A TRIBUTE TO BENJAMIN GRAHAM

1894-1976

by IRVING KAHN

BENJAMIN GRAHAM is widely known as the Father of the Profession of Security or Financial Analysts. His business career began in 1914 and was continuous until 1956. All who are identified with the Over-the-Counter area of the securities industry will be interested in the impact of Benjamin Graham's teachings on OTC securities. Most investors do not realize how many more corporations have their securities traded in the OTC market than the 3,000 companies whose issues are listed on an exchange. When Benjamin Graham began developing his methods of analyzing corporate securities, he realized that many factors were of greater importance than the listing.

Graham's teachings concentrated on discovering if the subject company's stocks or bonds were at a price that justified buying the entire business if it could be bought at that price. Because OTC securities are usually less frequently traded, and outside the glare of the publicity spotlight, he consistently found many more attractive issues among those that were not listed. The thousands of students and practitioners who have followed the precepts in "Security Analysis" or "The Intelligent Investor" have also found more attractive purchases, with less risk of being deceived into buying issues which are in current fashion, by combing the range of issues not traded on any exchange.

When we think back to all of our teachers at school and college, only a few stand out as major influences on our later life. For thousands of men and women in the world of finance, Ben Graham was such a memorable teacher. He taught classes of serious students, who finished the day's work to come up to Columbia School of Business and be exposed to his rigorous logic. His lectures on security analysis, like the classes of Socrates, invited interrupting questions and challenges. The contents of these lectures were as current as this week's securities market. Principles were developed or demolished with actual examples from corporate reports of the same companies the students studied in their daily jobs.

From the first classes in 1928 until Ben's academic retirement in 1955, these classes were continuously well attended. Bull market or bear market, there were always enough keen analysts who sought to improve their skills. Because his teaching always used current examples, many students kept repeating the course.

It was from these lectures that our "Bible", the standard text of our profession, "Security Analysis" by Graham and Dodd, evolved in 1934. The use of this text by universities and business schools all over the country, and its re-issue in many editions, proves how solid its principles have proven. Among the many thousands of his students, we find leading officials in investment firms, banks, insurance companies and corporations. Through Ben's classes, both at Columbia and even earlier at the N.Y. Stock Exchange's Institute of Finance, an entire generation was influenced in several major areas. These include creating professional standards. This has flowered into the three examinations now required to achieve recognition as a Chartered Financial Analyst. Ben was an important influence on the founding and growth of the New York Society of Security Analysts. He was a major force in the creation of the Financial Analysts Journal which the N.Y. Society subsequently transferred to the National Financial Analysts Federation. His articles in the Journal, which he modestly submitted under a nom

A recent picture of Ben Graham.

de plume, were widely read and heeded. When Ben and Jerome Newman incorporated their now famous Graham-Newman Corporation, in the winter of 1936, they opened a new area of sophisticated money management. They were pioneers in setting high critical standards for their selection of securities. Instead of following the crowd and buying well known listed corporations, Graham-Newman concentrated on finding values in securities wherever they might be. This resulted in a heavy selection of Over-the-Counter issues, including companies with limited floats. The twenty year record of Graham-Newman Corporation, which dissolved in the Summer of 1956, was probably at or near the top of any investment trust then extant. This writer was an original stockholder and remembers that he received dividends, in cash or kind, of over 20% per year and the liquidating value was greater than the initial investment.

What makes this result even more impressive was the high quality of the things they bought. While the names of the securities were often less than household names, their intrinsic high value made them far safer investments than most big listed companies.

The acid test of their management was the terms of management compensation. Ben and Jerry paid themselves 20% of completed gains, but, unlike most present money managers, required that any losses had to be made up before that year's gains were computed. Other examples of how Ben's principles and methods influenced the securities industry are his ethical standards. These included demanding full disclosures of pertinent facts both in the balance sheet and the income account. He was just as forthright in criticizing the obsolete dividend policies of AT & T as with some family-controlled company that accumulated massive cash to the detriment of their public shareholders. He was a pioneer in the movement that achieved the dividend passthrough for regulated mutual funds. His objections to double taxation of corporate income, first at the corporation and, secondly, to the individual receiving the dividend, may yet become part of our tax structure. Ben saw the advantages of issuing rights to buy new capital stock over the earlier traditional underwritten issues.

In his management of Graham-Newman Corp., he practiced what he preached. Anyone who recommended a new security situation was given the brokerage busines, despite his wide family of friends in Wall Street. If a tender offer was made to acquire shares from a large holder, it was also made to every other shareholder, however small.

I would urge readers of the Over-the-Counter Securities Review to get their Graham and Dodd off the shelf and, even though it may be an earlier edition, look back at the basic ideas which are largely applicable to today's markets. If they do not already own it, one of the best investments they can now make is to buy the last edition of Graham's "The Intelligent Investor."

Ben was completely skeptical about any consistent advantage obtainable from methods that depended upon charts or so-called market or technical analysis. He repeatedly exposed the inconsistencies of such claims even when they were temporarily popular. Wall Street, being the meeting place of fads, fictions, and phonies, there had to be times when Graham's teachings seemed to be eclipsed. But, as sure as sunrise, the varieties of his logical analyses proved to be correct.

The growth of pension funds and money managers made an important shift in what the new generation of security analysts identified as their fields of concentration. The big new money was directed almost exclusively into two kinds of securities. Either the "favored 50" or "vestal virgins" or else smaller companies whose sales, if not earnings, were growing several times more quickly than their industry competitors.

Ben's was almost a lone voice in exposing the fallacies of both such aberrations. He showed how concentration of large funds into shares of major corporations must swell their price/earnings ratios making them acquire a "scarcity value." When the inevitable cyclical or regulatory changes brought less than optimistic news, these high price/earnings ratios led to, not normal, but heavy selling from institu-

ABOUT THE AUTHOR

Irving Kahn, the author of this tribute, became Benjamin Graham's student in his first class in security analysis at the Columbia Graduate School of Business in 1928. He kept attending each semester until he became Graham's assistant. Doing research work on the first edition of Graham & Dodd's "Security Analysis" in 1934 earned the author's acknowledgment. Kahn was an original shareholder of the now famous Graham-Newman Corp. some of whose holders are still with him as an investment adviser. Mr. Kahn was formerly a partner in Abraham & Co., now merged into Lehman Brothers Inc. He was formerly a director of Grand Union Co. Since 1946 he has been associate editor of The Analysts Journal. Two of his sons, Alan and Tom, have continued the Graham tradition of value analysis into the new generation, being associated with Lehman Brothers.