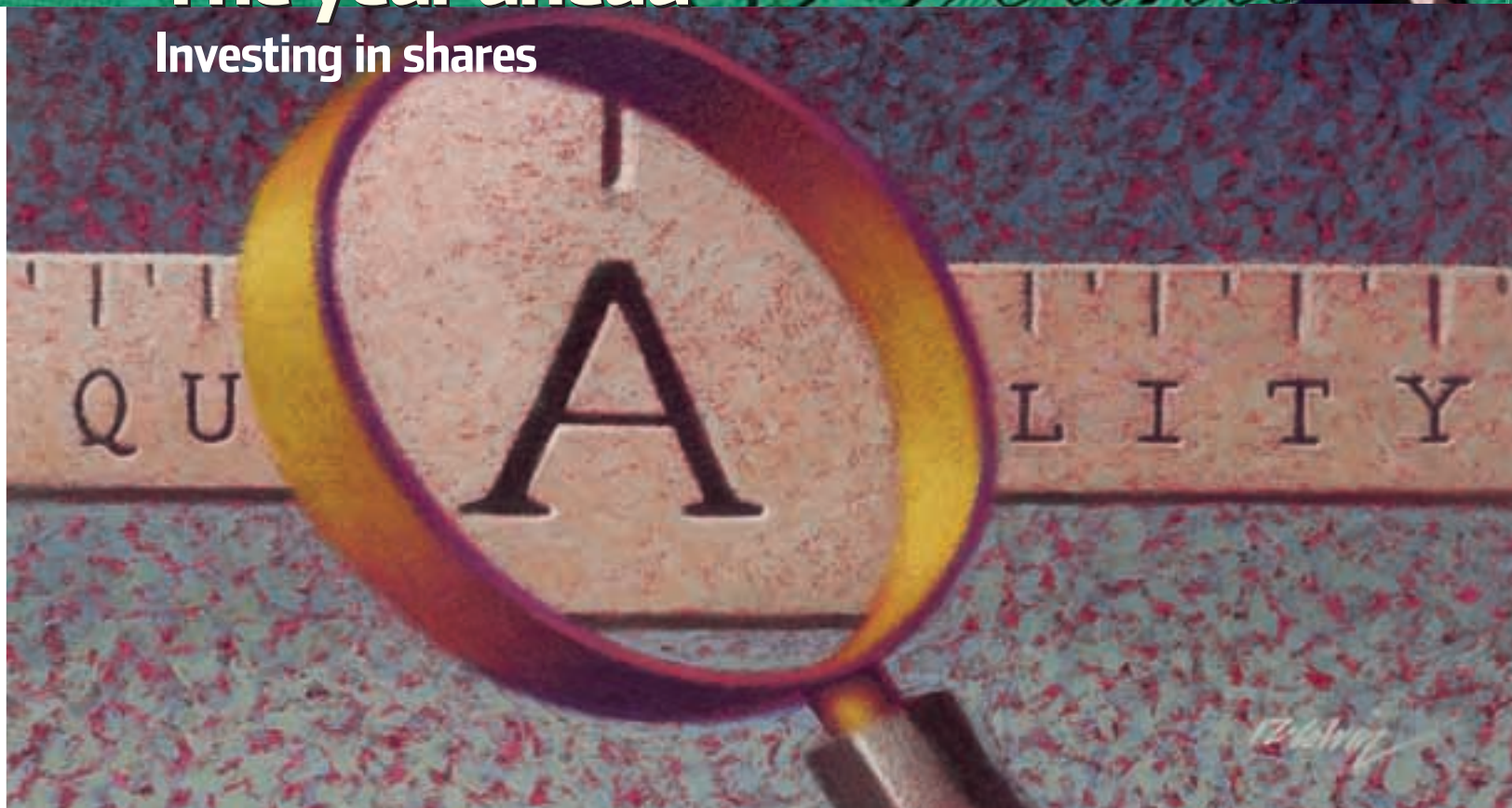




The year ahead

Investing in shares



Back to basics

Unless you are a disciplined value investor you will not have heard of Benjamin Graham. But his bottom-up strategy for company valuations could help you grow your stock returns, as **Richard Beddard** discovers

Though he's often acclaimed as the father of value investing, Benjamin Graham has a surprisingly low profile. We tend to remember him during bear markets, when stock market speculation is deeply unfashionable. That's because his safety-first approach specialises in focusing on the kind of bargain stocks that abound today.

Now we're in a bear market, it's time to dust off *Security Analysis*, the textbook Graham wrote in collaboration with David Dodd, a colleague at Columbia University, and get back to investing basics.

Margin of safety

Graham started as a messenger on Wall Street in 1914, amassed a fortune by 1929, lost most of it in the Wall Street Crash, recovered by 1937 and retired in

1956 with an unrivalled reputation. In an interview just before he died in 1976, he explained: 'I felt that I had established a way of doing business to a point where it no longer presented any basic problems to be solved... The things that presented themselves were typically repetitions of old problems which I found no special interest in solving.'

Graham thought a company was worth no more than the value of the assets it owned, or a generous fraction of its earning power. People who paid more for a share in a company than it was worth weren't investing, they were speculating, and so were people who bought shares in unproven or troubled businesses of dubious value.

Companies are speculative because they are highly indebted or have a poor record of profitability, for example. Prices are speculative, because enthu-

siastic buyers create more demand for the shares than they really warrant.

Investors, he said, avoid either kind of speculation and focus on sound companies selling at low prices. He called them 'bargain issues'.

Graham was so cautious about his own ability, and the uncertain stock market, that he built in a margin of safety, preferring to pay even less than a company's net asset value per share, the value of everything it owns minus the value of everything it owes, or demanding a high return, in terms of profits, for his investment.

Earning power

Graham preferred to take the average of at least five years of profits, and preferably 10, to calculate a company's earning power because a single year's profits can be unusually good, or bad.