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Stockbroking: what is it and is it for you? Ideas from an industry veteran

INTRO: Hello and welcome to Stock Broking 101.com, the podcast where we talk to industry veterans on the front lines. Welcome to episode 1 of the podcast and I'm your host Derek Hillen.

Derek: Now, this is my first time doing this and I'm going to make some mistakes, so, everybody out there please bear with me. I'm very happy today and fortunate to have my good friend and colleague in the room with me John Wadle. Welcome, John.

John: Yes, good to see you, Derek.

Derek: Yeah, good. We're recording here at the office and in the bathroom. So, it's getting kind of crowded. John, can you move over a little and give me some room?

John: (Laughs). Wow, that's big!

Derek: (Laughs). OK, I'll have to edit that out. I see we're off to a good start! Ok, John, why don't you tell me your title and what you do here?

John: Derek, I'm now working at Mirae Assets Securities as Head of Banks Research for the past two years and really oversee the banks research that we do both globally and focusing on the major Asian banks focusing on Hong Kong and China.

Derek: Right, right, ok. So, you oversee a team of analysts. Is that right?

John: Yes, right and as head of the team, I oversee three other analysts covering insurance stocks, China banks and Hong Kong banks and as well as Korea, which is our home market.

Derek: Right, exactly. So, when you say an analyst "covering" a stock or a sector, what does that mean?

John: Well, as an analyst covering a sector you have to understand the industry dynamics that are driving the profitability of the industry or the competitive environment in the industry and kind of really determine whether the stocks are discounting appropriately the outlook. In a sense, the market can be assuming one thing but in fact in reality the fundamentals can change quite dramatically.

So, it's really trying to analyze what's discounted already in the stock prices and also trying to see what's changing about the fundamentals of the business; either the profitability or the balance sheet or the bad debts. In the case of the banks, particularly it could be the government policies towards the banking industry which can alter the profitability or the business models for banks. So, you can say that it understands the interplay between the government, the industry and then, the economy.

That's at a macro level. At the micro level, we actually cover the stocks and have recommendations that would be "Buy," "Sell" or "Hold." So, overseeing a team, I kind of guide and collaborate with the bank analysts and to try to come up with the most commercial recommendations where clients are going to - on a risk adjusted basis - make the best judgment they can. And in some cases, their perspectives may be a one week trade, others may have as clients three months perspective because that's really their benchmark and others more, I would say, fortunate clients can take a two or three year-view and really don't care about the short term noise.

Derek: That's what I do with my PA when stocks go south.

John: (Laughs) Exactly.

Derek: PA, Personal Account - our own money. So, as an analyst you focus on the fundamentals rather than what the TV is saying or other white noise, right?

John: Yeah, what you hope to be able to do is find the white noise, what I almost call the "echo effect" of the market that really doesn't get the fundamentals correct.

That's when you can add the most value as an analyst. If you can kind of go against that echo and going against that sort of emotional state of the market, both when the market gets kind of extremely over excited in the bullish sense or gets extremely pessimistic and I can give you an example of that.

Back in November of 2010, Hong Kong Exchange was up to over 190 Hong Kong dollars (per share) and was trading at 27 times price to book and you know it did have a very high ROE and it had a great monopoly as a business, but effectively it had to earn a 100% ROE for 27 years to justify the share price. And every investor had looked at the share price and said back in the '07 peak it had gotten to 240, so therefore it had to go to 240. And my view was: no, just because the share price in history did that, it doesn't mean it has to go there. So, we highlighted that and it was very controversial in the sense because everybody was euphoric at the time, but it turned out to be the peak.

Derek: That was the peak, at 190 and you had to go against the grain. So, to be an analyst you have to be able to stand up sometimes and say the unpopular thing, is that right?

John: Yes. Exactly.

Derek: So, let's talk about being an analyst. How did you get into this industry and how long have you been an analyst?

