Investment Managers • Stockbrokers • Financial Advisers
Established 1872

Learning from the Greats

Access True Investment Wisdom

First in this Series:

Benjamin Graham

Key insights:

- *"An investment operation is one which, upon thorough analysis, promises safety of principal and an adequate return. Operations not meeting these requirements are speculative."*
- *"You must thoroughly analyse a company, and the soundness of its underlying businesses, before you buy its stock; you must deliberately protect yourself against serious losses; you must aspire to 'adequate', not extraordinary, performance."*
- *"The intelligent investor is a realist who sells to optimists and buys from pessimists."*

History ● Experience ● Foresight

Dedication

This essay is one in a series that examines the mindsets and methodologies of people who have won the approval of those for whom they have provided sound investment advice.

We believe readers will find a common thread that links the thinking of each subject of the essays.

Without question, none of 'the greats' have ever depended on luck; each has displayed patience, pragmatism, and a sound process.

We hope you enjoy and gain great personal value from each essay.

Definition

Buying into a market

"Even when the underlying motive of purchase is mere speculative greed, human nature desires to conceal this unlovely impulse behind a screen of apparent logic and good sense"

Benjamin Graham
'The Intelligent Investor'

Researched, written and presented by Eddie Lees,

a member of the Joseph Palmer & Sons Investment Committee.

Sourced from the author's private library and online resources.

January, 2019.

The Father of Value Investing

Benjamin Graham

A smartly dressed, thirty year old man boarded a train in New York city bound for the annual general meeting of the Northern Pipeline company; it was a little odd, to say the least, that the AGM would be held in Oil City, a small town in Pennsylvania, almost 400 miles from where its headquarters were located, just blocks away from Wall Street.

The dapper gentleman was Benjamin Graham, the year was 1926, and he was on an important mission. In the aftermath of the enforced breakup of Standard Oil, eight of the resulting companies were small operators of pipelines. While researching opportunities to invest in railway corporations (the giant organisations of their time), Ben Graham had stumbled across invaluable data on pipeline companies—data that were largely unavailable to regular stock market investors.

As a bright young man, who had embarked on a career in investing, Ben was a meticulous researcher, forever seeking value in the nooks and crannies of official reports of companies large and small.

What he had uncovered in the Northern Pipeline company was the fact that, despite the price at which the stock was quoted, the intrinsic value of the company was far higher.

He later recalled, *“I discovered*

all of the companies owned huge amounts of the finest railroad bonds; in some cases the value of the bonds alone exceeded the entire price at which the pipeline shares were selling in the market! I found, besides, that the pipeline companies were doing a comparatively small gross business, with a large profit margin, that they carried no inventory and therefore had no need whatever for these bond investments. Here was Northern Pipeline, selling at only $65 a share, paying a $6 dividend – while holding some $95 in cash assets for each share, nearly all of which it could distribute to its stockholders without the slightest inconvenience to its operations. Talk about a bargain security!"

Building New York (1926)
[No safety harnesses]

His conclusion was, *"I had treasure in my hands."*

Ben Graham's mission to Northern Pipeline's AGM was, as a shareholder, to address the board of directors and alert them to the opportunity to release value in the form of a dividend which exceeded the quoted share price.

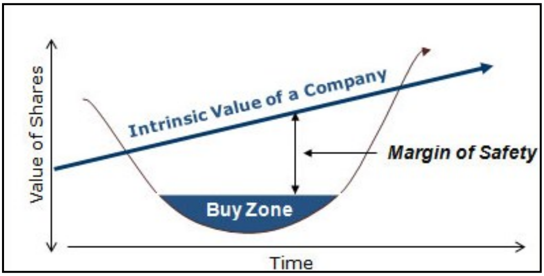
The board had been surprised that a single shareholder would travel such a distance to attend their AGM (after all, these meetings were held in remote locations for the express purpose of discouraging such 'visits') and the chairman used a technical point to deny their guest any speaking time at all.

Furious at this turn of events Ben Graham returned to New York, where he contacted small shareholders to win their proxies in order to gain two of the five seats on the Northern Pipeline's board.

The strategy worked and shortly thereafter the company took up the plan and issued a sizeable dividend.

This authentic anecdote tells us a lot about Ben Graham, not least that he was extremely perceptive as well as clever in simplifying complex ideas, all of which are in use by many successful investors to this day:

- His interest was not in running the companies in which he invested, rather his focus was to discover value that others simply did not see.
- A prime component of his approach was extensive research.
- He believed very much in establishing ' the intrinsic value' of the companies he considered and especially those in which he invested.
- He coined the name for the 'margin of safety' concept, which he created (see image).
- He created the allegory of 'Mr Market' who, every day, offers each investor a price for their securities: the price might be just right, or too high, or too low—but it is always there and investors can calibrate whether to hold, buy or sell; but at least, they should evaluate.



The 'margin of safety' concept simplified: it exists when a company's share price is significantly below its intrinsic value.

Benjamin Graham's private life is not well known, though it is fair to assume he fell for attractive women, having been married three times. Two of his sons died tragically (one by spinal meningitis, another by suicide).

