September 30, 2011

Value Investor INSIGHT

The Leading Authority on Value Investing

Betting on the System

Taking its original cues – literally – from Ben Graham, Tweedy, Browne has proven adept at applying timeless wisdom to modern-day investing challenges.

Walk through Tweedy, Browne's Park Avenue offices in New York and you'll see little of the frenetic activity often associated with managing money in today's rough-and-tumble market. "It's almost like a library," says Managing Director Thomas Shrager.

Such a studious approach has served investors quite well. Tweedy now manages more than $12 billion and its SICAV sub-fund, International Value Fund (CHF) has since inception in 1996 earned a net annualized 6.4%, vs. 1.2% for the MSCI EAFE (hedged to CHF) index.

Only selectively finding what they consider bargains in today's volatile markets, Shrager and his partners see opportunity in such areas as pharmaceuticals, security, Asian banks and spark plugs. See page 2

INVESTOR INSIGHT

Tweedy, Browne Company

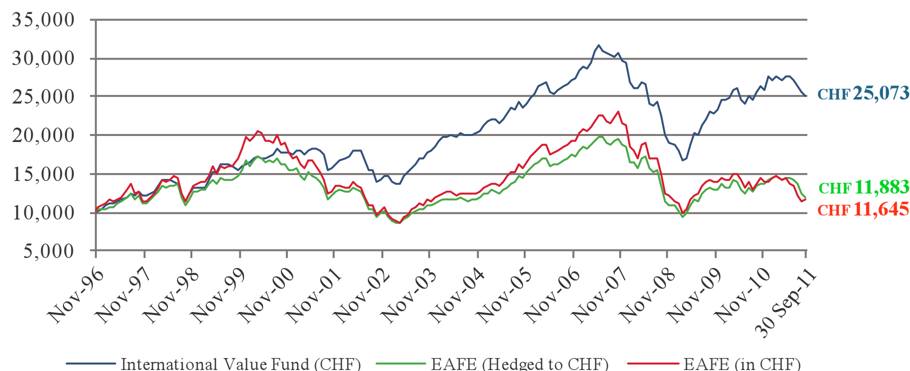
(*clockwise, from upper left*) Will Browne, John Spears, Tom Shrager, Bob Wyckoff

Investment Focus: Seek companies trading at a 35-40% discount to what a knowledgeable buyer would pay for a competitively acquired 100% position.

Tweedy, Browne International Value Fund (CHF) *(Hedged to the CHF)*

Growth of CHF10,000

31 October 1996 (inception) through 30 September 2011



The Fund described is a sub-fund of a SICAV established under Luxembourg law. Before each subscription, it is necessary to check in which countries the sub-fund or classes of shares are licensed for sale to the public. The sub-fund is currently registered for public sale in Luxembourg, Germany and Switzerland. The sub-fund may not be publicly sold in any other jurisdiction and may not be offered or sold in the U.S.A. ***This does not constitute an offer, and is provided for information purposes only.*** *Investments should only be made after a thorough reading of the current legal prospectus and the latest annual and semi-annual reports and after advice has been obtained from an independent finance and tax specialist. The prospectus, the simplified prospectus, the articles of incorporation, as well as the annual and semi-annual reports of the Fund can be obtained free of charge from the sub-fund's custodian, State Street Bank Luxembourg S.A., Shareholder Services, 49 avenue J.F. Kennedy, L-1855 Kirchberg, Luxembourg, and from the Representative in Switzerland, First Independent Fund Services Ltd., Klausstrasse 33, CH-8008 Zurich, Switzerland. The paying agency in Switzerland is Schwyzer Kantonalbank, Bahnhofstrasse 3, CH-6430 Schwyz.*
Past performance is no indication of future results.