John: Well, I think I started as an analyst collecting baseball cards and loving the statistics of baseball players and understanding, you know, what it meant putting together a good team. I was a baseball fanatic and then I physically realized that it wasn't possible to turn into a professional baseball player, so maybe my analytical curiosity started with baseball. When I was at university, I focused on economics but always had a natural gift for numbers and understanding what that meant in reality because it's actually one thing analyzing numbers and get to understand and the real world and I think that connection is critical.

I see a lot of CFAs or CPAs graduates and they're very good at numbers but they don't understand how that relates to the real world and in my experience of hiring people, I actually

don't like to just see that somebody has CFA qualifications or CPA, I would rather that they've actually done something real where they understand, you know how the real world works.

Derek: Like getting busted for counting cards in Vegas, or something.

John: Yes, exactly.

Derek: That would be a good thing. Ok.

John: Or understanding the probability of actually winning at gambling and realize that it's a probability game. It's not just about – unless you've got an inside trick – and that over time probability does prevail. It's not always about just luck.

Derek: So, were the probabilities of you getting in this business high or low?

John: Well, I can say that maybe was a little bit of... maybe in my...cultural DNA or you could say my life experience because I have an uncle, who was an international banker...

Derek: So, that's right, family DNA.

John: ...and it exposed me at a younger age to international banking, probably when I was twelve years old. So, my curiosity and interest and awareness started maybe when I was twelve. Having said that, when I graduated, I really accidentally came to Asia to be an analyst because I didn't want to go back to New York, which is where I was from. I really wanted to travel around Asia and then I ended up staying for the last twenty years. I wanted to avoid the rat race of finance because I had interned at Lehman Brothers in New York, 22 years ago and decided that I wanted to avoid the rat race and then I accidently joined the rat race and I haven't stopped for twenty years.

Derek: And joined it on the other side of the globe. I should have mentioned that we are sitting here in Hong Kong right now, so that's where we mean when we talk about coming here to Asia. So, what brought you to Asia? New York obviously was and still is the epicenter for global banking.

John: It was really my quest to travel, my curiosity and understanding of the world and personally seeing the world. I also was fortunate back in high school and college. I had spent two summers living in Japan and Korea. One, a cultural experience living in Zen Buddhist temple in Hiroshima, Japan as a high school student and the second was as a college student attending Yonsei University in Seoul. Yes, it was the year of the Olympics and that was 1988.

Derek: I was there.

John: 1988.

Derek: I was competing but I didn't win, so you probably didn't see me.

John: Yeah, exactly and unfortunately the Olympics had to start in late September because of the humidity and the Monsoons of August in Asia, so I had to go back to university and I actually missed the Olympics.

Derek: Oh, bummer.

John: Yeah.... Ben Johnson won and he cheated.

Derek: Yeah, Ben Johnson, the Canadian... yeah, I won a case of beer when he won and then I drank it and have to give it back. So, it was a bit embarrassing. Yeah, being part Canadian myself. Anyway, so you went back to school and then you came back to Asia, is that right?

John: Yes, I studied at London School of Economics and when I graduated it was '91; it was the Gulf War. The job market was terrible and just like it is today and instead of going back to New York and doing the conventional thing, I did the unconventional thing and I went to Korea, and got my first job.

Derek: And that was a smart move.

John: Well, looking back on it, it was very fortunate, and ironically it was a short story but I got introduced to the person who offered me the job while running in New York City and bumping in to them. So, you never know when you get a job opportunity.

Derek: Yeah, right. All the way out in Korea. So, what were you doing in Korea?

John: I started as an economist and financial analyst and actually the first company I was asked to cover was Samsung Electronics. And after doing the model as a young person who knew nothing, I went to my boss and I said, "But if I move the DRAM price a little bit, they can make or lose a billion dollars!" And I thought this is really scary as an analyst because how was I going to know which way to judge where the margin was going to go for the next year. And it was so sensitive because its margins were so low, that I could easily see a billion dollars movement in earnings was very easy to...it was going to be very volatile.

