Editorial comments by aldridge56@aol.com

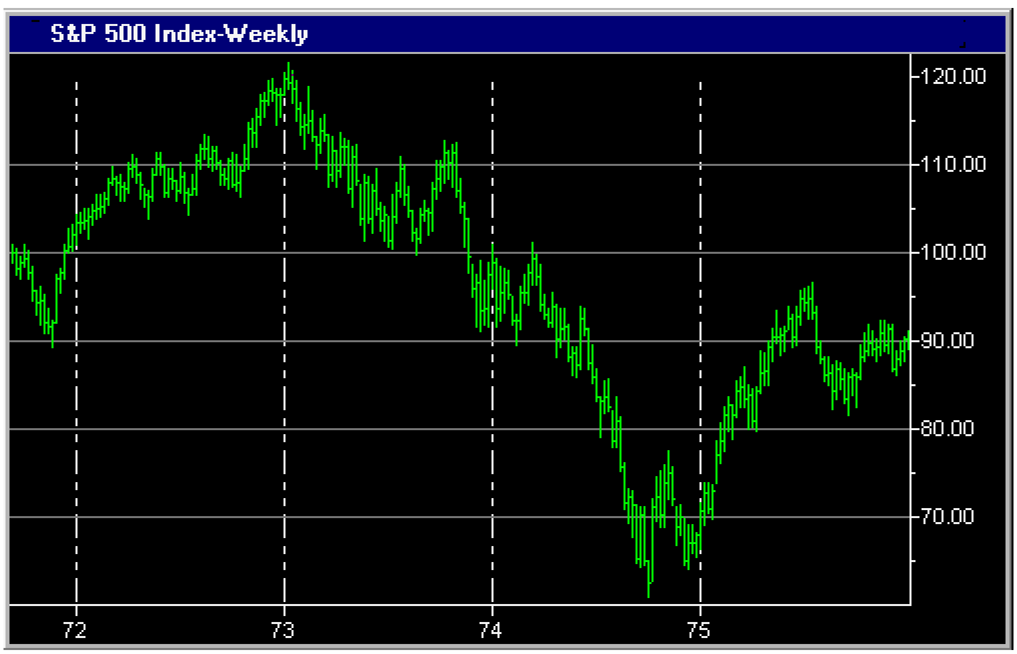
Warren Buffett--In November 1, 1974 Forbes Magazine

Under the 1974 headline, "Look At All Those Beautiful, Scantily Clad Girls Out There!," this profile in Forbes *magazine captures Warren Buffett's personality and chronicles the singular path he cut through the investment world. Though the piece is 34 years old, it sheds light on the man behind Berkshire Hathaway as the company's shareholders meet this weekend in Omaha, Neb.*

How do you contemplate the current stock market, we asked *Warren Buffett*, the sage of Omaha, Neb.

"Like an oversexed guy in a harem," he shot back. "This is the time to start investing."

The Dow was below 600 *(approximately 580)* **when he said that**. Before we could get Buffett's words in print, it was up almost 15% in one of the fastest rallies ever.



We called him back and asked if he found the market as sexy at 660 as he did at 580. "I don't know what the averages are going to do next," he replied, "but there are still plenty of bargains around." He remarked that the situation reminded him of the early '50s.

Warren Buffett doesn't talk much, but when he does it's well worth listening to. His sense of timing has been remarkable. Five years ago, late in 1969, when he was 39, he called it quits on the market[1]. He liquidated his money management pool, Buffett Partnership, Ltd., and gave his

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[1] In his May 29, 1969 Buffett Partnership Letter he stated his intention to require because: "However, it seems to me that opportunities for investment that are open to the analyst who stresses quantitative factors have virtually disappeared after rather steadily drying up over the past 20 years. $100 million eliminates a lot of this barren world. And a swelling interest in investment performance has created an increasingly short term and (in my mind) more speculative market.

clients their money back. Before that, in good years and bad, he had been beating the averages, making the partnership grow at a compounded annual rate of 30% before fees between 1957 and 1969. (That works out to a $10,000 investment growing to $300,000 and change.)

