Picking Stocks After Facebook **June 1, 2012**

http://www.nytimes.com/2012/06/02/your-money/stocks-and-bonds/how-to-pick-stocks-after-facebooks-ipo.html?_r=1&ref=ronlieber

By RON LIEBER

It has been hard not to gawk these last two weeks at Facebook's unruly initial public offering and its declining share price. Any spectacle like this practically dares you not to stare.

And in its wake have come the inevitable lawsuits, a Securities and Exchange Commission inquiry and the ever-popular concession that "mistakes were made" without pointing fingers at those who actually made them.

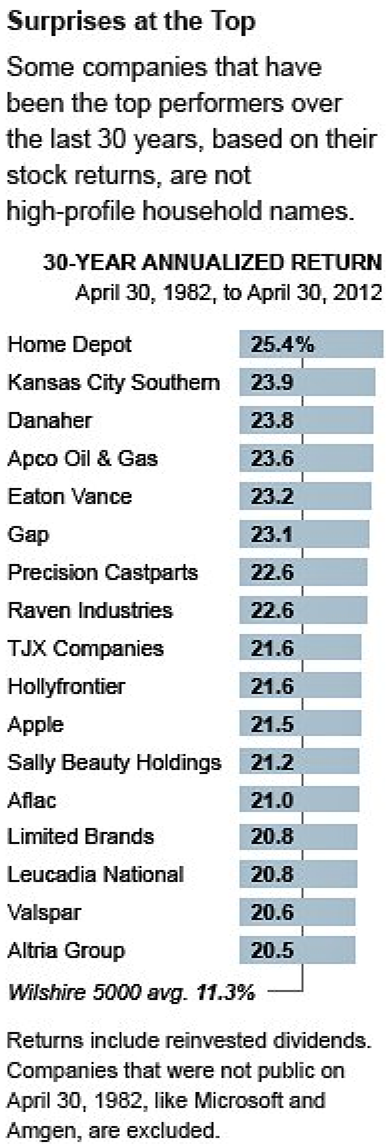
But it is investors who may be making the biggest mistake by drawing all the wrong conclusions. Facebook's I.P.O. was not a failure for Facebook, given the pile of money the company raised from willing buyers. Investors have lost nothing so far except on paper, save for those people who didn't consider the fact that the stock might actually go down and then sold out of panic or because they felt somehow cheated when the thing didn't pop.

And yes, many big institutional investors did get guidance from the underwriters' analysts when individuals did not. But who would expect anything different from a system that sure seems set up to use individual investors to create instant paper gains for the institutions that get first crack at the shares?

The real lesson here is how hard this stock-picking game is. Buying an individual stock is a wager on one company's unknowable future, and it can take decades of sustained investment in individual equities for your bets to really pay off, given that you're likely to have losers offsetting winners.

So this week, I asked Wilshire Associates to look back 30 years to the beginning of the big bull run in stocks and figure out which of the companies in its index of more than 5,000 American enterprises had performed best over that stretch.

My guess is that you haven't heard of half of the Top 10.



Back in 1982, would you have staked your claim on Danaher, the conglomerate that comes in at No. 3? Or might you have waited a few more years, until it was loaded up with debt courtesy of Michael Milken, the onetime junk bond king?

What about Apco Oil & Gas at No. 4? Or Precision Castparts at No. 7? Or maybe the high-tech balloons made by Raven Industries at No. 8 would have been more your taste. Ever heard of HollyFrontier at No. 10?

You get the idea. To have earned the 21 to 26 percent annualized returns (including reinvested dividends) that these companies delivered to investors over the last 30 years, you would have had to pick them out, invest enough to move the needle in your portfolio and then be smart enough to hang on.

Let's start with selecting the stocks. The top-performing stock on the Wilshire list is Home Depot. Was anyone pointing at that company back in the early 1980s and insisting that it was going to the moon?

"Oh no," said Arthur Blank, one of Home Depot's founders, when I asked him this week. "We had no idea that was going to happen. When we went public in 1981, we only had eight stores."

Indeed, the best investments are often the ones that few people have heard of, and sometimes the companies like it that way.

Take Danaher, which makes a variety of testing and dental equipment, among other things. Its founders are two brothers, Steven and Mitchell Rales, who named the company after a Montana fishing area and rarely talk to the media. Danaher executives did not return several calls for comment, and a former group president, George Koenigsaecker, said its silence had long been strategic. He helped oversee a transition to what became known as the Danaher Business System, a rigorous operating philosophy that survives to this day and wrings excess out of every part of every company it owns.

