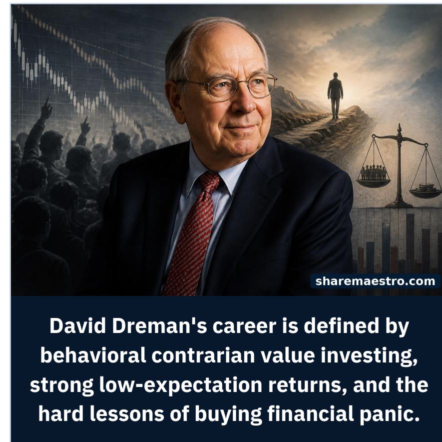
INVESTOR | BEHAVIORAL CONTRARIAN VALUE INVESTING

David Dreman Made Contrarian Investing a Study of Error, Then Lived Through Its Hardest Test



David Dreman's career is defined by behavioral contrarian value investing, strong low-expectation returns, and the hard lessons of buying financial panic.

David Dreman turned low valuation, analyst error, and crowd psychology into a disciplined investment doctrine, but the financial crisis showed how thin the line can be between buying panic and owning a value trap.

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In brief

David N. Dreman built one of Wall Street's most distinctive contrarian value careers by arguing that investors and analysts systematically overreact to bad news, overpay for favored companies, and underestimate the rebound potential of low expectation stocks. His work connected Graham and Dodd style valuation discipline with behavioral finance before the field became widely accepted. As founder of Dreman Value Management, longtime Forbes columnist, fund subadviser, and author, he gave practical form to a psychology based approach centered on low price-to-earnings ratios, cash flow, book value, yield, and earnings surprise asymmetry. His record included strong long-term stretches, notably at Scudder-Dreman High Return Equity Fund, but his heavy exposure to financial stocks during the 2008 crisis damaged results and led DWS to remove his firm as subadviser in 2009.

- Dreman's distinct contribution was to frame contrarian value investing as a behavioral discipline, not simply a search for statistically cheap stocks.
- His published work with Michael Berry emphasized that analyst forecasts are frequently wrong and that earnings surprises affect low and high P/E stocks asymmetrically.
- The Scudder-Dreman High Return Equity Fund produced powerful long-term periods, including a first-place 10-year Lipper ranking in its category as of November 2003, before later suffering badly in the financial crisis.
- The 2008 drawdown and DWS removal in 2009 remain central to any serious assessment of Dreman because they exposed concentration, sector, and balance-sheet risks in contrarian value investing.
- Dreman's continuing relevance lies in his insistence that expectations, valuation, and human error are inseparable, especially when markets are most confident that consensus is safe.

Performance markers

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Dreman Value Management founding	1977 Dreman founded his first investment firm, Dreman Value Management, Inc., in 1977, anchoring a career built around contrarian value management.
Forbes column tenure	30 years A 2014 adviser brochure supplement described Dreman as a regular Forbes columnist for 30 years.
Analyst estimate sample	66,100 consensus estimates Dreman and Michael Berry's 1995 Financial Analysts Journal study compared 66,100 consensus analyst estimates with reported earnings.
Low P/E earnings surprise persistence	At least 19 quarters Dreman and Berry found that mean reversion favoring low P/E stocks continued for at least 19 quarters after earnings-surprise news.
Scudder-Dreman High Return Equity 10-year Class A return	13.49% annualized before sales charge For the period ended November 30, 2003, the fund reported a 10-year Class A annualized return of 13.49%, compared with 10.63% for the S&P 500.
Lipper 10-year category ranking	No. 1 of 51 As of November 30, 2003, Class A shares ranked first among 51 Lipper Equity Income Funds over 10 years, based on total return unadjusted for sales charges.
DWS Dreman High Return Equity 2008 Class S return	-45.42% The 2009 prospectus reported a 2008 calendar-year Class S return of negative 45.42%, versus negative 37.00% for the S&P 500.
Dreman Value Management 2018 regulatory assets	$156.8 million across 22 accounts The firm's 2018 Form ADV annual amendment reported $156,766,128 in discretionary regulatory assets under management across 22 accounts.

