**16 Investing Rules from Walter Schloss**

From a 1994 lecture given by the legendary investor walter schloss

 1. PRICE IS THE MOST IMPORTANT FACTOR TO USE IN RELATION TO VALUE  
  
2. TRY TO ESTABLISH THE VALUE OF THE COMPANY. REMEMBER THAT A SHARE OF STOCK REPRESENTS A PART OF A BUSINESS AND IS NOT JUST A PIECE OF PAPER.  
  
3. USE BOOK VALUE AS A STARTING POINT TO TRY AND ESTABLISH THE VALUE OF THE ENTERPRISE. BE SURE THAT DEBT DOES NOT EQUAL 100% OF THE EQUITY. (CAPITAL AND SURPLUS FOR THE COMMON STOCK).  
  
4. HAVE PATIENCE. STOCKS DON’T GO UP IMMEDIATELY.  
  
5. DON’T BUY ON TIPS OR FOR A QUICK MOVE. LET THE PROFESSIONALS DO THAT, IF THEY CAN. DON’T SELL ON BAD NEWS.  
  
6. DON’T BE AFRAID TO BE A LONER BUT BE SURE THAT YOU ARE CORRECT IN YOUR JUDGMENT. YOU CAN’T BE 100% CERTAIN BUT TRY TO LOOK FOR THE WEAKNESSES IN YOUR THINKING. BUY ON A SCALE DOWN AND SELL ON A SCALE UP.  
  
7. HAVE THE COURAGE OF YOUR CONVICTIONS ONCE YOU HAVE MADE A DECISION.  
  
8. HAVE A PHILOSOPHY OF INVESTMENT AND TRY TO FOLLOW IT. THE ABOVE IS A WAY THAT I’VE FOUND SUCCESSFUL.  
  
9. DON’T BE IN TOO MUCH OF A HURRY TO SEE. IF THE STOCK REACHES A PRICE THAT YOU THINK IS A FAIR ONE, THEN YOU CAN SELL BUT OFTEN BECAUSE A STOCK GOES UP SAY 50%, PEOPLE SAY SELL IT AND BUTTON UP YOUR PROFIT. BEFORE SELLING TRY TO REEVALUATE THE COMPANY AGAIN AND SEE WHERE THE STOCK SELLS IN RELATION TO ITS BOOK VALUE. BE AWARE OF THE LEVEL OF THE STOCK MARKET. ARE YIELDS LOW AND P-E RATIONS HIGH. IF THE STOCK MARKET HISTORICALLY HIGH. ARE PEOPLE VERY OPTIMISTIC ETC?  
  
10. WHEN BUYING A STOCK, I FIND IT HELDFUL TO BUY NEAR THE LOW OF THE PAST FEW YEARS. A STOCK MAY GO AS HIGH AS 125 AND THEN DECLINE TO 60 AND YOU THINK IT ATTRACTIVE. 3 YEAS BEFORE THE STOCK SOLD AT 20 WHICH SHOWS THAT THERE IS SOME VULNERABILITY IN IT.  
  
11. TRY TO BUY ASSETS AT A DISCOUNT THAN TO BUY EARNINGS. EARNING CAN CHANGE DRAMATICALLY IN A SHORT TIME. USUALLY ASSETS CHANGE SLOWLY. ONE HAS TO KNOW MUCH MORE ABOUT A COMPANY IF ONE BUYS EARNINGS.  
  
12. LISTEN TO SUGGESTIONS FROM PEOPLE YOU RESPECT. THIS DOESN’T MEAN YOU HAVE TO ACCEPT THEM. REMEMBER IT’S YOUR MONEY AND GENERALLY IT IS HARDER TO KEEP MONEY THAN TO MAKE IT. ONCE YOU LOSE A LOT OF MONEY, IT IS HARD TO MAKE IT BACK.  
  
13. TRY NOT TO LET YOUR EMOTIONS AFFECT YOUR JUDGMENT. FEAR AND GREED ARE PROBABLY THE WORST EMOTIONS TO HAVE INCONNECTION WITH PURCHASE AND SALE OF STOCKS.  
  