The company shunned most visitors. "There was little value to sharing this knowledge and your people with companies you might acquire and improve, as opposed to them acquiring your people and improving themselves," said Mr. Koenigsaecker, who is the author of "Leading the Lean Enterprise Transformation" and is still a shareholder. "I should have bought more."

As a true believer with intimate knowledge of the company even after his departure in 1992, Mr. Koenigsaecker had the willpower to hold on to the stock. But this is a hard thing to do for most individual investors.

To earn the kind of money that can change your life, you either need to avoid losers that offset your winners or make the kind of outsize bet that can yield large gains. But that's too scary for many people when they consider the possibility of losing the initial investment.

Still, it's tempting these days to take a chance on a can't-miss stock, given how many people have had the equity in their homes fall or have missed out on years of saving for retirement to pay for medical bills or food and shelter during periods of extended unemployment.

Yet it's this desperation that can lead people to buy at the wrong time and then sell in a panic during ugly stretches that high-performing stocks like Amazon (not eligible for the list since it wasn't around in 1982) and Apple (at No. 11) often experience along the way.

That said, some people do make a lot of money this way. It's a smaller number than you think, however, and it's magnified by the fact that those people really like to talk about it when it happens to them.

At least they are humble enough to express their undying gratitude, given the opportunity. "It's one of the great things, and we will always appreciate that," said Mr. Blank, the Home Depot co-founder, who said that investors stop him almost every day to thank him. "People were able to send their kids to college or buy a second home or retire early or take care of their parents or people who were ailing, or they became more philanthropic."

It's because of true stories like this — and not the ones you never hear, about people who gave up on Home Depot stock during a stagnant stretch during the 1980s or bought it while it bounced around over the last decade or so — that people will keep trying. Some will get lucky, but odds are that it won't be you and odds are that it won't be in Facebook.

Meanwhile, despite some scary periods in 1987 and 2001 and 2008, if you bought all of the stocks in the Wilshire 5000 index 30 years ago and then hung on to them, you would have earned an annualized return of 11.3 percent through the end of this April.

Many of the people who crunch these numbers for a living, like Robert J. Waid, the Wilshire Analytics managing director who oversees its indexes, look them over and do the same thing that an increasing number of people are doing. They simply buy indexed mutual funds and treat the Facebook spectacle for what it is — an opportunity for rubbernecking and bemusement. "I haven't owned individual stocks in 25 years," Mr. Waid said.

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The Secret To Incredible Returns From An Old Market Legend

The Daily Reckoning | **February 09, 2012** |

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(New York Daily News Archive /Getty Images)

"Every human problem is an investment opportunity if you can anticipate the solution," the old gentleman told me. "If not for thieves, who would buy locks?"

I just met this remarkable fellow, full of wisdom on investing, yet hardly known beyond a small group of fans. His name is Thomas Phelps, and he's had quite a career. He was *The Wall Street Journal's* Washington bureau chief, a former editor of *Barron's*, a partner at a brokerage firm, the head of the research department at a Fortune 500 company and, finally, a partner at Scudder, Stevens & Clark (since bought out by Deutsche Bank). Phelps retired in Nantucket after a varied 42-year career in markets.

Along the way, Phelps figured out a few things about investing. He conducted a fascinating study on stocks that had returned $100 for every $1 invested. Yes, 100-to-1. Phelps found hundreds of such stocks, bunches available in any single year, that you could have bought and enjoyed a 100-to-1 return on — if you had just held on.

This was the main thrust of our conversation: The key is not only finding them, but keeping them. His basic conclusion can be summed up in the phrase "Buy right and hold on."

"Let's face it," he said, "a great deal of investing is on par with the instinct that makes a fish bite on an edible spinner because it is moving." Investors, too, bite on what's moving and can't sit on a stock that isn't going anywhere. They also lose patience with one that is moving against them. This causes them to make a lot of trades… and never enjoy truly mammoth returns.

Investors crave activity. Wall Street is built on it. The media feed it all, making it seem as if important things happen every day. Hundreds of millions of shares change hands every session.

But investors need to distinguish between activity and results. "When I was a boy, a carpenter working for my father made this sage observation: 'A lot of shavings don't make a good workman.'" As you can see, Phelps is a man of folksy wisdom.