Charts and timelines

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Risk	
Sector concentration permission	More than 25% in one sector allowed
Crisis quarter	-23.11%
Subadviser removal	DWS replaced DVM
Post-crisis scale	$156.8 million regulatory AUM

Timeline	
Investment career begins	Start of investment career
Firm founded	Dreman Value Management established
Flagship fund team	Joined High Return Equity fund team
Forecast and surprise studies	Two Financial Analysts Journal papers
Strong reported fund decade	No. 1 of 51 over 10 years
Crisis drawdown and removal	Class S fell 45.42% in 2008, DWS removed DVM in 2009
CIO succession	Cliff Hoover to become CIO
SEC registration status changes	SEC registration terminated

Philosophy	
Low expectations	Buy where expectations are depressed
Forecast skepticism	Treat consensus estimates as fragile
Multiple valuation tests	P/E, book value, cash flow, yield
Sell discipline	Target price, changed fundamentals, better opportunity

Performance	
Class A one-year return	23.18%
Class A 10-year annualized return	13.49%
Class A 10-year adjusted annualized return	12.82%
Class S 2008 return	-45.42%

The investor who wanted to buy discomfort

David Dreman's corner of Wall Street was never designed for investors seeking reassurance. His preferred hunting ground was where the story sounded damaged, the multiple looked low for a reason, and the research department had already moved on to something cleaner. In an industry that often sells confidence, he built a career around the opposite premise: confidence is usually most expensive when it feels most abundant.

That idea made Dreman more than a value investor with a low price-to-earnings screen. He became one of the bridge figures between old security analysis and modern behavioral finance. Benjamin Graham had warned that price and value diverge. Dreman tried to explain why they diverge so predictably, using investor psychology, analyst forecast error, and the market's treatment of earnings surprises as the mechanics behind the bargain.

His career matters because it contains both halves of contrarian investing's promise. In one period, the discipline produced admired returns and a public reputation strong enough to make his name shorthand for going against the crowd. In another, the same willingness to own despised financial stocks through a crisis helped cost him a flagship subadvisory mandate. Dreman's story is therefore not a hymn to cheapness. It is a case study in how difficult it is to distinguish temporary revulsion from permanent impairment.

A market education before the theories had names

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Dreman's market education began well before he had a platform, a fund, or a theory. He grew up around markets in Canada, with a father who traded commodities and invested the proceeds in stocks. The habit that later defined him, watching prices and people at the same time, had roots in that early exposure. Markets were not abstractions on a chart. They were arenas in which emotion moved capital.

After graduating from the University of Manitoba, Dreman's career took him through security analysis and investment publishing. He worked as director of research for Rauscher Pierce Refsnes Securities, as a senior investment officer at J. & W. Seligman, and as a senior editor at Value Line Investment Service. Those jobs placed him close to the machinery of professional judgment: earnings estimates, rankings, narratives, and the institutional tendency to extrapolate.

The formative scar was the late 1960s growth-stock boom. Dreman later recalled the period as a time when young investors believed money had become easy and experienced observers knew pain was coming. His own account credited Graham and Dodd with helping him avoid a total wipeout, but the lesson was sharper than a standard sermon about value. He saw that intelligence and access did not save investors when the crowd turned certainty into price.

Contrarianism as a behavioral proposition

By the time Dreman launched his own investment firm in 1977, he had settled on an explanation for recurring mispricing. The market did not merely overlook stocks. It overreacted. Favored companies became priced for an immaculate future, while neglected companies were priced as though disappointment would continue indefinitely. In that gap between assumption and reality, he believed, lay the contrarian investor's opportunity.

That stance made his work distinct from traditional balance-sheet bargain hunting. Dreman cared about valuation, but he wanted valuation attached to a theory of human error. Investors anchor on recent news. Analysts crowd around accepted views. Institutions prefer companies that are easy to justify in committee. The cheap stock is not automatically attractive, but the unpopular stock can become attractive when expectations have collapsed further than the business itself.

The language of behavioral finance later became familiar, but Dreman was using its practical insights before they became fashionable in asset management. His books, beginning with Psychology and the Stock Market in 1977 and continuing through several editions of Contrarian Investment Strategies, argued that investors cannot be understood as consistently rational processors of information. He was not content to say markets were inefficient. He wanted to identify the recurring errors that made them so.

The analyst forecast problem at the heart of the method

One of Dreman's most durable targets was Wall Street's faith in forecasts. The professional investment business depends on estimates, but Dreman argued that estimates often carry more precision than they deserve. Valuation models can look rigorous while resting on earnings projections that will not survive contact with reality. The issue was not that analysts were foolish. It was that forecasting corporate earnings in a changing economy is hard, and consensus can turn uncertainty into false comfort.

In a 1995 Financial Analysts Journal article with Michael Berry, Dreman compared 66,100 consensus analyst estimates with reported earnings across a large sample of NYSE, Amex, and OTC companies. The conclusion was blunt: forecasts differed significantly from actual results, only a minority fell within what many professionals would regard as an acceptable range, and error rates were not meaningfully rescued by business cycle or industry grouping.