Her best advice was "go and ask the company what they thought the expectation was and then if you believe them and you thought it was effectively downplaying expectations, go 10% above what the company was guiding for and if you didn't trust them go 10% below and say that you believe that the company will "miss." And it was probably the best advice because what other advice could you be get in that environment. But I also realized for me I had no advantage in understanding that industry and not enough curiosity and therefore kind of moved over to do banks and financial stocks because it was more linked to economic analysis. And I can put all of my interests together and I think that's key to being an analyst; you have to have an interest in what you do and be able to package together most of your interests in order to get, you know, through the work and grind of being an analyst because you've got to understand the financial data mining and data processing but you also have to be dogged about really understanding many aspects of your industry or your field of focus. Unless you're interested, don't do it.

Derek: Yeah. Exactly, because it's a lot of work.

John: Yeah.

Derek: So, you're started covering banks. That was what, twenty years ago?

John: Twenty years ago.

Derek: Wow. And how long did you spend in Korea?

John: I spent three years.

Derek: Three years.

John: And I never thought I would leave.

Derek: You liked it that much?

John: No, I thought I was trapped. (Laughs).

Derek: (Laughs). Trapped. At a young age of what, 25? So then, what happened?

John: I was lucky because, maybe through a hard work, determination and really just perseverance, I guess impressed some people as a young analyst. JP Morgan was setting up in Hong Kong in 1994 and they headhunted me at a very young age of 24. I was hired to be head of Asian Banks regionally by them and I was very lucky. And it shows you, I had no real plan but just curiosity, determination and knew what I really liked to do and the sort of process later on where the opportunity comes and it just kind of happened.

Derek: Yeah, and I think it was key to what you just mentioned: knowing what you like to do, you know, and if they had offered you a junior DRAM analyst position in Taiwan you would have known right away.

John: Yes.

Derek: Interesting. And that's kind of coincidentally the same job you have now.

John: Exactly. (Laughs).

Derek: It has obviously worked out.

John: Exactly. And also what I realize is that I always wanted challenges. So, luckily Asia for the last 20 years has evolved and grown so much that I would have initially covered Korea, Thailand and Malaysia back then - they were the big market. China didn't exist.

Derek: That's right.

John: And during the Asian crisis, I guess it's another good story where back in '98 the Asian financial crisis had hit, some companies were laying people off and JP Morgan, to my surprise, decided to fire all of us and close down the business in Hong Kong. And it turned out to be a blessing in disguise because I think that's how you have to approach life: make the most of every circumstance and realize that it happens for a reason and maybe it's something you can control or something that you couldn't have controlled or been responsible for but just move on and make the most of it. And they offered me to move in to investment banking in private equity and stay with them and I did it for a year and a half and had an incredible new earning experience and new opportunities. And then they let me move to Japan to set up a business from scratch of equity research and I went up to do that in Japan at a very good time. So, it also shows you have to be flexible and respond to change because the world does change and you have to move with those changes.

Derek: We've seen a lot of changes recently that is for sure. So, you went to Japan and how long were you there?

John: About two and a half years. And then again JP Morgan merged with Chase and I'd been there for seven years and I was made structurally redundant which was again a liberating experience and something that I looked forward to. And then I decided that I as I was getting married, I wanted to come back to Hong Kong and did that with enthusiasm and I joined UBS to do Asian bank research for them and did that for 8 years.

Derek: So that was what? Ten years ago?

John: That was ten years ago.

Derek: Ten years ago. So, you and I, I don't know if we overlapped at UBS because I was with UBS in Taiwan and in New York about that time, but I left in 2002.

John: And I joined in May of 2001, so we must have overlapped.

Derek: Yeah, because we know some of the same characters. And then you were Head of Banks Research at UBS based in Hong Kong, covering which markets?

John: Covering Korea, Hong Kong, HSBC, Standard Chartered, but UBS had an enormous platform, so I oversaw 13 bank analysts in every country and did massive reports, thematic reports and what you were learning as analyst is that thematic reports are very, very labor intensive. Very, very time intensive. It's like giving birth to a baby. Unfortunately though, once you have given birth to a baby, you know, a big sector report, a big thematic report and you're really exhausted, then you get told you have to go on the road two or three weeks to market it and you're doing that throughout Asia and you're doing that throughout the US, and you're doing that throughout Europe and you're jetlagged, you're fatigued, and you're doing eight meetings a day. Sometimes you're finding that your luggage is lost and you end up in a city with no suit to wear. But that is life.