He was born in the UK in 1894 (with the surname Grossbaum, which he later changed) and, when one year old, emigrated to

New York with his parents.

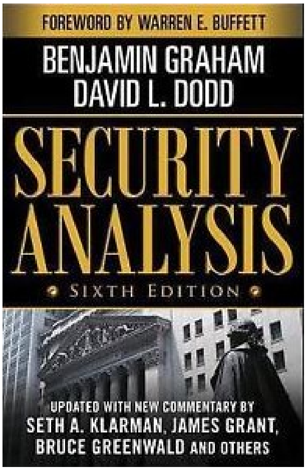
He became a brilliant student and arrived at Columbia University by way of a scholarship.

He graduated a ‘salutatorian’ and was second in his class at 20 years of age being then invited to teach at the university; his father had died, however, and left the family poor.

Ben’s need to support the family led him to take a job on Wall Street. His role at the firm of Neuberger, Henderson and Loeb saw him start on menial tasks (he was a ‘chalker’ at the outset) but his energy, education and enterprise saw him made a full partner in 1920

Three years later, at age 26, he set up his own partnership and five years after that (already a successful investor) he began giving lectures at his alma mater.

Students flocked to his sessions, which grew in popularity. Cooperating with student David Dodd, Graham published his first book, *Security Analysis*, in 1934. This technical treatise on investing has never been out of print and is still used in courses on investing.

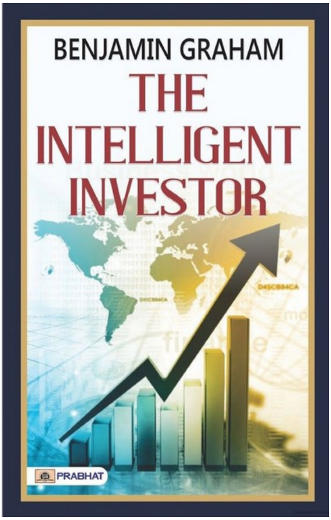


With his investment firm (Graham Newman Partnership) growing ever more successful and his lectures fully attended, Graham published his second book in 1949.

This was the *Intelligent Investor*, a shorter book than his first and written with the lay person in mind. It, too, has never been out of print. In fact this book is still featured in Amazon’s top 300 best sellers.

Being a polymath, Ben Graham was exceptionally well-read and often peppered his writings with quotes from the Greek and Roman poets.

In the 1950 student intake was a 19-year-old, fresh-faced youth from Omaha, Nebraska. His name was Warren Edward Buffet. Before long, this young man was smitten with his lecturer and became a disciple of the his teachings, later declaring that reading the *Intelligent Investor* changed his life, and that it is '*the best book about investing ever written'.*



He was so taken by what he learned from his tutor that he offered to work for his firm, without salary, just so he could learn more.

Buffet wasn't the only student to greatly profit from Graham's teachings.

Others included: William Ruane, Irving Kahn and Walter Schloss ,whose funds vastly outperformed the market.

The significance of the achievements of Graham's alumni cannot be overestimated and nor can their adherence to his invaluable insights and strict investing principles, which included:

1. Using rigorous research to identify the 'intrinsic value' of the share price of every company under consideration.
2. Making the concept of the 'margin of safety' the bedrock of investment decisions; this terminology has largely been reconfigured as the need for desirable companies to have 'a moat'.
3. Being acutely aware that, as with other human decisions, psychology plays a very important role in investment evaluations, which serious analysts should ignore as 'noise' (rumours are not facts).

It is no accident that Warren Buffet (aided by long-term partner Charlie Munger) has become one of the wealthiest people in the world. And it is instructive that he places much of his gratitude at the feet of Ben Graham from whom he learned so much.

The great and successful investors don't simply invest in a company because of its name, or its latest boast, or promotion; they dig far deeper than that.

Their prime questions are the same as the redoubtable Mr Graham's:

- What do I really know about this company?
- What is its intrinsic value based on future earnings or the liquidation value of its assets?
- Pursuant to my research, will my investing clients (and myself) benefit from fractional ownership interests in the form of shares?

And these questions are further underpinned by Graham's concepts on 'investor psychology, minimal debt, buy-and-hold investing, fundamental analysis, concentrated diversification, buying within the margin of safety, activist investing, and contrarian mindsets' each of which are still being used by serious investors all over the world'.

Ben Graham, 'Dean of Wall Street', 'Father of Value Investing', died a wealthy man in France, aged 82, in 1976.

On a historical note, the investment firm Joseph Palmer & Sons was founded some 22 years *prior* to Ben Graham's birth. In its original incarnation, the firm transacted primarily as a stock broker.

The founder's great grandson and his team have transformed the business into a modern, sophisticated manager of client portfolios, now accessible to the general public.

Many of Ben Graham's processes, greatly enhanced by advanced technology, are what guide the firm's investment decisions to this day. A particularly perceptive insights is top of mind every day:

"In the short run, the market is a voting machine; in the long run, it's a weighing machine."

And the weight of one's investments depends largely upon who is selecting and managing one's portfolio.

Amen to that.

Malcolm Palmer
Managing Partner
Joseph Palmer & Sons

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