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Investor Insight: Tweedy, Browne

Will Browne, Tom Shrager, John Spears and Bob Wyckoff of Tweedy, Browne Company describe why they're often "aggressively inactive" in managing positions, why tamping down volatility is overrated, where they like banks and where they don't, and why they see unrealized value in Roche, G4S, United Overseas Bank and NGK Spark Plug.

Tweedy, Browne is certainly not alone in applying the principles of Benjamin Graham in how it invests. How does that manifest itself in your strategy?

Will Browne: Our entire process is rooted in Ben Graham's simple philosophical framework for investing. He believed there were two values for every stock, the first being the current market price, and the second what the share would be worth if the entire company were acquired by a knowledgeable buyer or if the assets were liquidated, the liabilities paid off and the proceeds paid to stockholders. He called that the intrinsic value and argued that the time to buy was when there was a large spread between the current price and that value, and the time to sell was when that spread was narrow. Our work every day is essentially directed at valuing what businesses are worth.

The initial process is largely statistical, which enables us to focus our time on ideas with better probabilities of making the final cut. Most of our investments will have several of the following investment characteristics: low stock price in relation to book value, low P/E ratio, low price-to-cash-flow ratio, above-average dividend yield, low price-to-sales ratio compared to other companies in the same industry, low corporate leverage, purchases of a company's own stock by insiders, company share repurchases, and a stock price that has declined significantly from its previous high. In each case, research has indicated a historical statistical correlation between these investment characteristics and above-average investment rates of return over long periods.

With that philosophical base, our strategy has evolved. We've put greater emphasis on business quality, as opposed to the cigar-butt approach traditionally associated with value investing. If you pay a good price, getting into a good business that compounds earnings does your work for you while you sleep. As my estimable colleague John Spears puts it, "You can sit on your assets."

We also starting in the late 1980s concluded, as the types of information we needed became more available, that it made no sense to only apply our value principles to U.S.-traded stocks. The underlying process is universal and timeless and can be applied anywhere.

By necessity – as well as opportunity – we have also invested more in larger-cap stocks than was our heritage. There are plenty of reasons stocks of all sizes get cheap – our job as analysts is to determine which of those reasons are of lasting import and which are more temporary.

Describe some of the more common reasons stocks that attract you get cheap.

Bob Wyckoff: Often it's an external event to which the market overreacts. When the Durbin amendment regulating interchange fees on debit cards was introduced in Congress last year, shares of MasterCard [MA] got hit hard, but if you looked closely, the potential impact of the change affected less than 15% of its business. If you analyzed what happened when a similar law was passed in Australia, you saw that issuers offset lower debit-card fees by raising fees on a variety of other products, limiting the impact on MasterCard. Balancing that against a secularly growing, high-margin, high-barrier global business, we concluded that at around $200 – just over 7x forward EBIT – the stock was a buy. [*Note*: MA shares now trade at around $328.]

Tom Shrager: Another example of an external event creating opportunity is last year's public unrest in Thailand. Stocks sold off because people thought the country was falling apart, but throughout its

W. Browne, J. Spears, T. Shrager, B. Wyckoff

Wall Street's Pawnbroker

You'd be hard-pressed to name a firm with a more illustrious value-investing history than Tweedy, Browne. Founded in 1920 to make markets in inactively traded securities, its top customer by the 1940s was Benjamin Graham. In the go-go 1960s it frequently traded – including early purchases of Berkshire Hathaway – for up-and-coming client Warren Buffett. John Train's classic book, *The Money Masters*, devoted significant attention to the firm, affectionately dubbing it the "pawnbroker" of Wall Street due to its expertise in making markets in stocks acquired from desperate sellers.

By the 1970s Tweedy started shifting its emphasis to investing over trading and has never looked back. From less than $10 million in assets in the mid-1970s, the firm now manages more than $12 billion. The secret to its longevity? Says Will Browne, one of four firm Managing Directors: "A primary question all investors should ask of an investment firm is whether the strategy is based on a repeatable process or on the particular intuitive gifts of an individual. We can categorically say this is a process-driven organization and if any of us were hit by the proverbial truck, the firm wouldn't miss a beat."

history there have been a variety of coups and coup attempts and they haven't interrupted the dynamism and growth of the economy. One stock we bought in response – and still own – was Bangkok Bank [BBL:TB], a conservative, business-focused bank with a long history of prudent loan growth, an underleveraged balance sheet and very few of the loan-quality problems afflicting Western banks.

