# Al Boris’ Synopsis of John Train’s
# “The Money Masters”

“The Money Masters”, by John Train, is a simple to understand book that I consider to be the best on investing. The author dissects the investment philosophy of nine great investors- Benjamin Graham, Warren Buffett, John Templeton, Philip Fisher, Paul Cabot, Stanley Kroll, T. Rowe Price, Larry Tisch, and Robert Wilson. The reader will immediately grasp that there is more than one philosophy for investing, that everyone must have their own investment philosophy, and that it is fine to “copy” the investment philosophy of one or more of these “Masters”. That’s why I recommend this as the ***first*** book to read if you are starting, need to restart, or are just looking to improve your investment prowess. My Investment Philosophy consists of one half John Templeton and one half Philip Fisher, both of whom I had the pleasure of knowing and/or speaking with.

Of course times change and adaptations need to be made. Yet the investing principles ***and the behavioral characteristics*** on which these philosophies are based are timeless. Upon close inspection, you will recognize the similarities of the “Masters” ***behavior*** when investing.

WARREN BUFFETT

- Buy what is out of fashion and thus hard to resell quickly. Buy a lot and be prepared to be patient with any particular holding.
- Own only a dozen or so securities against traditional diversification – the “Noah’s Ark approach.” Buy two of everything in sight and you will end up with a zoo instead of a portfolio.
- The business world is divided into a tiny number of wonderful businesses-well worth investing in at a price-and a huge number of bad or mediocre businesses that are not attractive as long term investments.
- On rare occasions the wonderful businesses are almost given away. When this happens, buy boldly, paying no attention to current gloomy economic and stock market forecasts.
- Bonds (of bad or mediocre businesses) are often better investments than the stocks (of the same bad or mediocre businesses).
- Invest in “gross profits royalty” companies—companies that benefit directly from the large capital investments of the companies they serve. They themselves require little working capital to operate and often pour off cash to their owners (TV and radio stations that serve the auto industry, or large insurance brokers like Marsh & McLennan)
- As a boy, he was fascinated by technical analysis, developed his own techniques and indices and later discarded them in 1949 after reading The Intelligent Investor by Benjamin Graham.
- Benjamin Graham didn’t believe in qualitative analysis. He only believed in quantitative analysis, studying the available financials. He would only use information that was available to his readers. For example, one should only buy a stock selling for two-thirds of its own working capital and then sell it again when the market values it at 100% of its working capital.

- If you buy and hold you will do only about as well as the companies do.  You can hold onto a higher growth company for as long as it goes on developing rapidly.  But you must be sure to sell a "Graham" investment at the right time if it has a low return on capital.

- Of all the investors in this book, Buffett is the one who most perfectly understands the "business" of the companies he owns stock in.

- Those on Wall Street who talk of the stock trend or institutional sponsorship are ridiculous—comparing them with astronomers setting aside their telescopes to consult the astrology page.

- There are very few companies he considers interesting enough to buy at all, and even those he will only look at when they are very unpopular.  Of course you must know for certain what the values really are if you are going to have the confidence to buy in the teeth of a panic.

- Every year Buffett wrote his co-investors:  "I cannot promise results to partners, but I can and do promise this:

  1. Our investments will be chosen on the basis of value, not popularity

  2. Our patterns of operations will attempt to reduce permanent capital loss (not short term quotational loss) to a minimum.
     His stated goal was not absolute, but relative: to beat the Dow Jones by an average of ten percentage points per year.

- His experience with Dempster (a farm implements company) and the textile business of Berkshire Hathaway contributed to his present firm conviction never to buy another "turnaround."

- In another letter to partners, he said: "I will not abandon a previous approach whose logic I understand (although I find it difficult to apply) even though it may mean foregoing large, and apparently easy, profits, to embrace an approach which I don't fully understand, have not practiced successfully, and which possibly could lead to substantial loss of capital."

- ***When Buffett terminated the Buffett Partnership (because of pressures to act against his style by the partners) some experienced acute anxiety.  He felt that investors who lose their balance most completely are those who spend considerably more than they earn from their own work and are thus very dependent on investment income.

- The enormous advantage the independent investor has is that he can stand at the plate and wait forever for the perfect pitch.  You can not only wait for a bargain, but for the particular one that you understand and know to be a bargain.

- The competitive player should never depart from his area of superiority.  You might improve your investment performance by having a quota, one investment idea per year perhaps.  You only have to do a very few things right in your life so long as you don't do too many things wrong.  Therefore resolve ahead of time to make only a few big investment moves.  Many times though, feeling obliged to remain active he swings at far too many pitches instead of holding off until he has absolute conviction.  He seems to hear the clients howling, "Swing you bum!"