"Investors," Phelps continued, "have been so thoroughly sold on the nonsensical idea of measuring performance quarter by quarter — or even year by year — that many of them would hit the ceiling if an investment adviser or portfolio manager failed to get rid of a stock that acted badly for more than a year or two."

What investors should do is focus on the business, not on market prices. Phelps showed me financial histories of a long list of companies — earnings per share, returns on equity and the like. No stock prices. After one example, he asked: "Would a businessman seeing only those figures have been jumping in and out of the stock? I doubt it." But if they just sat on it, they'd be rich.

And this is the nub of it. Phelps is not a fan of selling good businesses.

He talked about how his friend Karl Pettit — an industrialist, inventor and investor — sold his shares of IBM stock many years ago to start his brokerage business. He sold them for a million bucks. That stake would eventually go on to be worth $2 billion — more than he ever made in his brokerage business.

Phelps told me the story of how he sold his Polaroid stock to pay a steep doctor's bill of $7,415 back in 1954. "Here is the confirmation of the sale," he said, which he keeps as a reminder of his folly. Less than 20 years later, his Polaroid stock was worth $843,000. That's an expensive doctor's visit.

Phelps also stands against market timing. He told me about how he predicted various bear markets in his career. "Yet I would have been much better off if instead of correctly forecasting a bear market, I had focused my attention through the decline on finding stocks that would turn $10,000 into a million dollars."

Because of his bearishness, he missed opportunities that went on to deliver 100-to-1. "Bear market smoke gets in one's eyes," he said, and it blinds us to buying opportunities if we are too intent on market timing.

"He who lives by the sword shall perish by the sword," he added. "When experienced investors frown on gambling with price fluctuations in the stock market, it is not because they don't like money, but because both experience and history have convinced them that enduring fortunes are not built that way."

Phelps showed me a little schematic that reveals how much a stock must compound its value to multiply a hundredfold:

35 years — 14%
30 years — 16.6%
25 years — 20%
20 years — 26%
15 years — 36%

You'll note that these are very long holding periods, but that's the point. The greatest fortunes come from gritting your teeth and holding on. You'll also see it's a fairly high hurdle. You need growth.

Read more: http://articles.businessinsider.com/2012-02-09/wall_street/31040325_1_investment-opportunity-investors-stock-prices#ixzz1x7XQZZEa

Of all the books on investing that I've read over the years, this one ***100 to 1 in the Stock Market*** was at once, the most pleasurable and most challenging to my own beliefs. Mr. Phelps spent over 40 years in and around Wall Street and the world of investing. His activities included being a private investor, columnist, analyst, author and financial advisor. His career spanned from just before the Crash of 1929 to the 70's.

In spite of the rather glamorous title, the book is actually about Buy and Hold investing. Yes, it is true that you could have made a million dollars by buying any of about 350 stocks he mentions if you had invested $10,000 and just sat back and watched it grow over time! Doesn't sound that exciting, does it? **However, I hope you didn't miss the point that he mentions AT LEAST 350 opportunities to have done this!** Most of the companies' names will be quite familiar to most readers.

Article by Chris Mayer

Quote

I just met this remarkable fellow, full of wisdom on investing, yet hardly known beyond a small group of fans. His name is Thomas Phelps, and he's had quite a career. He was The Wall Street Journal's Washington bureau chief, a former editor of Barron's, a partner at a brokerage firm, the head of the research department at a Fortune 500 company and, finally, a partner at Scudder, Stevens & Clark (since bought out by Deutsche Bank). **Phelps retired in Nantucket after a varied 42-year career in markets.**

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Article by Timothy Lutts

Quote

According to Mr. Phelps, you look for companies that provide:

1. Inventions that enable us to do things we have always wanted to do but could never do before.
2. New methods or new equipment that helps people do commonplace things easier, faster or at less cost than ever before.
3. Processes or equipment to improve or maintain the quality of a service while reducing or eliminating the labor required.
4. New and cheaper sources of energy.
5. New methods of doing essential jobs with less or no ecological damage.
6. Improved methods or equipment for recycling the materials used by civilized man instead of making mountains of waste and oceans of sewage.
7. New methods for delivering the morning newspaper without carriers or waste.
8. New methods or equipment for transporting people and goods on land without wheels.