The unrest gave us a great entry point into the stock – around 80% of tangible book value. Even today, while the stock [at a price of 141 Thai Baht] is now at closer to 1.2x book, the company can compound EPS at a low double-digit annual rate while the current dividend yield is close to 4%. Even if the P/E stays where it is, that's a nice expected return in today's interest-rate world. At the same time, in an acquisition, we'd expect a bank of this quality and with this potential to be worth probably 80% above the current market price.

How about an example of a company-specific glitch creating opportunity?

TS: This is hotly debated within the firm at the moment, but Cisco [CSCO] is a good example of a stock selling off so much after earnings disappointments that we took a position. After cash on the balance sheet, the shares today [at around $16] trade for less than 6x forward earnings. We never expected it to grow on the top line as fast as management did, but we'd be very happy here if they can hit the new 5-7% target they've set.

WB: The debate we're having is the extent to which we, or management, can forecast Cisco's future with confidence. That's why we bought a small position and it's under continual scrutiny.

John Spears: I'd make a general point here about our process. We take all the computer screening we do very seriously, but that's the easy part. The harder part is going through the public documents, reading call earnings transcripts, and speaking with management and people outside of the company who can shed light on the business – all in an effort to make conclusions about the sustainability of the business and its cash flow. How leveraged is the income statement to ups and downs? Does the company have much control over its pricing? Is there margin upside versus peers or are margins threatened by new competition? Is there technology risk? How does EBITDA cover interest expense in a downturn?

All of this is the hard work of securities research, for which there's no substitute for rolling up your sleeves and going at it. Will's father Howard was fond of saying, "No one ever learned anything by talking," and we still try to take that to heart in how we approach our research.

ON GLOBAL INVESTING:

The analysis and valuation of global businesses has become very similar, regardless of where they're based.

What discount are you looking for between intrinsic value and the current share price to be interested?

RW: It's a bit less for our global high dividend sub-fund, but in general we want to see a 35-40% discount from what a prudent man making an acquisition would pay for the entire business. We put it that way because sometimes, such as in 2006 and 2007, acquisitions are being done at levels we consider imprudent, so we don't use them in calculating intrinsic values. If you're fairly conservative in valuing the business and then demand a 40% haircut off of that, you should have a pretty healthy margin of safety.

Roughly 80% of your assets today are in non-U.S. companies. Was there some sort of strategic directive behind that?

RW: We started investing in a more organized way outside the U.S. when the first good foreign databases of stock and financial information came out in the early 1990s. That was primarily a function, as Will said, of wanting to expand the universe of stocks we'd look at for bargains, but was also an effort to give our clients more options for keeping their money with us. That so much of our assets today are in international stocks is the residual effect over time of where we've found opportunity.

WB: This is increasingly becoming a distinction without a difference. Nestlé is Swiss, Diageo is British, Johnson & Johnson is American and Philip Morris International is headquartered down the street from us but no longer has any business in the U.S. We own all of them and in most of the ways that matter to investors, the analysis and valuation of their businesses is very similar.

Businesses are dynamic entities, moving capital and assets to maximize opportunity. They increasingly operate on a worldwide basis, so we have to as well. We've found that knowledge of businesses and companies is quite transferable and have often applied our experience in one market to another. For example, we've had success over the past several years in buying Coca-Cola bottlers at different times and in different markets.

Are you active in Europe today?