- ***The relationship between a truly effective advisor and his clients is no simple matter.  Aside from anything else, if he's really successful the time comes when he doesn't need clients anymore, or finds that they cramp his style—witness Buffett himself.

- Buffett believes you need six qualities to be successful investor:

1. Must be animated by controlled greed and fascinated by the investment process. You must not be in a hurry and must enjoy the game.

2. You must have patience. You should never buy a stock unless you would be happy with it if the stock exchange closed down for the next 10 years. Buy into a company because you want to own it permanently, not because you think the stock will go up. You can't determine the correct value for a stock in all cases, or even in most, but you can in a few cases and that's all you need. Guessing stock movements is just guessing. If you are right about the company and buy it at a reasonable price, you will eventually be right about the stock.

3. You must think independently. Jot down your reasons for buying. When you have them all down, make your decision and leave it at that, without feeling the need to consult other people—no committee. If you don't know enough to make your own decisions you should get out of decision-making. As Graham says, "the fact that other people agree or disagree with you makes you neither right nor wrong. You will be right if your facts and reasoning are correct."

4. You must have the security and self-confidence that comes from knowledge with out being rash or headstrong. If you lack confidence, fear will drive you out at the bottom. He says it is as though you bought a house for $100,000 and immediately told the broker that you would sell it again if you got a bid of $80,000.

5. Accept it when you don't know something.

6. Be flexible as to the types of business you buy, but never pay more than the business is worth.

- Nobody is cleaver enough to buy stocks he doesn't really want and resell them to someone else at a profit.

- The characteristics of wonderful businesses are:

1. They have a good return on capital without accounting gimmicks or lots of leverage.

2. They are understandable. Why do they appeal to their customers?

3. They see their profits in cash.

4. They have strong franchises and freedom to price (pricing flexibility), although the number of truly protected areas in our economy is minute.

5. They don't take a genius to run.

6. Their earnings are predictable.

7. They are not natural targets of regulation.

8. They have low inventories and high turnover of assets. In other words, they require little capital investment.

9. The management is owner oriented.

10. There is a high rate of return on inventories plus plant (conglomerates usually fail this).

11. The best business is a royalty on the growth of others (requiring little capital itself, such as Marsh & McLennan).

- He recommends looking less at Earnings per Share (EPS) than at Return on Capital (ROC), which is what produces earnings. There are ways of manipulating EPS & earnings growth. ROC is harder to play with.

- Lack of marketability (of an investment) is unimportant to a true investor.

- The Dow Jones Industrial Average is worth 2x book value if you expect T-bills to yield 5% (1x if 10%, 3x if 1%).

- Almost no one should ever go short. If you do, then short the entire market. Buffett has no interest in shorting.

- Buy on weakness. Buffett has never seen a major discrepancy between market value and intrinsic value maintained over an extended number of years.

- Buffett knows of no one who has made <u>and kept</u> a significant amount of money trading stocks.

- Buffett's worst investments have been in retailing.

- Other bad investments include those where you have to periodically bet the entire company to stay in business (Lockheed, Boeing), debt-burdened companies, geometric growth companies requiring more and more cash, managements that don't tell the truth, and finally companies that sign long term service contracts for money received today.

- Buffett doesn't like venture capital investments because during a market washout you can buy real bargains instead.

- Cash rich companies should buy other cash rich companies and not build empires and/or have a formal acquisition department.

- In banking, what counts is how you manage your assets, liabilities, and costs. There is no advantage to being #1. Additionally, very few third world countries have ever repaid as much as they have borrowed.

- Buffett will never invest in commodities.

- You don't get as many bargains buying the business as you do buying the stock.

- The more one is a true investor, the less one need be concerned about liquidity.

PAUL CABOT

- Cabot is a founder and partner of State Street Management and Research.

- Harvard's endowment was much bigger than Yale's because they saved money every year, whereas Yale dipped into principal.

- Cabot's approach—care and realism

- "Not much grows in the shadow of an oak." Never take a successor on faith.

- Many dividends are declared out of capital because earnings are not rising as fast as inflation.