Derek: That is definitely the life of an analyst. Yeah, marketing is a big thing.

John: And the other thing...

Derek: You got to go out and see the clients all the time.

John: Yes. And the other thing about it is... because UBS was one of the leading equity franchises throughout those years, maybe not so true today, but you know, things do change.

The amount of new IPOs that came through on China, from 2004 on luckily for me I was involved in a lot of those, from Bank of China Hong Kong, to Bank of China, to China Merchants Bank. You know, a role of an analyst also is to be sometimes be deal-supportive but my own view was I had done many, many deals over twenty years.

You can be deal supportive but you have to be objective and you have to be transparent to clients at all times about the risks involved and also to sales and don't be pressured into overselling. You always have to be balanced. I think I survived and maintained credibility by not being pressured or to be unreasonable or too bullish.

Derek: That comes down to integrity. And that is what this business should be all about. But to outsiders it doesn't appear that way and whether you're a sales trader or an analyst, or a salesman, if you don't have integrity, it will be found out and you will be gone. So, that comes right down to integrity.

John: And that comes down also with developing a framework for how you analyze your sector or your companies that how you value those companies, you truly believe is the right framework. Because, you know, I give you an example: I believe that some analysis of DCMs or Gordon Growth are completely flawed projects to value any company that is a cyclical company because by definition you're valuing perpetuity to a cyclical company so you're making wrong assumptions. Garbage in, garbage out.

So, I still find that most of the analysts out there and most of the firms out there still hide behind these convoluted models. But in the end, if you can simplify things down to a framework for what you think is a company's intrinsic maximum value and it's floor valuation and understand when you're going to really make that company a "Buy" and when you're going to make it a "Sell". That is where you can develop conviction as an analyst to fight the emotions of the market.

Derek: Yeah, and that takes, I suppose, many years of experience to develop.

John: Yes, and it's got to be in some industry that you feel you have better understanding of those ranges and as I mentioned earlier, covering Samsung Electronics and the DRAM price, I had no confidence in being able to judge what the fair value for that company was, what the min or max was, or...

Derek: Or the cycle.

John: ...or the cycles. So I decided that I was not going to be confident to ever present an investment opinion because if I didn't have confidence in myself, I shouldn't go and tell that to clients.

Derek: Very true, that's a good point. So why don't we... let me ask you another question here: how about your average day? Now that we know what you do and your background, what's your average day like? You wake up in the morning, birds are singing, the sun is shining and you think, "Crap! It's Monday!" What happens next?

John: The average day involves... good question. First you get your morning meeting and you've got to decide have you published a report that can be reviewed in the morning meeting or has your team published something that needs to be highlighted and the conclusions marketed in a punchy way, can we highlight the conclusions to sales?

Secondly, you would typically have upcoming either company announcements or a visit to companies or clients coming in for that day, so, you know, it depends, you're really kind of juggling. Either you're going to be working on a model, you're going to be working on a report related to a company, or working on a report related to an issue. Now, I typically and maybe this would be a good advice to anybody thinking of being an analyst, I typically will have three, four or five ideas that I'm always working on in my head and processing in terms of the data to support my conclusions and developing those ideas in kind of a parallel process rather than just one at a time and then realize that which one become more relevant, or timely or more commercial.

I kind of build out on a kind of sequencing basis. People have said to me when I was getting into this business, it's a campaign of mindshare, it's a campaign of trying to develop opinions that build on themselves, that build on each other, that actually have some cohesion because unless you have that campaign where people can understand your thinking process then, it's not worth it. If it's just scattered ideas, then you're not really going to be trusted or followed as a thought leader. I think that being an analyst is being a thought leader in your sector, a thought leader of the stocks you cover. And ultimately the stock conclusion might not be as important as the logic of how you get there, so...