14. REMEMBER THE WORK COMPOUNDING. FOR EXAMPLE, IF YOU CAN MAKE 12% A YEAR AND REINVEST THE MONEY BACK, YOU WILL DOUBLE YOUR MONEY IN 6 YRS, TAXES EXCLUDED. REMEMBER THE RULE OF 72. YOUR RATE OF RETURN INTO 72 WILL TELL YOU THE NUMBER OF YEARS TO DOUBLE YOUR MONEY.  
  
15. PREFER STOCK OVER BONDS. BONDS WILL LIMIT YOUR GAINS AND INFLATION WILL REDUCE YOUR PURCHASING POWER.  
  
16. BE CAREFUL OF LEVERAGE. IT CAN GO AGAINST YOU.

<http://agreatereffort.blogspot.com/2009/12/16-investing-rules-from-walter-schloss.html>

He is not the most famous name in the world of stock

markets because of his concise effort to keep a despicably

low profile. He has the distinction only a

handful of investors have achieved in the history

of stock markets generating returns of 16 per cent (after

fees) against 10 per cent for the S&P 500 as an investor over

four decades. None other than the world’s richest man and

the best known investor Warren Buffet calls him “super-investor”

of Graham & Doddsville approach to value investing

and a “flesh-and-blood refutation of the efficient market

theory.” While most of us feverishly look at quarterly earnings

growth and takeaways from management meetings

to gauge whether a particular stock is investment worthy,

Walter shows how you can disregard those metrics and still

come out tops in the investment game. His strategy? Simply

buying stocks cheap.

Like most value investors, Walter would not like to play

into anything that’s unpredictable. That should explain why

the man is no great fan of earnings. “Earnings have a way of

changing, and it’s far more fickle than assets.” Even if you

get your projections of earnings right, the market’s view of

the company’s multiples that it deserves can change so he

would rather rely on the book.

One of Walter’s and, in fact, Graham’s favoured investment

strategies was buying stocks trading at 2/3rds of their

net current asset values and selling them when the price got

up to the working capital per share. “We’d have made 50 per

cent on our money and the firm averaged about 20 per cent

a year on that basis.” However, with such stocks disappearing

in the US, Walter decided to go for the second best value:

buying below book.

Walter explains how by investing in such junk stocks quoting

below book value you can insure yourself against the

risks of investing and can stand to benefit from them. Companies

and industries get into disrepute and nobody wants

them because they don’t make much money and since the

market is looking for earnings, who wants a company that

doesn’t earn much? According to Walter, historically, such

companies have made a comeback; a decline does not necessarily

signify the end.

One signature feature of Walter’s stock picks was that he

never declared his holdings - not even to his investing partners.

He would explain later that apart from preventing

others from buying into his potential investments and, consequently,

raising his purchase price, one of the real reasons

was that most of his investors could not stomach the names

of the stocks that he loved to invest in.

Walter displayed his hawk-eye on investments when he

shorted Yahoo and Amazon just before the tech meltdown.

Following the crash, Walter and Edwin liquidated their firm

on not finding any more good buys. In the final years of his

operations, the beauty of value investing sparkled yet again.

In 2000, when the markets world over were bleeding, Walter

returned 28 per cent and, in 2001, he gave 12 per cent compared

with the S&P’s -9 per cent and -12 per cent respectively.

Walter remained one-half of a two-man investment firm,

the other being his own son Edwin. Together they worked

out of a small room leased out to him by the other legendary

value investment firm Tweedy, Browne and Associates.

Working with a single phone they hired no employees. He

would comment later that he would like to keep overheads

to a minimum and more importantly that he did not have

the heart to fire somebody!

Walter never went to college but got inspired into the world

of investing after attending the evening school securities

analysts conducted by Benjamin Graham in the New York

University. He joined as an employee of Graham-Newman

in 1934. Just after the Great Crash of 1929, the prevalent

view of the stock market was so pessimistic that Walter’s

mother was criticised for allowing him to go to Wall Street.

