 **Forgotten Lessons?**

At a time when stocks markets are setting new all-time records almost daily (S&P 500 has so far closed at 66 all-time highs in 2021) and *speculation* appears to be trumping *investing*, we think it is a good time to remind everyone of some timeless lessons from Benjamin Graham. We believe these lessons have stood the test of time and are fundamental to sound investing (as opposed to speculation), even if they appear old-fashioned and outdated in today’s markets. These lessons have helped guide many of the world’s most successful investors for decades. At Oldfield Partners we think it would be a mistake for investors to forget these enduring lessons in today’s exuberant equity markets. We have extracted below what we consider key paragraphs from Benjamin Graham and David Dodd’s seminal book, Security Analysis (2nd edition), and included our view on each. At Oldfield Partners, these themes remain central to our investment approach even though they may appear ‘old fashioned’ in today’s markets. To us they remain core to successful long-term investing.

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**Forecasting**

*“When we are dealing with something as elusive and non-mathematical as the evaluation of future prospects, we are generally led to accept the market’s verdict as better than anything that the analyst can arrive at. But, on enough occasions to keep the analyst busy, the emotions of the stock market carry it in either direction beyond the limits of sound judgment.”*

**Lesson 1: Taking advantage of the emotions of the stock market is a safer way to invest than trying to predict an unpredictable future.**

**Expensive Stocks**

*“It must be remembered that the automatic or normal economic forces militate against the indefinite continuance of a given trend. Competition, regulation, the law of diminishing returns, etc., are powerful foes to unlimited expansion, and in smaller degree opposite elements may operate to check a continued decline.”*

**Lesson 2: Competition and regulation are powerful forces: Of the twenty largest companies in the World in 1989, none were among the twenty largest in 2021.**

*“The divergence in method between the stock market and the analyst—as we define his viewpoint—would mean in general that the price levels ruling for the so-called “good stocks” under normal market conditions are likely to appear overgenerous to the conservative student. This does not mean that the analyst is convinced that the market valuation is wrong but rather that he is not convinced that its valuation is right. He would call a substantial part of the price a “speculative component,” in the sense that it is paid not for demonstrated but for expected results.”*

**Lesson 3: Invest in companies that are demonstrably cheap rather than expensive companies which may have an attractive speculative component, even if the speculative component may turn out to be highly rewarding.**

**Value Companies vs Growth Companies**

*“That stocks with good past trends and favourable prospects are worth more than others goes without saying. But is it not possible that Wall Street has carried its partiality too far—in this as in so many other cases? May not the typical large and prosperous company be subject to a twofold limitation: first, that its very size precludes spectacular further growth; second, that its high rate of earnings on invested capital makes it vulnerable to attack if not by competition then perhaps by regulation?...Surely this can be true in theory, since at some price level the good stocks must turn out to have been selling too high and the others too low.”*

**Lesson 4: Every asset can be too cheap or too expensive regardless of how favourable its prospects are – price is what determines if an asset is attractive.**

*“It is natural and proper to prefer a business which is large and well managed, has a good record, and is expected to show increasing earnings in the future. But these expectations, though seemingly well-founded, often fail to be realized. Many of the leading enterprises of yesterday are today far back in the ranks. Tomorrow is likely to tell a similar story.”*

**Lesson 5: The market is usually reasonably efficient in valuing large and well managed companies.**

**Investment vs Speculation**

*“Strictly speaking, there can be no such thing as an “investment issue” in the absolute sense, i.e., implying that it remains an investment regardless of price...In the common-stock field this risk may frequently be created by an undue advance in price—so much so, indeed, that in our opinion the great majority of common stocks of strong companies must be considered speculative during most of the time, simply because their price is too high to warrant safety of principal in any intelligible sense of the phrase.”*

**Lesson 6: Investing is ‘safe’ only when there is an appropriate margin of safety.**

*“We do not imply that it is a mistake to pay more than 20 times average earnings for any common stock. We do suggest that such a price would be speculative. The purchase may easily turn out to be highly profitable, but in that case it will have proved a wise or fortunate speculation. It is proper to remark, moreover, that very few people are consistently wise or fortunate in their speculative operations…In the absence of such a mechanical check, they are prone to succumb recurrently to the lure of bull markets, which always find some specious argument to justify paying extravagant prices for common stocks.”*

**Lesson 7: Succumbing to the lure of a bull market and not staying disciplined on valuation can be a grave mistake for long term investors seeking to protect their capital.**

**Attitude Towards the Market**

*“A private business might easily earn twice as much in a boom year as in poor times, but its owner would never think of correspondingly marking up or down the value of his capital investment. This is one of the most important lines of cleavage between Wall Street practice and the canons of ordinary business. Because the speculative public is clearly wrong in its attitude on this point, it would seem that its errors should afford profitable opportunities to the more logically minded to buy common stocks at the low prices occasioned by temporarily reduced earnings and to sell them at inflated levels created by abnormal prosperity…Obviously it requires strength of character in order to think and to act in opposite fashion from the crowd and also patience to wait for opportunities that may be spaced years apart.”*

**Lesson 8: Patience and strength of character is key to successful investing.**

**Quantitative vs Qualitative Analysis**

*“To sum up this discussion of qualitative and quantitative factors, we may express the dictum that the analyst’s conclusions must always rest upon the figures and upon established tests and standards. These figures alone are not sufficient; they may be completely vitiated by qualitative considerations of an opposite import. A security may make a satisfactory statistical showing but doubt as to the future or distrust of the management may properly impel its rejection. Again, the analyst is likely to attach prime importance to the qualitative element of stability, because its presence means that conclusions based on past results are not so likely to be upset by unexpected developments.”*

**Lesson 9: While qualitative criteria and narrative is important, investing has to be rooted in rigorous quantitative analysis.**

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The lessons learnt from these extracts are particularly relevant today, such as the distinction between speculators and investors, normal economic forces militating against the indefinite continuance of a given trend, price being key to determining the attractiveness of a security and the strength of character required to think opposite from the crowd. At Oldfield Partners, these themes are core to our investment approach. This is the case even when they are out of favour by the rest of the market. It is an approach that has been proven through decades to be the safest way to protect and grow capital over time.

***Jacob Laursen  
Analyst  
November 2021***

**The value of all investments and the income from them can go down as well as up; this may be due, in part, to exchange rate fluctuations. Past performance is not necessarily a guide to future performance**

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