David Herro Resource Page

Background & Bio

Mr. David Gregory Herro, CFA is a Partner, Chief Investment Officer of International Equity, Vice President, and Portfolio Manager at Harris Associates L.P. Mr. Herro has been a Vice President and Portfolio Manager at Harris Associates Investment Trust, in particular, the $5.4 billion Oakmark International fund since September 1992. Mr. Herro joined the firm in 1992. He previously served as a Portfolio Manager at Principal Financial Group Inc. from 1986 to 1989. Mr. Herro was a Portfolio Manager at The State of Wisconsin Investment Board from 1989 to 1992. He has extensive investment experience, having started in the industry in 1986. He is a CFA charter holder. He earned an M.A. degree from the University of Wisconsin, Milwaukee in 1985. Mr. Herro also earned a B.S. degree from the University of Wisconsin, Platteville in 1983.

The Oakmark International Fund has produced a net annualized return of 10.6% since inception compared to 6.4% for the MSCI World Index (ex U.S.) over the same period.

David Herro Investment Philosophy

Herro says that he started out as a pure Graham and Dodd value investor, focusing primarily on low price/earnings ratios, good balance sheets and high dividend yields. But he moved away from this strategy early in his career. When asked why, he continues to say the problem with that strategy is “you can get caught in too many value traps.” Herro concluded he was better off focusing mainly on two variables in weighing investment attractiveness: company valuation and business quality.

“Starting out I was a Graham and Dodd investor, focused on low price/earnings ratios, good balance sheets and high dividend yields. The problem with that is you can get caught in too many value traps. I concluded I was better off focusing primarily on two key variables in weighing investment attractiveness: company valuation and business quality. Quality to me is a company’s ability to intelligently allocate capital and generate good economic returns from its businesses. If they’re proficient in allocating capital and they earn good returns, that means they’re going to grow value per share. That growth of value over time is the best catalyst to get price and value to converge.”

He breaks down what he means by business quality. “Quality to me is a company’s ability to intelligently allocate capital and generate good economic returns from its businesses. If they’re proficient in allocating capital and they earn good returns, that means they’re going to grow value per share. That growth of value over time is the best catalyst to get price and value to converge.”
To minimize risk, David puts disciplined stock selection ahead of industry or country selection. “The best way to navigate is to know your course ahead of time. Know the risk factors of the markets, avoid fads or trends and never invest if there’s a lack of proper investment or regulatory infrastructure.”

Herro looks for value by applying a normal multiplier on normal free cash flow on an enterprise-value basis. Then, when the stock trades at a sufficient discount to this value, 30% or more, Herro will buy. However, if there are no opportunities, cash in the portfolio will go up, although Herro himself has noted that his portfolio always tends to be fully invested as he’s always able to find attractive opportunities somewhere.

In terms of diversification, no more than 5% of Herro’s portfolio will be in one company, and no more than 30% of the portfolio will be invested within one country, or more than 25% in one industry.

The three factors Herro looks for when identifying value

1. Price to Cashflow of
2. Debt to Cashflow of
3. Return on Equity over three years of > 13.5%

Unlike other value investors, Herro likes to meet with management teams. Although he mentions that this comes at the end of the analysis, not the beginning. Herro likes to ask open-ended questions in order to vet management and establish their true understanding of the company.

A huge amount of Herro’s work comes down to the successful computation of long-term financial figures. Herro believes that his figures are accurate to within 10% to 15% of his intrinsic value estimates 75% to 80% of the time. The hardest part of investing Herro notes, is having conviction in your figures.

Of course, this approach means that Herro is contrarian by nature:

“...We’re very focused on paying a cheap price, and that only comes about when there’s some short-term challenge. I was in Hong Kong and Japan earlier this month and ran into a fellow investor talking about a slow, beaten-up sector he was avoiding like the plague. Well, that’s exactly where you should be looking!”

But while Herro is attracted to opportunities around the world, he is wary of emerging markets:

“...The problem with investing directly in emerging markets, however, is that it’s very difficult to find specific companies that have clear and transparent corporate governance, good profitability and good business models and whose stocks sell at attractive prices...”
Instead, David prefers to get EM exposure through well-diversified international companies located within developed nations, companies like Diageo, Procter & Gamble and Unilever.

In addition, Herro likes to stay away from commodities:

“...Even when com-commodity prices are high there seems to be too much leakage from the price these companies get and what shows up in free cash flow. There are strikes. Plants breaks down. Capex spending goes up. Operating costs go up. Not to mention the fact that success or failure hinges on a commodity price that is determined exogenously. We generally think these are 8-9x P/E businesses, and Mr. Market usually holds them in higher regard than that...”