He quit essentially because he found the game no longer worth playing. Multiples on good stocks were sky-high, the go-go boys were "performing" and the list was so picked over that the kind of solid bargains that Buffett likes were not to be had. He told his clients that they might do better in tax-exempt bonds than in playing the market. "When I got started," he says, "the bargains were flowing like the Johnstown flood; by 1969 it was like a leaky toilet in Altoona." Pretty cagey, this Buffett. When all the sharp MBAs were crowding into the investment business, Buffett was quietly walking away.

Buffett settled back to manage the business interests he had acquired, including Diversified Retailing, a chain of women's apparel stores; Blue Chip Stamps, a western states trading stamp operation; and Berkshire Hathaway, a diversified banking and insurance company that owned, among other things, a weekly newspaper, *The Omaha Sun*. The businesses did well. Under Buffett's management, the *Sun* won a Pulitzer prize for its exposé of how Boys Town, despite pleas of poverty, had been turned into a "moneymaking machine."

Swing, You Bum!

Buffett is like the legendary guy who sold his stocks in 1928 and went fishing until 1933. That guy probably didn't exist. The stock market is habit-forming: You can always persuade yourself that there are bargains around. Even in 1929. Or in 1970. But Buffett did kick the habit. He did "go fishing" from 1969 to 1974. If he had stuck around, he concedes, he would have had mediocre results.

"I call investing the greatest business in the world," he says, "because you never have to swing." You stand at the plate, the pitcher throws you General Motors at 47! U.S. Steel at 39! And nobody calls a strike on you. There's no penalty except opportunity lost. All day you wait for the pitch you like; then when the fielders are asleep, you step up and hit it."

But pity the pros at the investment institutions. They're the victims of impossible "performance" measurements. Says Buffett, continuing his baseball imagery, "It's like Babe Ruth at bat with 50,000 fans and the club owner yelling, 'Swing, you bum!' and some guy is trying to pitch him an intentional walk. They know if they don't take a swing at the next pitch, the guy will say, 'Turn in your uniform.'" Buffett claims he set up his partnership to avoid these pressures.

Stay dispassionate and be patient is Buffett's message. "You're dealing with a lot of silly people in the marketplace; it's like a great big casino and everyone else is boozing. If you can stick with Pepsi, you should be OK." First the crowd is boozy on optimism and buying every new issue in sight. The next moment it is boozy on pessimism, buying gold bars and predicting another Great Depression.

Fine, we said, if you're so bullish, what are you buying? His answer: "I don't want to tout my own stocks."

Any *general* suggestions, we asked?

Just common sense ones. Buy stocks that sell at ridiculously low prices. Low by what standards? By the conventional ones of net worth, book value, the value of the business as a going concern. Above all, stick with what you know; don't get too fancy. "Draw a circle around the businesses you understand and then eliminate those that fail to qualify on the basis of value, good management and limited exposure to hard times." No high technology. No multicompanies. "I don't understand them," says Buffett. "Buy into a company because you want to *own* it, not because you want the stock to go up."

"A water company is pretty simple," he says, adding that *Blue Chip Stamps* has a 5% interest in the San Jose Water Works. "So is a newspaper. Or a major retailer." He'll even buy a Street favorite if he isn't paying a big premium for things that haven't happened yet. He mentions Polaroid. "At some price, you don't pay anything for the future, and you even discount the present. Then, if Dr. Land has some surprises up his sleeve, you get them for nothing."

Have faith in your own judgment or your adviser's, Buffett advises. Don't be swayed by every opinion you hear and every suggestion you read. Buffett recalls a favorite saying of Professor Benjamin Graham, the father of modern security analysis and Buffett's teacher at Columbia Business School: "You are neither right nor wrong because people agree with you." Another way of saying that wisdom, truth, lies elsewhere than in the moment's moods.

All Alone?

What good, though, is a bargain if the market never recognizes it as a bargain? What if the stock market *never* comes back? Buffett replies: "When I worked for Graham-Newman, I asked Ben Graham, who then was my boss, about that. He just shrugged and replied that the market always eventually does. He was right--in the short run, it's a voting machine; in the long run, it's a weighing machine. Today on Wall Street they say, 'Yes, it's cheap, but it's not going to go up.' That's silly. People have been successful investors because they've stuck with successful companies. Sooner or later the market mirrors the business." Such classic advice is likely to remain sound in the future when they write musical comedies about the go-go boys.

