This is the 100th anniversary of Ben Graham's birth. Ignore at your peril the preachings of this particular Dead White European Male.

Let's celebrate Ben Graham's centenary

BY MARK HULBERT

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NEAR THE BOTTOM of the 1973-74 bear market, legendary investor Ben Graham was asked: "Are you amused or disappointed that it takes a real bear market to get analysts interested in your value approach?" Graham's response is recorded in a wonderful biography by Janet Lowe that celebrates his 100th birthday (*Benjamin Graham on Value Investing,* Dearborn Financial Publishing, $22.95). The old master quoted: "The thinking man looks at the world and sees a comedy. The feeling man looks at the world and sees a tragedy."

As a thinking man Graham would find plenty of comedy these days. It would amuse him the way people are going through contortions to pretend that there are value stocks available in this high-priced stock market.

Graham said to look for stocks selling for significantly less than their current assets per share, after subtracting all liabilities. Buying stocks such as these is equivalent to purchasing a dollar's worth of assets for 60 or 70 cents. Graham argued that not only are such stocks good long-term prospects, they also are low risk. Their liquidating value provides a safety net—what Graham referred to as the "margin of safety."

Contrast that with what is called value investing today. Most of the investment world simply divides the universe of stocks into two equal camps—growth and value. Standard & Poor's, which maintains two indexes to track growth and value stocks, defines growth to include those stocks in the S&P 500 that have the greatest price and earnings momentum. The value half is everything else.

This is a travesty of Graham's approach. It simply assumes that half of the stock market always will satisfy the definition of value. Yet even at the trough of the Depression, as Graham himself pointed out in the June 1, 1932 issue of FORBES, just over one-third of the industrial stocks on the NYSE were trading below their net working capital per share.

Graham believed that a good indicator of the market's overall risk level was the fluctuation in the number of stocks satisfying his criteria of value. When the number satisfying those criteria drops to a low level, then market risk is high.

By Graham standards, the current market is very risky because only a handful of stocks sell below net working capital per share. Investors who thus follow today's relaxed definition of value have none of the margin of safety provided by the original Graham approach.

The investment letter that perhaps most closely follows Graham is Charles Allmon's *Growth Stock Outlook.* Allmon's approach isn't identical to Graham's because Allmon focuses on secondary issues that Graham believed had no place in the defensive portfolio. But Allmon claims apostolic succession: He says that Graham, at the end of his life, told him that he might adopt Allmon's approach if he were a young man.

Certainly Allmon is like Graham in his belief that investors should get out of stocks as the number satisfying his criteria of value dwindles. Indeed, Allmon has been predominantly in cash since 1986—a lonely, increasingly isolated position—but he sticks to his guns.

This much cash during a bull market is like fighting a boxing match with one hand tied behind his back. Yet Allmon by no means is down for the count. Over the 14 years the *Hulbert Financial Digest* has been tracking investment letter performance, Allmon has remained in shouting distance of the top performers—with a compound annual return of 12.8%, versus 14.4% for the market itself. To do this well with a cash-heavy portfolio is impressive: On a risk-adjusted basis his letter is ahead of the market—and in second place among all the letters tracked since 1980.

Furthermore, even though Allmon's performance unadjusted for risk is behind the market, it wouldn't take all that much to bring it back above a buy-and-hold strategy. I calculate that a bear market of less than 20%—which is small by historical standards—would return Allmon to the select group of letter writers whose raw unadjusted return since 1980 is ahead of the market.

All of which suggests that the Ben Graham approach to investing is as valid as it ever was. When the bear growls again, people will flock back to Graham's banner. The 100th anniversary of his birth thus can be celebrated as a call to thinking people to lighten up on stocks. ■