“There would be no stock market in 1940,” people would say

then, he recalls. In 1955, Graham decided to retire and, Walter,

with his experience of working with Graham started his

firm.

Though Walter Schloss is often considered an ultra conservative

investor -- a person who will strongly and confidently

tout his policy of investing below book -- the fact remains

that he has shown that investing the way he does can work.

He has a 40-year record to prove it. We would like to thank

Walter’s wife, Anna Pearson Schloss, for the immense help

in assisting us through the telephone conversation. Excerpts:

**What did you learn from Graham about investing?**

Graham taught me about market valuation and I learned

how to find stocks selling below working capital. In those

days, you could find a slew of them. It was right after the

Depression of ’29 and the financial markets were still in decline.

Today prices are much higher, and it’s much more

difficult to find stocks selling at deep discounts. So many

investors today focus on earnings, but I focus on assets and

don’t try to predict next months’ earnings, which is a much

more difficult approach to investing.

**Can you tell us about your last visit to India?**

I was very upset when Japan attacked Pearl Harbor and I

enlisted in the army soon after that. They sent me to Missouri

for training and then they shipped me to Bombay. We

landed in Bombay on the way to Iran. The Russians were

attacked by Germany and we were helping with the truck

assembly plant that supplied equipment to them. I received

a medal from the Russians thanking me for my war effort. I

traveled on the Rhona, which was sunk later during the war,

and there was a loss of 1,190 lives. I guess I was lucky. I spent

a week in Bombay because that’s where we were repairing

the ship.

71

3

**How did you get into investing in the first place?**

In 1934, I got a job as a runner at a firm called Carl M. Loeb &

Co. (Later to be known as Loeb Rhodes). The following year,

I went to one of the partners of the firm and asked if I could

get into the security analysis department, but they turned

me down. The gentlemen I spoke with recommended a book

written by Benjamin Graham called Security Analysis, and

he said if I read this book I wouldn’t need to read anything

else; so, I bought the book and I discovered that Carl M.

Loeb & Co would pay a fee to the New York Stock Exchange

Institute to teach members of the firm who worked there the

workings of the stock exchange, so I took the course.

Benjamin Graham was teaching the course on security

analysis and I liked it. I graduated from there in 1939. After

spending a year-and-a-half in Iran, I returned to the States

and went to the Officers Cadet School. I became a second

lieutenant and was posted in the Pentagon. After the war

was over, Graham wrote me a letter that he was looking for

a security analyst and I accepted the offer, and that’s how I

got started.

**What is the starting point for your stock pick?**

First of all, I like to look at the balance sheet

and I don’t like debt because it can really

get a company into trouble. I prefer to buy

basic businesses with strong balance

sheets. I try to protect myself from permanent

loss of capital by investing in

stocks that are depressed. My son, Edwin,

and I look at computer screens to

see which companies look reasonably

priced, and then we send for the annual

report.

I am largely interested in companies

that are into manufacturing products,

be it shoes or automobiles, rather than

a television (broadcast) company or a

radio company. As long as the company

manufactures a product that is okay,

I am game. In manufacturing companies

too there are challenges. For example, automobile

companies in America today run high

costs because wages are higher here than say

China. So you need to assess such things but largely

we prefer products to services.

**Don’t you miss out on a lot of opportunities if you**

**focus only on manufacturing companies?**

I probably will, but you know you have to live the way it is

comfortable for you. For instance, I would not like to invest

in a company like McDonald’s even though it is successful,

because in the restaurant business if people are poisoned by

bad food then nobody wants to eat there anymore.

**What do you look for in annual reports apart from debt?**

I like to look at the financial records to see the history of

the company. If the company is a relatively new business, I

probably wouldn’t buy it because it would be much harder

to evaluate. But if the company was in business for the past

20 or 30 years or so, you would get a wider picture of its track

record and then you would look at the balance sheet.

