

Principles of value investing still hold true

By Dan Richards

Five time-proven lessons from Benjamin Graham.



At a recent lunch with a group of financial industry insiders, a debate arose over the top investor of all time.

Some of the names put forward were obvious: Warren Buffett, Peter Lynch, John Templeton and George Soros; one contrarian made the case for J.P. Morgan or the Rothschilds. Personally, I was with the contrarian.

But when conversation shifted to the most influential investor, the one person whose beliefs most transformed the investment profession, there was universal agreement on Benjamin Graham, considered the father of value investing, yet a name unknown to the average investor.

Today's markets can seem overwhelming, what with algorithmic computer trading, complex

financial derivatives and increasingly complicated products like leveraged exchange-traded funds.

The good news is that individual investors and financial advisers can still ignore all the noise and do well following the disciplines of value investing laid out 75 years ago by Mr. Graham.

A professor of finance at Columbia University from 1928 to 1957, Mr. Graham's views shaped a generation of money managers.

Among them was Mr. Buffett, who enrolled at Columbia with the explicit goal of studying with him and who joined Mr. Graham's firm after graduating with his master of economics.

Mr. Graham was co-author of *Securities Analysis* and *The Intelligent Investor*, written in 1934 and 1949, respectively, books that are considered investment industry classics and still used today – Mr. Buffett describes *The Intelligent Investor* as the best book on investing ever written.

Mr. Graham did more than just teach: The investment company he headed registered annual returns that topped 17 per cent over a period of 20 years.

Here are five tips from Mr. Graham that still serve investors well:

Lesson 1: Bringing discipline to investing

More than anyone else, Mr. Graham transformed investing from an art relying on instinct and hunches to a science, focusing on in-depth analysis and unwavering discipline.

Mr. Buffett has said of his professor: “Ben Graham taught us to look at stocks as businesses, use the market’s fluctuations to your advantage and seek a margin of safety. A hundred years from now, these will still be the cornerstones of investing.”

Lesson 2: Seeking a margin of safety

Mr. Graham believed the most important principle of investing was “margin of safety,” a core concept still employed by investment professionals. The margin of safety is the gap between what you can buy a stock for and what Mr. Graham called its intrinsic or true underlying value.

To this day, top money managers refer to the margin of safety when explaining why they take positions in companies; for example, you’ll sometimes hear money managers describe their philosophy as buying 100 cents of value for 50 cents or 70 cents, putting in place the concept of buying with a margin of safety.

Lesson 3: The elements of sound investments

In Mr. Graham’s view, the bigger the gap between a company’s stock price and its intrinsic value, the safer an investment and the greater the likely return.

He advocated seeking out companies with strong balance sheets, conservative financing, solid profit margins and strong cash flow. He was an especially strong proponent of companies that paid dividends that regularly rose.

Lesson 4: Investing v. speculation

Like his student Mr. Buffett, Mr. Graham was dismissive of speculators looking to get into and out of the market for quick profit. He would have found the trend to high-speed, in-and-out trading anathema.

Among his writings on this topic: “An individual should act consistently as an investor and not as a speculator. This means that he should be able to justify every purchase he makes and each price he pays by impersonal, objective reasoning that satisfies him that he is getting more than his money’s worth for his purchase.”

Lesson 5: Removing emotion from investing

Mr. Graham was also firm in his view that market valuations are often wrong. Using an apocryphal character named “Mr. Market,” who shows up at an investor’s door every day offering a different price for a stock, he wrote about the swings in sentiment that cause prices for the same company to rise and fall.

He was among the first to describe the effect of human emotion on the market with the lines: “Most of the time, common stocks are subject to irrational and excessive price fluctuations in both directions as the consequence of the ingrained tendency of most people to speculate or gamble ... to give way to hope, fear and greed.”

Among Mr. Graham’s other notable contributions on this topic was the metaphor of the market as a voting machine as opposed to a weighing machine: “In the short term, the stock market is a voting machine, with its prices based on the continually changing opinions of emotional, fickle investors, but in the long haul, the market is like a weighing machine,

measuring the value of stocks' underlying businesses.”

The result, he wrote, offers investors “an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal.”

It's easy today to be swayed by vocal opinion, be confused by conflicting advice and be influenced by cable TV oracles who sometimes seem to be competing for who can make the most extreme and outlandish statements.

In times such as these, it's remarkable how often the best advice is the old advice – many investors would be well served to look to Benjamin Graham's time-proven advice to chart their investment course.

Dan Richards is president of Strategic Imperatives. He is a faculty member in the MBA program at the Rotman School at the University of Toronto. richards@getkeepclients.com

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