We reminded Buffett of the old play on the *Kipling* lines: "If you can keep your head when all about you are losing theirs … maybe they know something you don't."

Buffett responded that, yes, he was well aware that the world is in a <u>mess</u>. "What the *DeBeers* did with diamonds, the Arabs are doing with oil; the trouble is we need oil more than diamonds." And there is the population explosion, resource scarcity, nuclear proliferation. But, he went on, you can't invest in the anticipation of calamity; gold coins and art collections can't protect you against Doomsday. If the world really is burning up, "you might as well be like Nero and say, 'It's only burning on the south side.'"

"Look, I can't construct a disaster-proof portfolio. But if you're only worried about corporate profits, panic or depression, **these things don't bother me at <u>these</u> prices."**

Buffett's final word: "<u>Now</u> is the time to invest and get rich."

Next is a transcript of a speech by *Ben Graham* in September 1974 discussing how cheap the market was.

Renaissance of Value

Rare Investment Opportunities Are Emerging.

The title of this seminar—"The Renaissance of Value"--implies that the concept of value had previously been in eclipse in Wall Street. This eclipse may be identified with the virtual disappearance of the once well-established distinction between investment and speculation. In the last decade, everyone became an investor--including buyers of stock options and odd-lot short-sellers. In my own thinking, the concept of value, along with that of margin of safety, has always lain at the heart of true investment, while price expectations have been at the center of speculation.

At this point let me consider briefly an approach with which we were closely identified when managing the *Graham-Newman* fund. This was the purchase of shares at less than their working-capital value *(current assets minus current liabilities)*. That gave such good results for us over a 40-year period of decision-making that we eventually denounced all other common-stock choices based on the usual valuation procedures, and concentrated on the sub-asset stocks. The "renaissance of value," which we are talking about today, involves the reappearance of this kind of investment opportunity. A *Value-Line* publication last month listed 1,000 such issues in the non-financial category. Their compilation suggests that there must be at least twice as many sub-working-capital choices in the *Standard & Poor's Monthly Stock Guide*. (However, don't waste $25 sending for an advertised list of "1,000 stocks priced at less than Working Capital." Those responsible inexcusably omitted to deduct the debt and preferred stock liabilities from the working capital in arriving at the amount available for the common.)

It seems no more than ordinary sense to conclude that if one can make up, say, a 30-stock portfolio of issues obtainable at less than working capital, and if these issues meet other value criteria, including the analysts' belief that the enterprise has reasonably good long-term prospects, why not limit one's selection to such issues and forget the more standard valuation methods and choices? I think the question is a logical one, but it raises various practical issues: How long will such "fire-sale stocks"--as *Value Line* called them--continue to be available; what would be the consequences if a large number of decision-makers began as of tomorrow to concentrate on that group; what should the analyst do when these are no longer available?

Such questions are actually related to broader aspects of the value approach, involving the availability of attractive investment opportunities if and when most investors and their advisors followed this doctrine.

Some interesting questions relating to intrinsic value versus market price are raised by the takeover bids that are now part of our daily financial fare. The most spectacular such event occurred a few weeks ago, when two large companies actively competed to buy a third, with the result that within a single month the price of *ESB inc.* advanced from $17.50 over $41. We have always considered the **value of the business to a private owner as a significant element in appraising a stock issue.** We now have a parallel figure for security analysts to think about: the price that might be offered for a given company by a would-be acquirer. In that respect, the *ESB* transaction and the *Marcor* one that followed it offer much encouragement to those who believe that the real value of most common stocks is well above their present market level.

There is another aspect of takeovers that I want to bring up here, on a somewhat personal basis, because it relates to an old losing battle that I have long fought to make shareholders less sheep like vis-à-vis their managements. You will recall that the first bid of *INCO* was termed a "hostile act" by the *ESB* management, who vowed to fight it tooth and nail. Several managements have recently asked stockholders to vote charter changes that would make such acquisitions more difficult to accomplish against their opposition-- in other words, make it more difficult for stockholders to obtain an attractive price for their share. The stockholders, still sheep like, generally approve such proposals. If this movement becomes widespread, it could really harm investors' interests. I hope that financial analysts will form a sound judgment about what is involved here and do what they can to dissuade stockholders from cutting their own throats in such a foolish and reckless fashion. This might well be a subject for the *Financial Analyst Federation* to discuss and take an official stand on.