**Do you dislike debt completely? Would you prefer a company**

**with zero debt as opposed to a company with some**

**debt ?**

I like to buy companies with very little debt so it has a margin

of safety. If you’ve noticed, a great many companies today

are in trouble because they’ve taken on too much debt.

**How do you assess when a company is truly undervalued?**

When you look at any company, you see where the stock has

been selling for in the past. You also see what the company

manufactures. I like to buy basic businesses not high flyers

that sell at huge multiples.

**How do you determine what is a high price?**

I like to look at the market price versus the book value, because

it gives you a good starting point. I like companies

that sell near their book value. I find the Value Line Survey

of stocks very helpful to get an overview on different industries.

You have to do a certain amount of research.

**How often do you meet the company managements?**

I’m really not in the position to run around the country to

meet with management like Peter Lynch used to do. It takes

too much out of you. I want to live to be a hundred, so I decided

against doing so. I limit myself to looking at the annual

report, the balance sheet, looking at the background

of the company, seeing that the management owns a lot

of stock in the company and the reputation of the

people running it. You have to make judgments

about each individual stock. If you do all this,

you don’t have to meet the management. I

don’t really focus on what the earnings are

going to be next year, I try to protect myself

and that I don’t lose money.

**Are you still actively investing?**

Not as active as I once was, but I do

buy occasionally if I like something.

**What is your sell strategy ?**

I think it’s much easier to identify

when something is cheap rather

than when to sell. We would probably

sell at where the stock sold out in the

past when earnings had recovered. If we

think there is a possibility of a deal we

are tougher on our sell price.

Sometimes we sell when the whole industry

has moved up sharply, and there are also

times when we sell because we find something

better or cheaper. In value investing, if you find A

has gone up but B is much cheaper you switch to

the cheaper but generally we sell after a period of

one year to get the benefit of taxes.

**What do you mean exactly when you say you see the price**

**of the stock in the past?**

Basically, we see if we buy the stock at the 20’s and, historically,

the price has gone up to the 40’s and 50’s, when it gets

back to the 40’s and 50’s we feel it has got back to where it

was before.

But that does not mean that it won’t go higher, but we just

use it as a benchmark. If we think the stocks are still undervalued,

then we hold it. We often find that we sell a little

too early. But when you sell something you have to make it

attractive for someone to buy it. So if you wait to the point

where the stock is really overvalued then you run the risk of

nobody wanting to buy it and it could go down again.

**What do you do if a stock falls further after you have**

**bought it?**

When we see something that has gone down in price a great

deal, we buy it. We like to buy stocks on the way down. A lot

of people don’t like that approach but I’m comfortable buying

on the way down.

**When you identify a stock to buy, what will be your initial**

**allocation? Do you keep some money to average if the**

**stock falls?**

Well, you don’t know how low it is going to get to begin with.

I think if you think it is an incredible situation you should

probably put in at least 50 per cent of what you would put in

that stock. But sometimes, if we think, it is really good, we

put 70 per cent. You never know because it could go up immediately

and I think sometimes you think that the stock is

not that cheap but you want a little bit to get your feet wet

then you would buy only 10 per cent.

**What is your usual holding period?**

The average is four to fi ve years; because when I buy a stock

that is depressed it hardly ever turns around immediately.

**What is your biggest investment mistake?**

I don’t want to tell (laughs)! Well, when I was working with

Graham in 1949 I think a man came to me and said that

there is this company whose product is rather good because

it deals with computers. I went to Graham and told him that

I like the stock – it had risen quickly from 18 to 21 -- and Graham

said, “You know Walter, we don’t buy that kind of stock.”

The stock then went up to 50, and in due course to 2000 before

the stock was split. The stock was Xerox. It turned out

to be a tremendous buy, but Graham did not want to buy it

because he did not know enough about the business.

**What books do you recommend on investing?**

Benjamin Graham’s Intelligent Investor with the updated

version byw Jason Zweig.