The investment implication was central to his strategy. If consensus earnings estimates are fragile, then stocks priced for excellent forecasts are exposed to severe disappointment. By contrast, companies already priced at low multiples may have less room to fall when news is merely bad rather than catastrophic. Dreman's contrarianism was not a reflex to buy every loser. It was an argument that the market systematically misprices the odds around expectation changes.

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Earnings surprises and the asymmetry of expectations

Dreman's most persuasive evidence came from the behavior of stocks after earnings surprises. A positive surprise for an expensive, admired company may already be partly anticipated by investors who have paid for perfection. A negative surprise can be punished brutally because it violates the narrative that justified the price. The mirror image can occur in cheap, unloved stocks, where expectations are so low that bad news may already be reflected and good news can force a rapid repricing.

In another 1995 Financial Analysts Journal article, Dreman and Berry argued that positive and negative earnings surprises affected high P/E and low P/E stocks in an asymmetric way that favored the low P/E group. The paper also found that long-term reversion to the mean, with low expectation stocks showing above-market returns and favored stocks showing below-market results, continued for at least 19 quarters after the news.

This was the empirical heart of Dreman's appeal. It offered a disciplined way to explain why low multiple stocks could outperform without relying solely on a vague claim that they were cheap. The market's mistake, in his telling, was not simply valuation. It was valuation under the influence of narrative, recency, and emotional response. Cheap stocks became most interesting when low price, financial durability, and low expectations met the possibility of better than feared news.

From Graham and Dodd to an investable screen

Dreman did not reject Graham and Dodd. He modernized one branch of their tradition for a market increasingly dominated by earnings models, professional forecasts, and institutional narratives. Graham's margin of safety remained visible in Dreman's refusal to pay for fashion. But Dreman's contribution was to emphasize the psychology behind why securities became cheap and why investors often failed to exploit that cheapness.

The operating process was deliberately plain. A Dreman strategy typically began with low price-to-earnings ratios, then tested candidates against book value, cash flow, dividend yield, and financial soundness. The aim was not to purchase statistical wreckage indiscriminately. It was to assemble a portfolio of companies whose prices reflected excessive pessimism while the underlying businesses retained enough strength to survive, recover, and surprise.

The 2009 DWS prospectus for DWS Dreman High Return Equity Fund captured that practical construction. The fund sought a high rate of total return, invested primarily in large U.S. companies considered undervalued, screened for P/E ratios below the S&P 500 average, and then compared price with book value, cash flow, and yield. It also allowed sector emphasis, including the possibility of investing more than 25 percent of assets in a single sector. That last permission would later become important.

Portfolio construction as disciplined discomfort

Dreman's portfolio construction reflected his belief that real contrarian investing requires more than a single brave purchase. The point was to build exposure to a pattern of market error. A lone cheap stock can be a mistake. A carefully selected group of financially durable low expectation stocks can turn behavioral mispricing into a repeatable discipline, provided the investor survives the waiting period.

This is where Dreman's method differed from theatrical contrarianism. He was not trying to shock the market with isolated bets. The process used screens to identify candidates, fundamental analysis to separate temporarily unpopular companies from deteriorating businesses, and diversification to make the thesis less dependent on a single corporate recovery. The portfolio was meant to express a statistical and psychological edge rather than a heroic prediction.

Yet the same structure could create discomfort at the sector level. If pessimism was concentrated in banks, insurers, energy, or other troubled industries, a valuation discipline could naturally lead the portfolio into those areas. The 2009 prospectus made clear that the fund could emphasize financial services or another sector and could exceed 25

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percent of total assets in one sector. Dreman's opportunity set was therefore partly shaped by where market fear happened to be clustered.

The Forbes platform and the public contrarian

Dreman's influence grew because he was both a practitioner and a public explainer. His long Forbes tenure gave him a regular platform to translate behavioral value investing into a style that individual investors could understand. He wrote not as a detached academic, but as a manager trying to turn unpopular securities into portfolios. That combination helped make contrarian investing a household phrase among market readers.

The public role mattered. Many value investors speak in the language of assets, earnings, and discount rates. Dreman added a steady warning about the danger of consensus. His columns and books asked readers to distrust fashionable certainty, to examine the assumptions embedded in price, and to recognize that complexity can make decisions worse rather than better when it amplifies overconfidence.