There is a least a superficial similarity between the prices offered in takeovers and those formerly ruling in the market for the first-tier issues, as represented by "the favorite 50." *(Graham is referring to the Nifty-Fifty Glamour, Growth stocks-see Loomis Article.)* The large institutions have acted somewhat in the role of conglomerates extending their empires by extravagant acquisitions. The P-E ratio of *Avon Products* averaged 55x in 1972, and reached 65x at the high $140. *(Graham speaks here of the "Nifty 50" which were the stocks that institutions could pile into at "any" price because of their high quality earnings growth and performance.)* This multiplier could not have been justified by any conservative valuation formulae. It was not made by speculators in a runaway bull market; it had the active or passive support of the institutions that have been large holders of *Avon*.

As I see it, institutions have been persuaded to pay outlandish multipliers for shares of the *Avon* type by a combination of three influences. First, the huge amounts of money they have to administer, most of which they decide to place in equities. Second, the comparatively small number of issues to which their operations were confirmed, in part because they had to choose multimillion-share companies for their block transactions, and partly by their insistence on high-growth prospects. The third influence was the cult of performance, especially pension fund management.

The arithmetic here is deceptively simple. If a company's earnings will increase 15% this year, and if the P-E ratio remains unchanged, then presto! The "investment" shows a 15 percent performance, plus the small dividend. If the P-E ratio advances—as it did for *Avon* in almost every year--the performance becomes that much better. These results are entirely independent of the price levels at which these issues are bought. Of course, in this fantasia, the institutions were pulling themselves up by their own bootstraps--something not hard to do in Wall Street, but impossible to maintain forever.

These institutional policies raise two implications of importance for financial analysts. **First, what should a conservative analyst have done in the heady area and era of high growth, high multiplier companies?** I must say mournfully that he would have to do the near impossible--namely, turn his back on them and let them alone. The institutions themselves had gradually transformed these investment-type *companies* into speculative *stocks.* I repeat that the ordinary analyst cannot expect long-term satisfactory results in the field of speculative issues, whether they are speculative by the company's circumstances or by the high price levels at which they habitually sell.

My second implication is a positive one for the investing public and for the analyst who may advise a non-institutional clientele. We have many complaints that institutional dominance of the stock market has put the small investor at a disadvantage because he can't compete with the trust companies huge resources, etc. The facts are quite the opposite. It may be that the institutions are better equipped than the individual to speculate in the market; I'm not competent to pass judgment on that. **But I am convinced that an individual *investor* with sound principles, and soundly advised, can do distinctly better over the long pull than a large institution.** Where the trust company may have to confine its operation to 300 concerns or less, the individual has up to 3,000 issues for his investigations and choice. Most true bargains are not available in large blocks; by this very fact the institutions are well-nigh eliminated as competitors of the bargain hunter.

Assuming all this is true, we must revert to the question we raised at the outset. How many financial analysts can earn a good living by locating undervalued issues and recommending them to individual investors? In all honesty I cannot say that there is room for 13,000 analysts, or a large portion thereof, in this area of activity. But I can assert that the influx of analysts into the undervalued sphere in the past has never been so great as to cut down its profit possibilities through that kind of over-cultivation and over-competition. (The value analyst is more likely to suffer from loneliness.)

True, bargain issues have repeatedly become scarce in bull markets, but that was not because all the analysts became value-conscious, but because of the general upswing in prices. (Perhaps one could have determined whether the market level was getting too high or too low by counting the number of issues selling below working-capital value. When such opportunities have virtually disappeared, past experience indicates that investors should have taken themselves out of the stock market and plunged up to their necks in US Treasury bills.)