**What is your favorite pastime?**

I love playing bridge. But, unfortunately, it’s hard to get a

game together. I also fi nd traveling with my wife, Ann, very

enjoyable.

**Profi t Guru**

**ini- Outlook PrOfit** 3 October 2008

74

**A Discussion of Dr. George Athanassakos with Mr. Walter Schloss**

**New York, NY, May 8, 2008, 6:00 pm – 8:00 pm**

In his efforts to preserve the ideas, philosophies and style of investing of legendary value investors, Dr. Athanassakos met with Mr. Walter Schloss in New York on May 8, 2008. They met for dinner at a small Greek restaurant, called the 3 guys, on Madison Avenue between 75th and 76th streets. Over the restaurant’s famous stuffed turkey dinner, Dr. Athanassakos and the man that Mr. Buffett refers to as “the super-investor” discussed a number of issues related to Mr. Schloss’ successful career that spanned 45 years from 1956 to 2000 and over which period Mr. Schloss beat the market by 4% after expenses and lost money only in two years – higher return with lower risk!

Walter’s great grandfather immigrated to the US from Germany in the late 1800’s. The advice he had gotten from his own father was “work hard and trust in god, but if this does not work then look up your cousin in New York”, which he did. This is how the Schloss family came to be in the US. Walter’s character of frugality, controlling expenses and distain for “losing money” was instilled in him by seeing the calamity and adverse effect that his grandfather’s bankruptcy had on his family. He saw his grandfather go bankrupt and his father struggle through life. His father died relatively poor at 104. Walter now 92 seems to have inherited good genes.

Schloss started his limited partnership in the middle of 1955. In 1963, he earned the Chartered Financial Analyst designation. Walter’s son Edwin joined the partnership in 1973 and the fund changed its name to Walter & Edwin Schloss Associates. Over the period 1956 to 2000, Mr. Schloss and his son Edwin provided investors a compounded return of 15.3% compared with the S&P 500’s annual compounded return on 11.5%.

Mr. Schloss learned his trade starting in 1935 from the Dean of Value Investing Mr. Ben Graham at Columbia University, when he took Graham’s course on Security Analysis. The course impressed on him the ability to identify undervalued stocks through the many real life examples Graham brought to class, at the time including Coca Cola and Colgate- Palmolive. Responding to a question Mr. Schloss explained that while some talent is

needed, value investing can be taught by courses such as the one developed by Dr. Athanassakos at the Richard Ivey Scholl of Business.

Over the years, Mr. Schloss tested himself to see if he could control his emotions by waiting for a stock to fall further before buying it even thought he liked the stock in the first place and when it was at a higher price. Through the years Schloss developed a keen discipline and patience, but also the human qualities of compassion for his fellow citizen. He never had an interest in accumulating a large position in any company to threaten taking the company private and/or force a merger as he has always felt that such actions led to many people losing their jobs, something that he did not like to be the cause of.

He avoids making mistakes by not talking to managers who may affect one’s decisions while he finds the process time consuming and confusing. He prefers to look at companies that have reached new lows, but he does not necessarily feel that they are necessarily undervalued. His next step is to check value line, who controls what within the company, the company’s history and its management and the amount of debt a company carries.

On the other hand, his mistakes include not buying companies for their business like Buffett does and not talking to management and visiting plants. He has always liked to look at balance sheets, book value relative to market value, companies with low debt and the history of a company.

He finds it more difficult to sell than buy. But he believes that when a stock rises significantly it is more vulnerable to a decline.

He attributes his success to hard work, controlling costs, luck and knowing his territory. The biggest lesson he learned as an investor is “Do not lose money”.

He has confidence in the US economy and he expects it to come out of the current malaise with many opportunities arising for investments. On the other hand, he does not trust the governments of China and other popular emerging economies and he prefers to invest in the US. As he said, never short the US.

After Mr. Schloss had finished his ice cream, dinner was over. We paid and we were on our way. We said our goodbyes and Schloss crossed Madison Avenue on his way to his condo around the corner.

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