RECOMMENDED BOOKS

- Benjamin Graham – Intelligent Investor
- Edgar Laurence Smith – Common Stocks as a Long-Term Investment
- Phillip Fisher – Common Stocks and Uncommon Profits

PHILLIP FISHER

- "I don't want a lot of good investments; I want a few outstanding ones." Fisher doesn't want to be a jack-of-all-trades and master of none.
- Companies of interest combine outstanding business management with a strong technological lead.
- Fisher's key idea is that you can make a lot of money by investing in an outstanding enterprise and holding it for years and years as it becomes bigger and better.
- Old and famous companies that have passed their prime and are losing ground are by no means conservative holdings.
- "Scuttlebutt"—the "business grapevine" is extremely important yet most investors don't recognize it because it doesn't lend itself to financial ratios.
- A good source of scuttlebutt is the trade show because both competitors and customers know the answers. These contacts must be cultivated because they may or may not be hesitant to express their views. Industry association executives are also worthwhile sources.
- Scuttlebutt is a two-way street so you must become knowledgeable enough to provide value to your sources as well.
- Characteristics of an attractive business include growth from new and existing products, a high profit margin and return on capital together with favorable trends for both; effective research; a superior sales organization; a leading industry position giving advantages of scale; and a valid "franchise" proprietary products or services.
- Management characteristics include integrity, implying conservative accounting; accessibility; an orientation toward long-range results (if necessary at the expense of this quarter) without equity dilution; a recognition of the pervasiveness of change; excellent financial controls; multidisciplinary skills; good personnel policies including management training.
- Too high profit margins attract competitors.
- A statistically cheaper #2 company in an industry is not a more attractive investment
- All things being equal, the shareholders of a well-run company are best served when the company constantly reinvests a substantial part of today's profits for continued growth. This assumes that the ROI is greater than if the shareholders received a dividend and invested it themselves. Or, a company could do a stock repurchase program.
- "It's a good deal easier to know <u>what's</u> going to happen than <u>when</u> it's going to happen."
- Fisher excoriates the "performance game" – those who pretend they can guess what is going to happen in the market a year – or indeed a few months from now.

❖ How Fisher does it:

1 Unlike the figures needed in Graham's approach, Fisher depends upon the grapevine or scuttlebutt machine that he develops with all his contacts. If you can't or aren't willing to develop this, hire an advisor.

2 Three phases in analyzing a business are:

- Absorbing the available printed material
- Triangulating through business sources
- Visiting management

❖ When to buy

1 Buy when earnings are depressed and investors are discouraged during the startup period of a new plant or investment.

2 Buy on bad corporate news or other temporary misfortune

3 Buy when an unusually large investment in plant is required in a capital intensive industry.

4 Don't hesitate to buy because of a war scare. "War is always bearish on money."

❖ Most investors instead buy when they've sifted through masses of economic data and conclude that the business outlook is favorable, sometimes even consulting investment newsletters or magazines, which tell them to hold off "until the outlook clarifies." Obviously the investor who holds off ends up buying with the crowd and pays a higher price. Bull markets end and bear markets begin in good times when everyone's optimistic. The bottom comes in bad times when everyone's desperate. So, it's safest to do the opposite of what Wall Street consensus indicates (note how similar this is to John Templeton's advice).

❖ Stock prices rise when you have a combination of rising earnings and rising PE multiple.

❖ When to sell:
"If the job has been correctly done when a common stock has been purchased, the time to sell it is – almost never." The two exceptions are: you made a mistake in your original appraisal or if the company ceases to qualify under the same appraisal method. A possible third is that the company may get so big in its own market that it cannot do much better than its industry or indeed the economy as a whole. A fourth is that you discover a particularly attractive new opportunity so you cut back on holding with lesser growth prospects. Be careful though since you probably know less about the new company than the old one, about which you have been learning more and more for years, so there is a risk of making a mistake.

❖ You cannot know almost everything that could be important about more than a few companies. The years of increasing familiarity with companies should not be thrown away.

❖ You should not sell because you think that a stock is at too high a price – has "gotten ahead of itself" – or because the whole market is due for a slide. Selling for either reason implies that you are clever enough to buy the stock back more cheaply later. But in practice, you almost always miss the stock when it recovers. And you have the taxes. If you think the stock has a reasonable prospect to triple, why sell it if it is 35% overpriced today. And there is always the possibility that the stock's price reflects good news that you don't know about yet.

- The silliest reason to sell is that the stock price has gone up a lot. A truly great company will grow on and on. That it has advanced substantially since you bought it only means that everything is going as it should.

- Service companies and others without realizable values in solid assets were once viewed with suspicion; today it's the other way around because investors worry that every plant may be a potential buggy whip factory which will earn money for the workers and the government but not for its owners.