RW: We have added to some of our existing positions whose shares have declined fairly sharply, such as [German media company] Axel Springer [SPR:GR] and [French oil company] Total [TOT]. But many of the European companies we own that are globally diversified, underleveraged and with a multiplicity of products – like Nestlé, Diageo and Unilever – haven't seen their shares trade off that much. They're reasonably priced and we like them, but the entry points aren't necessarily wonderful here.

WB: What we are not doing is plowing into Greece or Italy or the big European banks because the stocks have gotten so cheap. If we did things just by the numbers, we'd be all over BNP Paribas, Intesa

Sanpaolo or maybe a domestic-oriented Greek company or two. Our view is that in many such cases there are too many indeterminable, unquantifiable issues to deal with. If there's even a slight risk a big French bank blows up or the Greek company you buy today may trade in new drachmas in 18 months, why bother? We have plenty of other things to do.

How does your portfolio break down by market cap?

RW: Because it's where we believe the value is, our portfolios today have a larger-cap bent, with probably 70% of assets invested in companies with a $5 billion market cap and above. Seven or eight years ago the inverse was true – we'd go back to that if valuations warranted.

Given how much money you're investing, isn't it hard for a small-cap to have much of a portfolio impact?

JS: We run a fairly diversified portfolio, with no more than 3-4% in any individual name and, in our international sub-funds, generally 100+ positions. Any individual small-cap doesn't make a big difference one way or the other, but enough of them can. Our general rule is that there has to be at least $100 million in float, with at least $200,000 in trading volume per day.

An example we've added in the last year or so is an Irish home builder called Abbey [ABBY:LN]. The stock is up modestly, but at the time we bought it it was trading at two-thirds of tangible book, had net cash equal to 97% of its market value, had a long-term average return on equity of about 13%, and had just announced a new buyback program. There wasn't a lot of complex analysis necessary to conclude the stock was cheap. That's the type of stray cat we're happy to take in from time to time.

Turning to specific ideas, describe your investment thesis for Roche [RO:SW].

TS: After completing its acquisition of Genentech in 2009, Roche is now the largest biotech company in the world, with roughly half of its total revenues coming from biologic drugs. Its overall portfolio is overwhelmingly cancer-focused, including blockbusters such as Avastin, Rituxan and Herceptin. It also has a large diagnostics business, accounting for 20-25% of total revenues, which is very profitable and strong in such areas as in-vitro diagnostics, where it's the global market leader over competitors such as Siemens, Abbott, and Johnson & Johnson.

There are several things we like about the company's position. One is the emphasis it has on cancer drugs, which as a category we believe is the least susceptible to regulatory and reimbursement challenges. These are for the most part highly specific, targeted life-or-death treatments, which will be far harder to attack on price than something like Viagra.

The diagnostics business is also an advantage. The future of cancer treatment is going to increasingly involve more personalized medicine, where certain drugs work for some patients and not for others. Roche's Herceptin, for example, works just in women who have an over-expression of a particular gene called HER2. The presence of HER2 is determined by a diagnostic test, the results of which help determine which treatment to follow and therefore reduce the incidence of mis-prescribing an expensive drug that won't work. That dynamic played out over many different types of Roche drugs should bode well not only for diagnostics sales, but also for drug-reimbursement levels by government and other payers around the world.

INVESTMENT SNAPSHOT

Roche Holding
(Swiss: RO:SW)

Business: Discovery, development and sale of pharmaceutical and healthcare-diagnostics products globally. After buying Genentech, now world's largest biotech.

Share Information
(@9/29/11, Exchange Rate: $1 = CHF 0.897):

Price	**CHF 151.50**
52-Week Range	CHF 120.30 – CHF 161.40
Dividend Yield	4.4%
Market Cap	CHF 127.10 billion

Financials (2010):

Revenue	CHF 47.47 billion
Operating Margin	34.9%
Net Profit Margin	18.7%

Valuation Metrics
(Current Price vs. TTM):

	RO	S&P 500
P/E	15.4	13.5

RO PRICE HISTORY

THE BOTTOM LINE

Strong positions in biologic cancer treatments and diagnostic testing should defend and serve the company well in an evolving healthcare environment, says Tom Shrager. The stock's current earnings yield and dividend imply a low to mid-teens compounding, he says, even without assuming any wins from an attractive new-drug pipeline.