Oakmark International

David Herro, CFA is a Partner, Chief Investment Officer of the Oakmark International Equity fund.

**Average Annual Total Returns** (09/30/14)

10–year 9.37%
5–year 10.61%
1–year -0.64%

Excerpt from the Oakmark International Fund: [Third Quarter 2014 report](#)
Intesa Sanpaolo, an Italian retail and commercial bank, was the top contributor to performance over the past 12 months, returning 50%. Intesa’s share price has rebounded as fears over Italy’s banking system and government have subsided. We have always believed these fears were overblown and that Italy was in much better long-term fiscal health than many of its periphery countries. The new CEO has committed to return EUR 10 billion to shareholders via dividends over the next four years...

Another top contributor was Olympus, the world leader in endoscopes and other medical equipment, which returned 18% over the past twelve months. Management continues to invest in the medical business with a focus on growth in surgery... Although the camera business remains weak in our view, Olympus also plans to invest in this division, and management’s goal is to boost revenues enough to cover costs this year.

The largest detractor from performance for the quarter and the past twelve months was CNH Industrial, a manufacturer of agricultural and construction equipment. As expected, the company’s agricultural equipment business is experiencing reduced sales due to lower crop prices and farm profitability...

There was abundant portfolio activity during the past quarter. We sold our positions in Geberit and OMRON and added four new names to the Fund: Exor, an Italian-based investment company which owns stakes in CNH Industrial and Fiat; G4S, a U.K.-based security services company; Melco Crown Entertainment, a Hong Kong-based casino, gaming, and entertainment resort operator; and Swedish Match, a Swedish-based company whose primary source of revenue is derived from smokeless tobacco.

Quotes

“You have to be careful because of the nature of the corporate structure.”

“Whereas Toyota is the world leader in autos from an operational perspective, they are still a laggard in terms of running the business for the owners. They do not appear to care about maximizing shareholder value.”

“The shareholders have done very well since he left. We probably tripled our original investment over seven years.”

“We rallied the shareholders to vote out Mr. Saatchi, and then we told the board we were going to vote them out.”

“The most undervalued stocks today are large-caps.”

"We go where there is value, not where everyone else goes. Sometimes the best value is where no one else is at.”

Shareholder letters
Below is a selection of letters from David Herro to Oakmark investors. A full list of quarterly letters dating back to 1995 can be found [here](#).

**Oakmark International Fund: Third Quarter 2014**
2Q14 | David Herro Market Commentary

**Oakmark Global Select Fund: First Quarter 2014**
4Q13 | David Herro Market Commentary

**Oakmark Global Select Fund: Third Quarter 2013**
2Q13 | David Herro Market Commentary

**Oakmark Global Select Fund: First Quarter 2012**
4Q11 | David Herro Market Commentary

**Oakmark International Small Cap Fund: First Quarter 2011**

**Articles**

- [Value Investing the David Herro Way](#)
- [David G. Herro, CFA - Harris Associates LP](#)
- [International Favorite David Herro's Top Five Holdings](#)
- [David Herro | The Guru Investor](#)
- [Buy Japan, Europe equities: Top fund manager - CNBC.com](#)
- [Oakmark's David Herro Offers a Few Picks - ValueWalk](#)
- [Tesco CEO Needs Time as Investors Grow Impatient](#)
- [Writedown: David Herro, the man who gambled - and lost](#)
- [David Herro's International Fund Up 41%, 5 New Buys](#)
- [David Herro Named Morningstar's International Stock Fund Manager of the Decade](#)
- [Why I'm betting big on Europe - Fortune](#)
- [Herro: Have Courage of Your Convictions - Morningstar](#)
- [David Herro on what's wrong with Illinois and the GOP](#)
- [Story: Tom Keene Talks to Harris Associates' David Herro](#)
- [The World's Greatest Investors - God Help Us! - Forbes](#)
- [David Herro, noted fund manager and car buff, tells party guests to dress 'racy](#)

**Videos**

- [How David Herro Is Picking European Stocks - Bloomberg](#)
- [David Herro on Stocks, Investment Strategy: Video](#)
- [David Herro's Top 3 Global Investment Picks - Businessweek](#)
- [David Herro on the Reasons for Current Investor Behavior](#)
- [Herro on Investing in European Financial Stocks](#)
- [Herro Says 'Devil' in Details on SAP's Sybase Takeover: Video](#)
- [David Herro - WealthTrack](#)