- Whether a given investor needs a higher dividend depends on what stage the investor is in in managing their affairs. If an investor can save money, then it's more efficient for him to have a company plow back its cash into the business.

- High dividend stocks perform worse, price-wise, than low dividend stocks.

BENJAMIN GRAHAM

- Wrote among other books -- <u>The Intelligent Investor</u>. This is for most people an easier read than his <u>Security Analysis.</u>

- Graham believed you could pick stocks solely through looking at their numbers (financials) without concern for the quality of the business or the character of management.

- Graham's investment pool, called the Benjamin Graham Joint Account, declined 70% (as compared to 74% for the Dow and 64% for the S&P500) from 1929 to 1932. Margin made the numbers worse. He was personally wiped out even though he had originally ducked 1929. He was enticed back in before the final bottom.

- Graham's greatness as an investor may well have been his ability to say "No". He felt no compulsion to invest at all unless everything was in his favor. (Recall Buffett's commentary – "Swing you bum!")

- Diversification was important to him yet he always kept one foot out the door ready to run if his calculations went awry. This caused him to miss major market moves. Besides reentering the market too soon in the thirties, he missed the great bull move starting in 1950.

- All his professional life he sought an entirely quantitative method for stock picking – one that didn't depend on anything one couldn't be sure about such as social trends, new products, and quality of management.

- Toward the end of his career, he developed three tools for identifying a bargain stock which he said rendered his earlier more elaborate technique less necessary.

- Graham constantly made a distinction between an "investment" and a "speculation." An "investment" must be based on "thorough analysis," must promise "safety of principal" and a "satisfactory return." If any of these are missing, it is a speculation.

- A lack of "thorough analysis" is mere guessing and constitutes most of what passes for investment in the stock market. By his willingness to accept bets at the wrong odds, the speculator gives the investor his opportunities.

- Graham says that not every security can be analyzed and the outlook for many companies is indeterminable.

- Real earnings consist of dividends paid plus the increase in net assets per share – which usually appears as the change in earned surplus, including voluntary reserves.

- Graham believes it is a mistake to just compare this year's earnings to last year's without determining whether the company's position has really improved by that amount.

- The market pays no attention to underlying reality during periods of speculative enthusiasm.

- "It always seemed, and still seems, ridiculously simple to say that if one can acquire a diversified group of common stocks at a price less than the applicable net current assets alone – after deducting all prior claims and counting as zero the fixed and other assets – the results should be quite satisfactory." The key is "if you can find enough of them to make a diversified group and if you don't lose patience if they fail to advance soon after you buy them. Sometimes the patience needed may appear quite considerable." In the Intelligent Investor, he gives and example of having to wait 3 ½ years for one stock.

- His "bargain issue" approach – a company selling for less than its net current asset value – provides the easiest of thermometers for the overall temperature of the market. Lots of "bargain issues" means the market is depressed.

- It makes sense to put a lot of money in one enterprise that you are directly involved in yourself (as an executive of a company might) though for an outsider to do this is difficult and usually unsuccessful because he is usually so nervous about his holding that he sells out prematurely.

- It is extremely difficult to decide just what a growth stock is and even when an investor is right he usually doesn't have the confidence to take advantage of it.

- Growth funds seem compelled to buy "official" growth stocks. So one must really buy growth stocks before they are generally recognized – when their PE ratios are little more than the rest of the market.

- Curiously for all his deprecation of overpaying for growth he suggests that 30x for a stock with sustainable growth of 14% is OK (as is 23x for 10%, 41x for 20%).

- Preferred stocks issued at par offer neither the security of a bond nor the growth potential of a stock.

- Graham is suspicious of exotic securities such as convertibles and warrants and IPOs because IPOs are usually brought out when the speculative pot is boiling and convertibles are "fair weather instruments" in good times they do well but not as well as common stocks and in bad times they do worse.

- Graham reaffirms the Wall Street maxim, "Never convert a convertible."

- Graham invented "Mr. Market".

  1. The passion of the crowd creates over or under valuation. You have to be like a doctor working over a patient who has fallen to the ground in a riot – rarely lifting your head to contemplate the madness around you.

  2. Let's suppose we own an interest in a business with a partner – Mr. Market. Everyday Mr. Market, depending upon which side of bed he got out of and the dreams or fears that possess him at the moment, sets a price at which he will either buy us out or sell us more of an interest in the business. Most of the time we need pay no attention. Only if our sober study of the facts – of which we know as much as Mr. Market – convinces us that his price is absurdly high or low need

we take notice of his offer. We need never to act except to make an advantageous trade. At other times the true investor "will do better if he forgets about the stock market and pays attention to his dividend returns and to the operating results of his companies."