Sources: Company reports, other publicly available information

How do you assess the risks of generic competition?

TS: It clearly exists, with multi-billion drugs like Herceptin and Rituxan going off patent in Europe over the next two to three years. We'd argue, however, that the market is overstating the financial impact of Roche's biologic drugs losing patent protection. In general, creating so-called "biosimilars" of biologics is far more expensive and difficult than creating traditional generics. You're dealing with living organisms, which raises significant questions about whether the biosimilar will really be equivalent and whether it can be produced consistently over time. These issues will limit competition and should make the cost differential between biosimilars and the original drug much smaller than it has been with generics.

The company is also looking to extend the lives of its top franchises in innovative ways. For example, they have developed a new drug that when used in combination with Herceptin may prolong its use in first-line treatment from one to two years. They also have an exciting breast-cancer treatment called T-DM1 that when used with drugs like Herceptin in chemotherapy helps target the attack specifically on the cancer cells and not healthy cells around them. Something like that could significantly extend the life of Herceptin, as well as other of the company's cancer treatments.

In valuing the stock, now trading at 151.50 Swiss francs, are you putting a value on the new-drug pipeline?

TS: We don't need to in order to find the stock attractive. It trades today at 11.6x the 13 Swiss francs in EPS expected for this year. That translates into an 8.5% earnings yield, on top of which they pay a 4.4% dividend. Even if the P/E stays at kind of a utility-company level, you're looking at the potential for low- to mid-teens compounding on your investment.

We do believe Roche has one of the best pipelines out there. They have a multiple myeloma drug that was just approved. They have a new schizophrenia treatment that has shown great promise and is in the late stages of the approval process. Maybe most interesting is a drug called dalcetrapib, which unlike statin treatments like Lipitor, raises good cholesterol rather than lowering bad cholesterol. The more good cholesterol, the less plaque formation in your arteries. Some key clinical-trial results on this will be out in the first quarter of next year. If it ultimately works, this could be a $5 billion-per-year drug.

WB: Think of this as a bond alternative with a nearly 9% current earnings yield, with a coupon that is likely to grow along with earnings at maybe 5-6% per year. In addition, there's a nice dividend yield. Backing that up is a pretty high-quality business with hard-to-duplicate assets, a decent moat and some pretty strong long-term secular demand for its products. We consider that a reasonable place to put some money.

Explain your interest in global security company G4S [GFS:LN].

RW: This is the world's largest publicly traded provider of security services, which runs the gamut from bodyguards, building security and alarm-system monitoring to cash and valuables transportation and prison management. It's a global business, with around 615,000 employees based in 110 countries, making it one of the only security companies that can handle the diverse and often far-flung needs of large corporations and governments. We've owned the stock for some time, but

INVESTMENT SNAPSHOT

G4S Plc
(London: GFS:LN)

Business: Global provider of security services, including guards, alarm systems, electronic monitoring, armored trucks and prison management.

Share Information
(@9/29/11, Exchange Rate: $1 = £0.64):

Price	**£2.68**
52-Week Range	£2.27 – £2.95
Dividend Yield	3.4%
Market Cap	£3.77 billion

Financials (2010):

Revenue	£7.40 billion
Operating Margin	7.1%
Net Profit Margin	3.4%

Valuation Metrics
(Current Price vs. TTM):

	GFS	S&P 500
P/E	15.4	13.5

THE BOTTOM LINE

The world's largest publicly traded security company, G4S is primed to benefit from an increasingly wealthy – and dangerous – developing world, says Tom Shrager. He expects multiple expansion and an increasing dividend to enhance the low-teens compound share-price growth implied by the current earnings yield and dividend payout.