That did not make him a mere pundit. His firm managed real portfolios and subadvised funds. The 2014 Form ADV brochure supplement described him as founder and chairman of Dreman Value Management, listed five books, and noted that articles discussing his methods had appeared in major financial publications. It also stated that he had been a regular Forbes columnist for 30 years. By then, Dreman was not simply an investor. He was one of the recognizable voices of behavioral contrarian value.

A flagship fund's strong years

The strongest case for Dreman's method came from periods when low expectation stocks had room to recover and the market paid investors for enduring discomfort. The Scudder-Dreman High Return Equity Fund offered one public window into that record. By the end of November 2003, the fund's Class A shares had posted a 23.18 percent one-year total return before sales charges, compared with 15.09 percent for the S&P 500.

The long-term numbers were also favorable at that point. The same report showed a 10-year Class A average annual total return of 13.49 percent before sales charges, compared with 10.63 percent for the S&P 500. On an adjusted-for-sales-charge basis, the fund's 10-year Class A average annual return was 12.82 percent, versus 10.63 percent for the index. Lipper ranked Class A first out of 51 equity income funds for the 10-year period.

Those figures explain why Dreman's reputation survived beyond theory. He could point to a process, publish evidence, and manage money through a period that rewarded his discipline. The report also noted that Dreman Value Management, founded in 1977, managed more than $7.5 billion as of December 31, 2003. The business had institutional scale, a recognizable flagship, and a philosophy that appeared to work when valuation spreads and expectations gave it room.

The hidden cost of being early

The danger in Dreman's style was not that it ignored risk. It was that its definition of risk differed from the definition many fund shareholders implicitly used. A low valuation can reduce expectation risk, but it cannot eliminate business risk, leverage risk, liquidity risk, or regulatory risk. In a crisis, those risks stop being theoretical. They determine whether a cheap stock survives long enough to become a bargain.

Contrarian investors also face the chronic problem of timing. If a stock is hated, it can become more hated. If a sector is statistically cheap, it can become systemically impaired. Dreman's process tried to improve the odds by emphasizing financial soundness and multiple measures of value, but the method still required patience from clients, trustees, and distribution platforms. That patience is often shortest when the strategy is most visibly out of step.

This is the practical paradox of behavioral investing. It asks investors to exploit other people's panic, but the investor's own clients are human too. They experience drawdowns, compare managers, and question whether a long-term

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discipline has become denial. Dreman spent a career arguing that psychology drives markets. In 2008, the psychology that mattered was not only in the securities he owned. It was also in the institutions that had hired him to own them.

The financial crisis and the bank-stock test

The financial crisis became the defining adverse test of Dreman's later career. Banks and insurers, natural targets for a low valuation contrarian after large price declines, were not merely unpopular. Many were exposed to funding stress, credit losses, opaque securities, government intervention, and capital structures that could permanently dilute or wipe out equity. What looked cheap on trailing numbers could be expensive if book value and earnings power were still falling.

DWS Dreman High Return Equity Fund's 2008 results were severe. The 2009 prospectus showed the Class S shares down 45.42 percent for calendar 2008, compared with a 37.00 percent decline for the S&P 500. Its worst quarter in the displayed period was the fourth quarter of 2008, at negative 23.11 percent. The financial highlights for the year ended November 30, 2008 showed a Class S total return of negative 47.25 percent.

DWS then moved to remove Dreman Value Management as subadviser. Forbes reported in April 2009 that Dreman had been removed from the $2.2 billion High Return Equity Fund, which was down nearly 50 percent over the prior year, and that the fund was to be renamed DWS Strategic Value around June 1. The episode did not erase Dreman's prior record, but it permanently complicated it.

Why the 2009 removal still matters

Dreman's 2009 removal is often reduced to a simple morality play: a contrarian was punished for being early, or a value manager mistook financial leverage for cheapness. Neither version is sufficient. The decision took place during a period when fund boards, advisers, and shareholders were under intense pressure. A strategy built on buying distress had to answer for owning distress when the distress became systemic.

The criticism was not that Dreman abandoned his method. It was almost the opposite: he followed it into a sector where historical valuation relationships were breaking under unprecedented balance-sheet stress. That is the harsher lesson. A disciplined process can still fail if the variables it trusts, such as book value, normalized earnings, and dividend capacity, are less reliable than they appear. Contrarianism protects against consensus error, not insolvency.

Yet the removal also shows the institutional difficulty of long-horizon investing. Forbes quoted a Morningstar analyst who was surprised by the firing and thought Dreman's experience and long-term success warranted a longer leash, while also acknowledging subpar performance. That tension remains familiar in fund management. Investors say they want differentiated managers until differentiation produces painful tracking error at the wrong time.

