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One Value, Three Methods

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Works Cited:

Damodaran, Aswath. "Intrinsic Valuation." Valuation 2016. Webcast 2, 30 Nov. 2017, New York City, New York University.

Assessment:

In the industry of investing, every portfolio manager has their own signature strategy. Based on their strategies, they may start different types of companies, like hedge, mutual, and activist funds. Even though their objectives are completely different, they all must conduct valuations of their holdings to manage their risk and ensure positive returns. In this lecture, Professor Aswath Damodaran of New York University describes a few different types of valuations that exist in the diverse sphere of portfolio management.

To start the class, Professor Damodaran began by correcting a few traps that new valuations typically fall into: bias, preciseness, and complexity. The most enlightening one of these three traps was bias. Before taking this class, I took the words of sell-side research analysts. Although I always backed up these assumptions with my own research, I believed most

of what analysts wrote. Professor Damodaran explained, however, that sell-side analysts have an inherent upward bias because they must keep their client company happy. Moving forward, I can now be more critical of the reports that sell-side analysts publish, and try to pinpoint exactly where their valuation is skewed upwards.

Intrinsic valuation, using the discount cash flow model, was the first method of valuation discussed during the lecture. Simply put, a discount cash flow model puts future earnings in terms of today's dollars, giving you an "intrinsic value" for the company. Although this method of valuation lessens the market exposure risk by somewhat separating the investor from the herd mentality of the market, it can often become biased because of preexisting notions of the company, leading to an inaccurate valuation. This problem is further exacerbated by the many discretionary inputs that a discount cash flow requires, such as a discount rate and an estimate of cash flows. I believe, however, that I can overcome these challenges and that intrinsic valuation is the most fitting method for my circumstances. I have the ability to wait five to ten years for the market to correct itself, I have always been relatively separate (and sometimes a bit contrarian) from the crowd, and have faith in my own work, which are all required to successfully create an intrinsic valuation.

The second type of valuation that Professor Damodaran discussed was pricing. Unlike intrinsic valuation, pricing is entirely dependent on the whims of the market because the value of one asset is determined by evaluating the price of other, similar assets. In this sense, the value of an asset is simply what someone else will pay for it. This consequently forces pricing to become an "incremental" game, where events that shifts the crowd's perception (like earnings reports and calls) ultimately determine the profitability of a trade. Because of the quick movements of these

trades and the duality of this game of pricing, investors that work with short term (six month to one year) time horizons and the ability to take both long and short positions are the most suited for this type of pricing.

Finally, the last basic type of valuation is contingent claim, or derivative, valuation. The most important lesson from this part of the lecture was that it is not just derivatives that can be valued like derivatives, companies who are highly dependent on any other asset should also be valued more like a derivative due to their connection with another asset. This made me realize why I was so hesitant to value companies in industries like pharmaceuticals and oil and natural gas: I was using the wrong valuation method. I was attempting to value them intrinsically, and the data that I use is skewed because to gain an accurate valuation on a derivative-like company, you must let the underlying asset take a large role in your valuation.

Professor Damodaran's lecture allowed me to gain a large amount of insight into not only what kind of investing style I would like to pursue in the future, but also how they can all intersect to produce even better returns that are more suited to my specific needs. Moving forward, an intrinsic valuation style is still best suited to my goals, but different aspects of pricing and contingent claim valuation can greatly assist me with understanding the markets and taking any worthwhile investment opportunity that appears.