Derek: ...that's what clients always say. They want us to be able to challenge them and force them to think about things in different ways. So, they often don't care whether it's a "Buy" or "Sell," believe it or not, because they need to make up their own decisions of whether they're going to buy a stock or not but they want to know more about our thinking and if it helps them with their thinking.

John: Exactly, exactly and that logic will help them decide whether they're going to agree or disagree, you know, so we inform and advise but ultimately the clients decide, so, remember that sometimes the recommendation is very important because it shows the conviction of the logic but the clients aren't really looking at the conclusion by itself, they're really looking at the logic.

Derek: Exactly. That's a good point. So, you're telling me that pretty much every day is different?

John: Every day is different. It involves marketing, clients, company visits, morning meetings, marketing usually every two months to different parts of the world, so you're going to go to Asian marketing trips, European marketing trips, US marketing trips. You will do onsite visits to companies and banks and there are seasonal earnings periods where companies will report quarterly or half annual results and you will attend the analyst meetings and you will typically try to figure out how you can add value either in advance of those results or how those results may change your overall investment thesis. Whether it's going to just validate it or significantly lead to an upgrade or a downgrade. And I've always said to analysts, you should always have three factors in your mind that if you've got a "Buy" on a stock, what are the three factors that if you saw them happen, would allow you or convince you to immediately downgrade the stock?

So, in your mind you thought it out already, what those three factors are and vice versa, if you have a "Sell" on the stock, you want to be able in your mind think of what are the three factors you're looking for that would compel you to upgrade because if you see those three factors in your mind and you spot them happening, it's the one who can spot them and react fastest that's going to maybe get some timely recommendations right for clients. And sometimes stock calls, especially for traders or hedge funds, because nowadays the business has changed. You, probably ten years ago, only had long-only accounts. Now, you probably have 50% more short term, hedge fund-related trades or neutral positions where they are taking long/shorts and were technical type investment conclusions, with long-only being maybe 50% of your client base. So, you also have to be more nimble as an analyst understanding that those two client bases will interpret the way of making money differently.

Derek: Exactly. And so, when you talk to them you have to be aware of which type of client you are speaking to. So that's good. So, then, tell me, what you like and don't like about your job or this business?

John: It's a good question. What I like about it is, I can think hard and have opinions and influence other people and actually learn from a lot of smart people. When you can interact with a lot of clients from all over the world and a lot of companies, you learn a lot, so I'm always learning, which is the gratifying part of it.

There is notoriety sometimes, you get press coverage, and you're a public figure for the firm, so, that's rewarding at times if you're right. And if you're wrong, you want to hide.

Derek: Yeah, and if you're wrong that's where the "notoriety" comes in...

John: (Laughs). The tough thing about the job it is a constant physical and time consuming grind. So, stamina is critical and also you can sort of say you've got to be able to think on your own and therefore, you know, I can do that and persevere but I find a lot of people don't like to be forced to sit and write a report for six, seven straight hours. So, it's that intensity, now, over time you learn rather than to dread that, you learn to figure out how to synthesize things and make it simpler but it's a time consuming job.

Derek: Yeah, that takes a lot of energy to keep up that intensity of effort considering, you know, we are working twelve hours a day or more.

John: Yes.

Derek: So, what advice then would you offer to somebody who is either new to this business or consider becoming an analyst?

John: Well, only get into it if you really like the subject involved and the area that you're focusing on as an analyst because if you're going to be a telecoms analyst, or internet analyst, or a banks analyst, or intern as an analyst, you have to have some general curiosity and passion for it.

I ultimately believe too that you have to specialize because I have seen a lot of analysts throughout the years who maybe get easily bored and want change and variety, will change sectors every year. And that will typically, I would argue, lead to somebody being a generalist but the clients not really knowing how to use them as an expert in their area. And if you do that, if you really are a generalist type analyst, then you probably want to move on and become a strategist and figure that out earlier rather than just being a company coverage analyst, or a sector analyst because I would argue it (the business) really does reward specialization over time.