So far I have been talking about the virtues of the value approach as if I never heard of such newer discoveries as "the random walk," "the efficient portfolios," the Beta coefficient, and others such. I have heard about them, and I want to talk first for a moment about *Beta*. This is a more or less useful measure of past price fluctuations of common stocks. **What bothers me is that authorities now equate the Beta idea with the concept of "risk."** Price variability yes; risk no. **Real investment risk is measured not by the percent the stock may decline in price in relation to the general market in a given period, but by the danger of a loss of quality and earnings power economic changes or deterioration in management.**

In the five editions of *The Intelligent Investor*, I have used the example of *A&P* shares in 1936 to 1939 to illustrate the basic difference between fluctuations in price and changes in value. By contrast, in the last decade the price decline of *A&P* shares from $43 to $8 paralleled pretty well a corresponding loss of trade position, profitability, and intrinsic value. The idea of measuring investment risks by price fluctuations is repugnant to me, for the very reason that it confuses what the stock market says with what actually happens to the owners' stake in the business….

The value approach is always been more dependable when applied to senior issues than to common stocks. Its particular purpose in bond analysis is to determine whether the enterprise has a fair value so comfortably in excess of its debt as to provide an adequate margin of safety. The standard calculation of interest coverage has much the same function. There is much work of truly professional caliber that analysts can do in the vast area of bonds and preferred stocks--and, to some degree also, in that of convertible issues. The field has become an increasingly important one, especially since all well-rounded portfolios should have their bonds component.

Any security analyst worth his salt should be able to decide whether a given senior issue has enough statistically based protection to warrant its consideration for investment. The job has been neglected at times in the past 10 years--most glaringly in the case of the *Penn-Central Railroad* debt structure. It is an unforgivable blot on the record of our profession that the *Penn-Central* bonds were allowed to sell in 1968 at the same prices as good public- utility issues. An examination of that system's record in previous years--noting, inter alia, its peculiar accounting and the fact that it paid virtually no income taxes—would have clearly called for moving out of the bonds, to say nothing of the stock even at prices well below its high of $86.

We now have a situation which all bonds sell at high yields, but many companies have an overextended debt position. Also, many of them do not seem to have sufficiently strong protective provisions in their bond indentures to prevent them from offering new debt in exchange for their own common stock. (A striking example is the current bond for stock operations of *Caesar's World*.) These widespread present maneuvers seem to me to be so many daggers thrust in the soft bodies of the poor creditors.

Thus security analysts could well advise a host of worthwhile switching in the bond field. Even in the Federal debt structure--where safety is not an issue--the multiplicity of indirect US government obligations all sorts, including some tax-exempts, suggests many opportunities for investors to improve their yields. Similarly, we have seen many convertible issues selling close to a parity with the common; in the typical case, the senior issue has offered a higher yield than the junior shares. Thus, a switch from the common stock into the senior issue in these cases would be a plain matter of common sense. (Examples: *Studebaker-Worthington* and *Engelhard Industries* preferred vs. common.)

Let me close with a few words of counsel from an 80-year-old veteran of many a bull and bear market. **Do those things as an analyst you know you could do well, and only those things.** If you can really beat the market by charts, by astrology, or by some rare and valuable gift of your own, that's the row you should hoe. If you are really good at picking stocks most likely to succeed in the next 12 months, base your work on that endeavor. If can foretell the next important development in the economy, or in technology, or in consumers' preferences, and gauge its consequences for various equity values, then concentrate on that particular activity. But in each case you must prove to yourself by honest, no bluffing self-examination and by continuous testing of performance, that you have what it takes to produce worthwhile results.

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If you believe--as I've always believed--that the value approach is inherently sound, workable, and profitable, then devote yourself to that principle. Stick to it, and don't be led astray by Wall Street's fashions, illusions, and its constant chase after the fast dollar. Let me emphasize that it does not take a genius or even a superior talent to be successful as a value analyst. What it needs is, first, reasonably good intelligence; second, sound principles of operation; third, and most important, firmness of character.

But whatever path you follow as financial analysts, hold onto your moral and intellectual integrity. Wall Street in the past decade fell far short of its once-praiseworthy ethical standards, to the great detriment of the public it serves and the financial community itself. When I was in elementary school in this city, more than 70 years ago, we had to write various maxims in our copybooks. The first on that list was "Honesty is the best policy." It is still the best policy...

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