversify away more than 90% of the unsystematic risk
- ❑ Systematic risk is the market risk of an investment. Hedging can be used to reduce such risk.



**THE TOOLS AVAILABLE FOR HEDGING ARE NUMEROUS...**

**HEDGING**

Long / short  
positions

Beta neutral trades

Derivatives

Cash

**DERIVATIVES HAVE BEEN CALLED WEAPONS OF MASS DESTRUCTION, BUT PRUDENTLY USED PARADIGM CAPITAL BELIEVES THEY WILL CONTRIBUTE TO HIGHER RISK ADJUSTED RETURNS...**

DERIVATIVES

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graph TD; A[DERIVATIVES] --> B[FX forwards]; A --> C[Equity puts and calls]; A --> D[Index puts for catastrophe insurance]; A --> E[Index shorts]; A --> F[Credit derivatives for catastrophe insurance];
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FX forwards

Equity  
puts and calls

Index puts  
for  
catastrophe  
insurance

Index shorts

Credit  
derivatives for  
catastrophe  
insurance

## THE PURPOSE OF HEDGING...

- Avoiding permanent loss of capital
- Always have cash available to invest when the opportunity set is the best
- Effective hedges give a psychological edge

## WHAT IS THE OUTCOME OF SUCCESSFUL HEDGING...

*“Excess cash coupled with courage,  
based on facts and knowledge,  
in time of crises should produce excess returns”*

Paradigm Capital

## SINCE INCEPTION, PARADIGM CAPITAL'S VALUE INVESTING STRATEGY SHOWS A SUBSTANTIAL OUTPERFORMANCE...