Derek: And it also makes your job a lot better if you're doing something you like.

John: Yes. Exactly.

Derek: I've known analysts when they were transferred to another office and they had to take a sector on that they hated, or that they had no inherent interest in and that just ruined their lives. So, that's really important. Fortunately we both love our jobs, right?

John: Yes. (Laughs).

Derek: So, what else, what should a young person or somebody in school be thinking about? I mean, how important is education? What should you be doing to prepare yourself for this type of career?

John: I don't think you can necessarily, you have to have an analytical math aptitude clearly and math skills...

Derek: Can I interject? John is speaking as an analyst, not as a salesperson, because I'm terrible at math. (Laughs).

John: (Laughs). Exactly, but I think that an analyst has to have math competence. But try to think about the real world and how the real world really behaves and acts and there is an aspect that you could almost argue and it's corporate behavior that is psychological, right?

That there's motivation that companies are driven by their either greed, or fear, or other impulses and understanding what drives psychology of the business is important. What motivates people? Because, you know, you really can't trust what people say.

You've got to kind of analyze objectively what is actually happening sometimes in companies because what people say can be very different from reality.

Derek: I was just going to ask you that because as you were talking it reminded me and I've been to a hundred thousand company meetings, meeting corporates and all the different sectors for many years and I have had, on several occasions, and I remember quite clearly when, you know, the chairman or the senior person that I was speaking to at the company was lying to my face. Have you had that happen as well?

John: Well, as a banks analyst what I learned is that all banks will lie and that is just part of their, maybe their qualifications to be a banker. Either they don't know that they are lying or they do know and that's even more troubling. There is a source of motivation, which is that most people want to see the world in a rosy way, they really want to kind of sugarcoat things and you have to be skeptical.

If you're an analyst and you just trust what people say, well, you're not going to last that long as an analyst. Having said that, I think you have to be able to discern as well, you know, when is the right time to be skeptical because markets do have a way of kind of going through their emotional bubbles and you know, you don't want to be too early, as well, to be a skeptic.

Derek: True and I think that we should also clarify that companies don't lie often. It's only because it happens so seldom that it stands out so clearly.

John: Also, it's not just lying, it's just the business risks they're taking are bigger than they are aware of. So, business cycles change, products cycles change, their input prices can change and their selling prices can change, so, in any business things are outside of their control. It's not that their necessarily lying. Their expectations can be very wrong relative to reality. You can't trust their word as truth about the future. As an analyst you have to be able to judge what you think of how the future is going to unfold...

Derek: Based on probabilities.

John: Based on probabilities, based on insights, based on things, you may be able to discern about the world but just taking the guidance of a company, I would say, is dangerous.

Derek: Yeah and that tends to be what junior analysts do. All of them. Until they start figuring out, that's not the way to go. Alright, good. That's very interesting. Any other parting thoughts or suggestions, funny stories, jokes?

John: Funny stories, well, having worked at UBS before for eight years, all I would say is that recently there was a bubble in gold which I had pointed out to quite a lot of investors and for me, fortunately it shows that being a banks analyst you can also say, maybe spot some anomalies in anything around the world and that collapse in gold since the peak, was a well timed sort of insight. Now, ironically for me my wife is in the jewelry business, so I did have a natural hedge and I needed that hedge because I did work at UBS for eight years and hence I'm still working! (Laughs).

Derek: Yeah, exactly. (Laughs). I should have mentioned, John just came back from a conference with UBS at the private bank where actually told an auditorium of 100 people that very story.

John: But before the actual recent financial scandal...

Derek: The trading fiasco. So, it was still funny.

John: It was still funny at the time, no longer.

Derek: It's no longer still funny. Ok, that's good. Now you've been with us here at Mirae Assets Securities for two years since then. That's good. Ok, so John Wadle, Head of Banks Research at Mirae Assets Securities based in Hong Kong, thank you, again, very much for your time and that's it for now.

Thanks for listening to the broadcast, be sure to check out the website: www.stockbroking101.com and we'll see you next time.