- ❖ One should never buy a stock because it has gone up or sell it because it has declined. "Never buy a stock immediately after a substantial rise or sell one immediately after a substantial drop."
- ❖ On "Predictive Formulas" he demonstrates that they lose their utility just when a playback shows them to have worked well retrospectively.
- ❖ Excluding GEICO stock, Graham was never managing more than $20 million.
- ❖ At the end of his life, he reversed some of his ideas because everyone was using those techniques and he thought there was little hope of outsmarting everyone else.
- ❖ His new techniques included buying stocks at less than their working capital value, a debt/equity ratio that is less than one, earnings yield twice the prevailing AAA bond yield (5% bond/10% earnings yield/10 PE).
- ❖ Sell When:

  1 Its gone up 50%

  2 After 2 years, whichever comes first

  3 If the dividend is omitted

  4 Current price is 50% over new target buying price

- ❖ When the formula wears out move on, which it will inevitably do since any formula is likely to be rendered obsolete by events. Its own success will eventually be its undoing. Any simple mechanical technique without the "leap of faith" required in all investing is bound to wear out, lose followers, and eventually come back again (like the tides or the wheel coming full circle).

STANLEY KROLL

- ❖ Commodity trader, yet techniques that are apropos to stock investors.
- ❖ For 13 years as commodity broker, he let his clients call the shots and lose their money. Then he had a revelation. He left the retail side and began trading for his own account and anyone else who let him call the shots (which at first were few).
- ❖ His system is to wait until a major trend is clearly established and then do your buying and selling during periods of correction against that trend. When the trend finally concludes, liquidate.
- ❖ ***A typical mistake investors make is to increase the size of their orders as the trend continues: they pyramid. As a result when the trend finally reverses, they lose money very fast, since most of their money was invested near the end of the move. Kroll invests less and less on each correction, so when the turn comes, he still has good profits even though his last few trades were unsuccessful.
- ❖ When the major trend does change definitively he only sells into strength, not weakness.
- ❖ How to recognize major trends?

1. The broader the market the more identifiable the trend, i.e., if GM is going up (and an uptrend in GM is identifiable) then the whole market is going up. Small stocks however, jump around more erratically.
2. You can still be wiped out by manipulators.

- ***Never argue with the market. If the trend turns against you get out. With commodities (unlike stocks) never average down.
- Exclude any information that you are not certain is completely true.
- A commodity "fact" is probably fiction. Anything true is already reflected in the market. The market action, if you know what it means, will tell the true story.
- ***The easiest way to purge oneself of the herd instinct is to simply not know what the crowd is doing so he refuses to listen to "news."
- Inspiration and whims are almost always expensive.
- One of his favorite quotes is from Edwin LeFevre's <u>Reminiscences of a Stock Operator</u> about how you never grow poor taking profits. But neither do you grow rich taking a four-point profit in a bull market. Where I should have make $20,000 I made $2,000. That is what my conservatism did for me.
- ***Another quote: "It never was my thinking that made the big money for me. It was always my sitting. My sitting tight. You always find lots of early bulls in bull markets and early bears in bear markets. Men who can be both right and sit tight are uncommon. I found it one of the hardest things to learn. But it is only after a stock operator has firmly grasped this that he can make big money."
- ***An expression attributed to Jesse Livermore, "Money is made by sitting not trading."

T. ROWE PRICE

- Seeking the "fertile fields of growth", and then holding growth stocks for long periods of time.
- A growth company is one with "long-term growth of earnings, reaching a new high level per share at the peak of each succeeding major business cycle and which gives indications of reaching new high earnings at the peak of future business cycles. It may have declining earnings <u>within</u> a business cycle.
- Industries and corporations both have life cycles and the most profitable and least risky time to invest is <u>during the early stages of growth</u>. After a company reaches maturity, risk rises.
- If he bought at 20 he established that he would sell some at 40 even if everything changed for the good. Likewise, if he determined to buy more at 13, so he would, even if the news from the company was discouraging.
- Nothing grows in the shadow of an oak. The strong-willed loner has weak followers.
- He held Black and Decker for 35 years, Honeywell for 34 years, 3M for 33 years, Merck for 32 years.
- Price's requirements for growth companies:

1. Superior research

2. Lack of cutthroat competition

3. A comparative immunity from governmental regulation

4. Low total labor costs, but well paid employees

5. At least 10% ROE (invested capital) with high profit margins and superior EPS growth

- Investors also need experience and judgement, must take into account social, political and economic influences.