Sources: Company reports, other publicly available information

have been adding to it recently in our global high dividend sub-fund.

TS: This is like a consumer-products company in that it has a full range of products, from the most basic to the more sophisticated. That makes it well positioned to capitalize on what we believe is a secular growth business – as wealth is created, particularly in developing markets, demand for security on a variety of fronts is likely to increase. If Diageo or Nestlé wants to open an office in Kuala Lumpur, G4S could help them there with security. They've got guards on oil tankers going through the Gulf of Aden. Places like the Middle East and Brazil, increasingly wealthy but also increasingly dangerous, have been big growth areas. Given all that, the crisis in 2008-09 barely impacted their results.

WB: Security is one of those things that's pretty difficult to cut. Think about the three guys who sit at the front desk of your office building. It's a tiny part of the operating cost of the building, but you want them there. You like that they know people's names. If one of them is sick, you want to know you'll get a decent replacement right away. That type of thing makes this a reasonably sticky business, which is a quality we like to see.

How profitable is it?

TS: Overall EBIT margins are 5.7%, which we believe can expand for two main reasons. One is that they earn higher margins in emerging markets, which are accounting for an increased share of total revenues. They also should continue to see somewhat of a mix shift as they upsell higher-margin services to existing, growing clients.

At a recent price around £2.70, how are you looking at valuation?

RW: It's a fairly similar story to the one with Roche. The P/E on estimated 2011 earnings is around 11.5x, translating into an earnings yield of 8.7%. The dividend yield is 3.4%. That provides a nice return in today's environment, and you can make a reasonable case for growth in both the P/E – as margins expand – and in the dividend.

The payout ratio is still a relatively conservative 35% of net income and the dividend has increased 18% per year over the last five years. Empirically, when you have a low payout ratio and a good dividend yield, it's usually an indication you've found what turns out to be a pretty cheap stock.

Your interest in banks today seems largely confined to Asia. Why is United Overseas Bank [UOB:SP] attractive?

WB: This is one of the three leading commercial and consumer banks in Singapore, which is universally regarded as one of the strongest national banking systems in the world. It's well-regulated, does a lot of straightforward trade finance, and generally has high underwriting standards. The typical mortgage holder, for example, doesn't spend more than 30% of his or her income on servicing the debt. UOB has also expanded its geographic footprint and now gets roughly 35% of revenues from outside Singapore, primarily in neighboring Indonesia and Malaysia.

TS: By most any metric, this is a solid, conservatively run bank. Returns on equity, at around 16%, are quite healthy. We like that annual loan growth over the past ten years has been around 7%, not the type of rapid growth that would suggest you're piling up potential problems at a

INVESTMENT SNAPSHOT

United Overseas Bank
(Singapore: UOB:SP)

Business: Full-service Asia-Pacific commercial and consumer bank holding company with primary operating subsidiaries in Singapore, Malaysia and Indonesia.

Share Information
(@9/29/11, Exchange Rate: $1 = S$ 1.296):

Price	**S$17.21**
52-Week Range	S$16.79 – S$21.00
Dividend Yield	4.1%
Market Cap	S$27.07 billion

Financials (as of 6/30/11):

Total Assets	S$218.92 billion
Return on Assets	1.2%
Return on Equity	12.3%

Valuation Metrics
(Current Price vs. TTM):

	UOB	S&P 500
P/E	10.5	13.5

THE BOTTOM LINE

The story is simple, says Tom Shrager: This is a successful, conservative bank in an attractive part of the world, whose shares trade at a large discount to what a knowledgeable third party would pay to buy it. History bears out that an acquirer would pay at least a 14x multiple, he says, which would result in a share price of closer to S$24.