Succession, shrinking scale, and the firm after the crisis

After the crisis, Dreman Value Management moved from the age of founder dominance toward succession. In September 2010, the firm announced that E. Clifton Hoover would assume the chief investment officer role effective October 31, while Dreman would continue as chairman, investment committee member, and manager of the Dreman High Opportunity Fund and Dreman Market Overreaction Fund. The announcement framed the transition as the product of several years of planning.

The succession plan also emphasized continuity. Hoover had joined in 2006 as co-chief investment officer, co-director of research, portfolio manager, and managing director. The firm described its philosophy as a low P/E approach that sought to exploit market overreactions through discipline and consistency. In other words, Dreman's method was not presented as a founder's intuition but as an institutional style to be carried forward.

The scale of the business later looked very different from its peak public profile. The firm's 2018 Form ADV annual amendment reported $156.8 million in regulatory assets under management, 22 accounts, and four employees, with

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Dreman listed as chairman, chief investment officer, chief compliance officer, and a control person. The SEC's investment adviser public disclosure system later showed the adviser's SEC registration as terminated effective June 29, 2018. The brand endured, but not as the large mutual-fund subadvisory force it had once been.

The academic tide moved toward him, then beyond him

Dreman's reputation benefited from a broader shift in finance. Behavioral ideas moved from the edge of professional debate toward the center. The work of Daniel Kahneman, Amos Tversky, Richard Thaler, Werner De Bondt, and others challenged the assumption that markets always process information efficiently. Dreman's practical message, that investors make systematic errors under uncertainty, became less heretical over time.

De Bondt and Thaler's 1985 paper, Does the Stock Market Overreact?, found that prior loser portfolios outperformed after formation while prior winners lagged, supporting the idea that markets could overreact to dramatic news. That evidence sat naturally beside Dreman's view of low expectation stocks. It gave academic reinforcement to what he had been arguing in market language: the crowd often carries recent experience too far into price.

At the same time, the academic story did not belong exclusively to behavioral finance. Fama and French's 1992 work found that size and book-to-market equity helped explain cross-sectional stock returns while beta did not do the job the capital asset pricing model had assigned it. For Dreman, this was useful but not identical. He saw value's excess return as an expectations and psychology problem. Others framed it as risk, factor exposure, or compensation for distress. The debate remains unresolved, which is precisely why his career is still worth studying.

What Dreman got right

Dreman's most durable insight is that expectations matter as much as fundamentals. A great company can be a poor investment if the market has already capitalized too much greatness. A mediocre company can be rewarding if the market has priced it for disaster and the disaster fails to arrive. This sounds simple, but it is difficult to practice because expectations are embedded in price, reputation, and emotion at once.

He also understood the institutional incentives that make contrarian investing hard. Analysts prefer forecasts that can be defended. Portfolio managers prefer holdings that clients recognize. Committees prefer narratives that do not embarrass them. The result is that favored stocks can remain favored too long and neglected stocks can remain neglected until evidence forces a repricing. Dreman's work helped investors see that the edge was not merely in arithmetic. It was in the willingness to look wrong.

Finally, he gave behavioral finance an investable grammar. Low P/E, low price-to-book, low price-to-cash-flow, higher yield, earnings surprise, and mean reversion became practical tools for exploiting overreaction. His later book, Contrarian Investment Strategies: The Psychological Edge, was reviewed in the Journal of Behavioral Finance as a clear attempt to connect psychology with investment strategy. That is where Dreman's influence is strongest: he made investor error operational.

What can still go wrong

The most dangerous misunderstanding of Dreman is to treat low multiples as proof of safety. Cheapness can reflect neglect, but it can also reflect fraud, leverage, technological decline, regulatory pressure, or a business model whose economics have permanently changed. The market can overreact, but it can also recognize decay earlier than accounting numbers do. Dreman's own crisis-era experience is a warning against confusing statistical value with durable value.

Another danger is that behavioral explanations can become too comforting. If a position falls, the contrarian can always say the crowd is panicking. Sometimes that is true. Sometimes the business is deteriorating faster than the investor's model. A good contrarian process therefore requires exit discipline, balance-sheet skepticism, and humility about normalized earnings. Without those, the method can become an elegant way to average down.

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Dreman's legacy is strongest when read with both admiration and caution. He showed that markets are shaped by repeated human errors and that disciplined investors can profit when expectations become extreme. He also showed that the same discipline can suffer deeply when the facts are worse than the crowd fears. The enduring lesson is not to buy whatever others hate. It is to ask whether the hate has created a price below reality, and then to be honest enough to recognize when reality has changed.

Disclosure

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