- Price was "qualitative" while Graham was "quantitative". Graham believed the qualitative led to subjectivity and impressionism.

- To capitalize on the "fertile fields for growth," first identify an industry that is still enjoying its growth phase and then identify the most promising company within that industry.

- The two best indicators of a growth industry are unit volume of sales (not dollar volume) and net earnings. Investors are usually aware of the most exciting companies but are not aware when they are maturing. When an industry is going downhill it might do so on "leverage" – carrying profits down even faster than unit volume.

- New growth products can cause an old industry to experience new growth.

- The best companies in an attractive industry show profits right through the down phase of a business cycle or by showing higher earnings from peak to peak and bottom to bottom through several cycles.

- Qualitites that can contribute to a companies superiority are:

1. Management

2. Research

3. Patents

4. Strong finances

5. A favorable location.

- ***Price does not believe in the <u>specific prediction</u> of a company's future. Just stick with the best companies in the highest growth industries. "Do not try for a pinpointed mathematical approach that creates an illusory certainty out of an unknowable future."

- Market washouts create greater opportunities in cyclical growth stocks than stable growth stocks. Starting from the bottom of a bear market first buy washed out cyclical growth stocks then stable growth that never went down as much. Later in his life he abandoned this due to taxes. He focused on finding good stocks that he could just buy and hold.

- Watch the earnings yield. It's the inverse of the PE ratio. It's the investors' own return on the money he has invested. The low return on a growth stock bought at a high multiple becomes serious when bonds are offering attractive yields as an alternative.

- When buying growth stocks, have a specific plan that is written out and adhered to.

1. Valuation

- A record of earnings growth.
- Growth stocks (especially the ones you are interested in) are out of fashion.
- "Blue chips" are worth higher multiples.
- Stable growth stocks are worth more than cyclical growth stocks that are subject to vagaries of the business cycle, and of course cyclical are worth a higher multiple of their recession earnings than of their boom earnings.
- One should pay a lower multiple of earnings for growth stocks when bonds are available at high yields.
- When the general level of stock prices is low enough so that they are yielding 5% or more, you should pay a lower PE for growth stocks than when stock yields are low. An appropriate PE might be 33% over the lowest PE the stock touched.

2 Scale Buying

- As a stock fell to his target buying range he started buying, without bottom fishing which he felt didn't pay. He might have done some buying near the low but his average price was usually near his original target.

❖ When selling, watch for:

1 A decline in the return on investing capital

2 Business recessions which create a confusing background noise

3 Some industries have their own cycles separate from the business cycle, confusing things further

❖ Scale selling

1 Wait until it has risen 30% over its upper buying price limit. Then sell 10% and another 10% when it had advanced 10%.

❖ Later in life he changed to 3 categories of growth stocks:

1 Growth stocks of the future.

2 Older seasoned growth stocks with less dynamic prospects.

3 Mixed bag including natural resource companies at "receivership prices."

❖ Always employ as the highest investing virtues:

1 Common sense

2 Realism

3 Flexibility

JOHN TEMPLETON

- In 1939, after the war had broken out, he bought one hundred dollars worth of every single stock on both major exchanges selling for no more than one dollar per share. He ended up with 104 companies of which 34 were bankrupt. He held each for an average of four years and got $40,000 for the whole group.

- Templeton bought only what was being thrown away and held for an average of four years.

- ***At 56 he sold his firm and started all over again. He said that having many different clients had made him so busy he couldn't think about his investments. He also moved to the Bahamas where he could get away from the thinking of the "crowd".

- A small fund is more flexible and a commitment in the stock of a small company can substantially affect fund performance if it doubles.

- Templeton does not need to stick to large familiar names: what trust companies wrongfully call quality. An established small specialty company with fat profit margins selling for a low PE is often a safer investment – if you are sure you have the facts right – than a huge, mediocre, heavily unionized and regulated standard industrial that sells at a high PE because everybody knows about it. Managers of large portfolios avoid smaller companies.

- The fund's portfolio consisted of 220 names for diversification.

- Templeton's basic philosophy is: "Search among many markets for the companies selling for the smallest fraction of their true worth."

- The best bargains will be in stocks that are completely neglected, that other investors are not even studying.

- It can be remarkably tricky to invest in a people business. If things go well, the insiders will want to increase their "take."

- "A flexible viewpoint is the professional investor's greatest need, and will be increasingly needed in the future." At some time almost anything is likely to become a bargain, if you're in a position to evaluate the neglected factor that will change things for the better. You need the ability to recognize unfamiliar values.