Sources: Company reports, other publicly available information

compound rate. The bank is self-funding, with a loan-to-deposit ratio of less than 80%, much lower than the typical Western bank. Loans to tangible book value is 6.5x – versus well in excess of 10x at most Western banks – which means they have additional leverage capacity on the balance sheet if they choose to use it. In terms of loan quality, total impairment charges dropped nearly 60% in 2010, and the provision for loan losses is now more than twice the level of unsecured non-performing assets.

So the story is simple: A solid bank in a dynamic, growing part of the world whose stock trades at a pretty significant discount to what we think a knowledgeable third party would pay for it.

What do you consider a more reasonable value for the stock, now at around 17.20 Singapore dollars?

TS: Estimated EPS this year is around 1.70 Singapore dollars, so the shares trade at 10.1x earnings. The current dividend yield is just over 4%. History bears out that an acquirer would easily pay at last 14x earnings, or around S$24, for this franchise today.

Does the ownership structure make it saleable?

TS: This is the only one of the three top Singapore banks that isn't partly owned by the government. There is a family with a large minority share, but in our experience – we've owned the stock on and off for some time – management has been adequately focused on shareholder value and we're confident they'll represent our interests well, sale or no.

You've been fairly tentative in Japan, but describe the potential you see in NGK Spark Plug [5334:JP].

TS: This is the type of company we like in Japan, with significant international operations, good market positions and decent margins, but with a valuation that more than reflects the challenges facing the country today.

Depending on how you count it, NGK is one of the top two players in the global spark-plug business, with a 35% share, and also either #1 or #2 in oxygen sensors, in which it has 40% of the market. Spark plugs and sensors together account for 75% of revenues and earn mid-teens operating margins, primarily because a majority of the business is in the aftermarket – selling to places like AutoZone or directly to mechanics – where margins are much higher. Currently 80% of this business comes from outside Japan.

Changing technology in internal-combustion engines is working to the benefit of the largest suppliers of both spark plugs and sensors. Everything today is optimized to the millisecond by computers, which has meant that while historically people assumed it didn't matter if you mixed and matched spark plugs, today the prevailing wisdom is that fuel efficiency is optimized by using all the same brand of plug at a time. That's made the aftermarket business even more attractive to large players like NGK.

Japanese companies have had a hard time growing. Is that not the case for NGK?

TS: Revenue in the core automotive business has grown 5% per year over the last ten years, while EBIT has increased 7% annually. That type of growth has been rare for Japanese companies. What's shocking is that after all that compounded growth in its biggest business, NGK's enterprise value over the past ten years actually decreased substantially, from ¥345 billion to around ¥220 billion today.

INVESTMENT SNAPSHOT

NGK Spark Plug
(Tokyo: 5334:JP)

Business: Manufactures and markets spark plugs for internal-combustion engines and makes ceramic components for semiconductor and telecom equipment.

Share Information
(@9/29/11, Exchange Rate: $1 = ¥76.555):

Price	**¥1,051.00**
52-Week Range	¥916.00 – ¥1,355.00
Dividend Yield	2.1%
Market Cap	¥234.95 billion

Financials (FY ending 3/31/11):

Revenue	¥269.23 billion
Operating Profit Margin	10.7%
Net Profit Margin	8.8%

Valuation Metrics
(Current Price vs. TTM):

	NGK	S&P 500
P/E	9.7	13.5

THE BOTTOM LINE

Tom Shrager considers this the type of company attractive today in Japan, with significant international operations, healthy market positions and with a valuation that more than reflects Japan's macro problems. Just selling a non-core ceramics business, he says, would dramatically increase the stock's current bargain-basement valuation.

Sources: Company reports, other publicly available information

One big drag on the share price in our view is that the other 25% of revenues come from a lousy business selling ceramic components used in things like telecom equipment and semiconductors. It's very cyclical and not even that profitable when times are good. Unfortunately, as is typical for a Japanese company, they so far haven't wanted to get rid of it.

What upside do you see in the shares from today's price of ¥1,050?