- Watch out for industries that are natural candidates to be socialized and watch out for inflation.

- How does the investor escape from the unending static of "news" and opinion, the surge and ebb of the passions of the crowd? Experience. After getting bloodied for so long jumping on every bandwagon, one learns some measure of detachment from the crowd's enthusiasms and desperations. Templeton's location at Lyford Cay in the Bahamas helps him.

- Templeton, as well as Fisher, depends on industry scuttlebutt as well as studying portfolios of other funds.

- Questions he asks management:

  1 Do you have a long-range plan?

  2 What will be your average annual growth rate?

  3 Why should the future be different from the past?

  4 What are your problems?

5. Who is your ablest competitor and why?

6. If you couldn't own stock in your own company, which of your competitors would you want to invest in and why?

- ❖ Once a stock goes up and is no longer a bargain, if he finds a much better buy, out goes the first one.

- ❖ Templeton thinks he may be overly patient so now if, among two stocks, one is starting to attract interest and the other is still in eclipse, then he gives preference to the one that is starting to move.

- ❖ Crucial analytical factors:

    1. PE

    2. Operating profit margins

    3. Liquidating value

    4. Growth and consistency of earnings

- ❖ It takes neither training nor experience to go out and buy a highly visible premier growth stock without regard to price.

- ❖ ***Everything has its season, which does not last forever. The world changes its spots, and the investor must change his. The cardinal rule is flexibility. You must get ready to change when everything seems to be working particularly well. When the cycle is perfectly in gear with your expectations, prepare to jump.

- ❖ ***Don't trust rules and formulas.

LARRY TISCH

- ❖ I have no system like Graham, I'm a pragmatist. Most people don't have the discipline to stick to a system. I just wait until the fourth year, when the business cycle bottoms, and buy whatever is offered, whatever I think will have the biggest bounce. Coming off the bottom, lots of things will double or triple before the next peak in the cycle, two or three years later. You never know what they'll be.

- ❖ Referring to whether growth or value is better: No, anything has its price.

- ❖ "The one thing I look for most is free cash flow after all capital expenditures." Profits that have to be reinvested in more capital outlays may not really be profits at all. "Most of the time you should expense capital outlays in the year they are incurred, not capitalize them and add them to the balance sheet. More and more, a big company has to go on spending money just to maintain its existing earnings stream. Isn't that really an expense, rather than something that should be considered as a true increase in value?"

- ❖ The biggest mistake corporate managers make is <u>ego</u>. The second biggest problem is a manager who surrounds himself with yes-men. The third biggest is a variation of the second. The manager who isolates himself. Another big problem in companies is that mediocre people eventually get to the top – the guy who waits the longest becomes the boss.

- ❖ Tisch makes money because he acts in <u>opposition</u> to the mass of investors who lose to Tisch every time they change course. They can't beat the market. They <u>are</u> the market.

## ROBERT WILSON

- ***Wilson's rule: any successful approach to investing is bound to fail in due course.

- Wilson gets his ideas from talking to others.

- The major difference between Wilson's approach and others is that he insists on stocks in which there is a major risk, because only such a stock is likely to go way up. "Unless there is fear in a stock, it probably doesn't have a great capital gains potential." Yet he is enraged when he hears, "there is no downside risk in this stock."

- Don't try to anticipate how fast competition will undercut an established company there's no use theorizing; its best to wait and see what really happens.

- Companies are often destroyed not by competition but by themselves. They get soft.

## MASTERS COMPARED

- Fisher, Price, and in a way Buffett, all practice variations on the same basic approach: plant a tree and watch it grow and grow. Buy a successful growing business and share in the building of value as it develops. The method isn't too risky if the price is right. Stick to what you can know a lot about: if the business has been growing, and is growing, you have reason to believe it should go on growing for at least a while.

- Graham, Tisch, and Buffett look primarily for what's so cheap right now that you almost can't lose.

- Buffett understands business and thinks like a businessman (which Graham did not) thus he emphasized the importance of a business franchise, and of excess assets in a company, which can be redeployed for the benefit of the owners. He won't pay a high multiple. Earnings yield should be as high as the prevailing bond yield and he's glad to sell when a stock becomes high priced.

- Fisher understands growth and identifies specific companies while Price understands growth through the "fertile field" of an industry.

- Price and Fisher felt growth will attract good management.

- Price took the longest view and he expected to pay a premium for long solid growth. He emphasized solid growth like Buffett and Fisher.