TS: After net cash of around ¥150 per share, the stock currently trades at only about 7.8x estimated 2011 earnings of ¥115 per share. That alone is cheap, but we haven't given up on them exiting the ceramics business, which would help the stock both by improving earnings and by indicating to shareholders that management is focused on where the company has a long-term competitive advantage. Were that to happen, the multiple could easily move to the mid-teens, which is below where the stock has traded for long periods in the past.

RW: Management has paid some deference to shareholders – they pay a 2.1% dividend yield and bought back shares last year. But even if nothing happens with the ceramics business, we own something with a nearly 13% earnings yield, that pays a dividend, and that's in a global business that has decent growth prospects and is improving in quality.

What could go wrong here?

TS: Long-term the big issue to watch is the extent to which diesel engines, which don't use spark plugs, and hybrid engines, which use fewer spark plugs, take global market share. It's not something that's shown up in NGK's numbers, but that's clearly a risk to be aware of.

You're not active sellers, but describe a stock or two you've sold lately and why.

TS: We like to say we're aggressively inactive, which translates into annual turnover in our portfolios of 10-20%. We are usually buying stocks that we think are cheap for temporary reasons, so as long as we understand and closely monitor both the business drivers and what can go wrong, we're perfectly willing to give them time to perform. And as Will mentioned earlier, if value is compounding, we don't want to get too cute in trying to trade in and out.

Of course share prices do reach our estimate of value and we sell. When shares of Arca Continental [AC:MM], a large Coke bottler in Mexico, recently moved to an EV/EBITDA multiple that was high compared to relevant past deal valuations, that prompted us to start selling down our position.

ON PLAYING DEFENSE:

We've earned our money over time in down markets. Low-expectations stocks are less susceptible to corrections.

In the case of SK Telecom [017670:KS], the leading cellular service provider in South Korea, we sold because it is trying to buy a minority interest in semiconductor company Hynix, which we think is outrageous. We and some other shareholders have tried to fight it, but that's fallen on deaf ears. They essentially told us to take a hike, and we are.

Critique your performance during the 2008 crisis.

TS: We've earned our money over time by significant outperformance in down markets, which is primarily a function of owning low-expectations stocks that are less susceptible to market corrections.

In 2008 we beat our benchmarks but had a terrible year on an absolute basis. There was no place to hide, but we did avoid much of the pain in financial stocks like Freddie Mac, MBIA and AIG. We got out of MBIA and Freddie in 2007, but held on longer than we would have liked in AIG because we didn't yet see the evidence in the numbers saying we should get out. We reacted when we did, selling most of our position between $25 and $30 on a pre-reverse-split basis.

RW: For the most part, the underlying businesses of the vast majority of companies we owned didn't at all fall apart. In general, we liked what we owned, took comfort in our diversification, and assumed there'd be another day for the value to return. That's what has historically happened and it did again this time as well, so we don't feel we permanently lost a lot of money in 2008.

How has the recent market swoon affected your collective mood?

RW: So much in the investment world has become focused on tamping down volatility that it's gotten somewhat away from an emphasis on returns. We see that as an opportunity. If you're willing to look further out and accept the inherent randomness of what can go on in the interim, we can sit with an undervalued portfolio of unleveraged, diversified businesses with business models that aren't going to become obsolete and feel quite comfortable about its prospects.

WB: Investors come up with all kinds of reasons to own or not own stocks, and in times of stress the reasons can become nonsensical because people get driven by this cascade of negative information. We see analyst reports all the time that say they don't like a stock short-term or they don't see a catalyst in the next six months, but that it's attractive long-term. Implicit in that is the notion that, "I'm going to know exactly the right time to step in and I'll let you know a few days before it's obvious to the rest of the market." Based on our experience and everything we've seen about people's ability to time the market, we don't understand how to make money on that basis.

One of the key strengths of a time-tested process is that it anchors you on more objective measurements. Having that kind of discipline helps you keep your wits about you. VII