- Graham wanted a <u>financial</u> bargain. Templeton wanted a company that in a few years would be worth more than its present market price even if it wasn't worth it today. So, Templeton is both a growth and value investor.

- Cabot and Tisch have no method except thoroughness and realism. Everything is specific. Let the public have the big ideas and sell them your stock. Let the public get disillusioned – and buy the stock back again. They are only looking for quality merchandise, but not the best possible companies, as Buffett is. Cabot will look farther ahead and take bigger risks.

- Each master has certain common attributes:

    1 Realistic – flexible

2 Intelligent

3 Dedicated to his craft

4 Disciplined and patient

5 Loner

- On flexibility: It's sufficient to be a master of one game rather than trying to learn two or three as long as you retire to the sidelines when the game you know is no longer being played.

- ***Within one's craft, one must not waste time and skill on unproductive inquiries. That's where disciple enters. Abandon unattainable objectives such as trying to make money in short term trading, trying to discover the unknowable, technical analysis, or investing according to formulas, particularly if they require a computer to apply.

- ***Don't follow so many companies that you know less than the person you are buying from or selling to.

- ***Patience, which comes from knowledge and discipline, seems to be the hallmark of a professional. If you know you're right it's not hard to wait. If you don't know and aren't disciplined, you risk getting shaken out just at the wrong time.

- All great leaders, artists, and thinkers have to be loners; since buying what the crowd spurns and selling what the crowd craves is the essence of the master's art. He must be serenely able to do the opposite of the herd, even though the herd instinct is the strongest human emotion.

CONCLUSIONS

- Investment Do's:

1 Avoid popular stocks. During bursts of enthusiasm, let a stock rest for awhile if it has run up wildly over a period of days or weeks. A highly favorable purchase is likely to seem odd, uncomfortable, risky, dull or obscure at the time you buy it.

2 Avoid fad industries. A way to spot this is if mutual funds are formed to concentrate on an industry in question or if companies' stocks jump because they announce that they propose to enter a field. When a company changes its name to indicate going into a new industry, its time to be skeptical of that industry.

3 Avoid new ventures. Venture capital is for pros, not passive portfolio investors.

4 Avoid "official" growth stocks.

5 Avoid cyclical heavy-industry "blue chips" that have static earnings and sell for too high a price because of their security.

6 Avoid gimmicky investment products with high transaction costs.

7 Bonds don't preserve capital (unless you reinvest all the income).

8 Forget about technical analysis. The study of value is the basis of stock investment. There are no shortcuts. The "technician" however, tries to predict stock movement without reference to value. It is not knowable from what a stock did last month or last year how it will do next month or next year.

❖ What does work? One must start by asking for whom? What works for one person may not work for another because of personality differences. Remember that someone is selling what you buy – probably someone who knows everything you do, and possibly someone who knows a lot more.

1 Only buy a stock as a share in a good business that you know a lot about.

2 Buy when stocks have few friends – particularly the stock in question. You must have knowledge and nerve.

3 ***Be patient: don't be rattled by fluctuations, particularly if it goes down right after you bought it. Don't then sell thereafter when it recovers to your purchase price. Your cost is an accident. The quote doesn't affect the company's outlook. Watch the business, not the quote.

4 Invest, don't guess. Don't "swing for the fences" or try to "catch the bounce off the bottom." As Buffett says, only buy something that you'd be that you'd be perfectly happy to hold if the market shut down for ten years.

5 High yields are often a trap. Good companies have better opportunities for that cash in their own businesses. Watch out for companies who are taking on debt faster than it's paying out dividends.

6 Only buy what's cheap right now, or almost sure to grow so fast that it very soon will have been cheap at today's price.

7 If stocks in general don't seem cheap, stand aside.

8 Keep an eye on what the master investors are doing.

9 Buy a mutual fund if you find all this work too hard.

10 Figure out what your philosophy is and stick to it. Your philosophy should match:

- Your experience and skill
- Your tolerance for yield and volatility
- Your tax bracket

11 Be flexible. The old order, as its principles are overused, must always yield place to the new – not that the new is ever really new.

❖ From theory to practice.

1 For Value – Ben Graham. Read The Intelligent Investor.

2 For Growth – Fisher, Price (with Buffett criteria).

- This approach does offer the chance to lose money toward the end of a major bull market. Almost nobody has the tough independence of spirit to get off the bandwagon when it is in full gear. Guard against pyramiding. Note: a hedge fund manager, working for a big cut of realized profits, can put a fortune in his pocket toward the end of a bull market without having to disgorge it when the collapse follows, so he's very tempted to overstay the party.

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