Walter & Edwin Schloss Associates, L. P.
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"Why We Invest the Way We Do"

(Lecture delivered by Walter J. Schloss on May 16th, 1996 at the Behavioral Economics Forum at the Harvard Faculty Club in Cambridge, Mass.)

A friend of mine who is a therapist at a mental facility in the New York area, asked me as a favor if I would give a lecture at his facility. He said that there were many intelligent patients there who had emotional problems, but he thought my speech would be helpful to them. I agreed to go, and after being introduced to the audience, I started to talk about investments. After a time, a big fellow in the front row got up and shouted "Shut up, you idiot and sit down". I turned to the therapist and asked him what I should do. My friend said, "The therapy is working, that's the first intelligent thing that fellow has said in months!".

I was reminded of this, because back in 1973, Forbes Magazine wrote an article about me modestly entitled, "Making Money Out of Junk". I hope that this lecture will moderately improve my standing in the investment community. In any case, I'm approaching this meeting on behavioral economics with some trepidation. I don't think investing is a science. I rather look at it as part art and part science with some boundaries. My son, Edwin, and I don't consider our approach a behavioral science, it's just bargain hunting and since a number of value investors have gotten into the field, it has become harder to find bargains.

We want to buy value. We buy a lot of securities. We know a lot of people who don't like our kind of diversification, but we

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can't help that. If you were running a department store, you would like the buyers you employ to purchase suits or dresses, etc. that are good value for the customer. My daughter thought it would be nice to go to Saks Fifth Avenue in New York and buy my wife a dress for $640. plus tax that wasn't on sale. My wife, being a Depression baby like me was horrified at the price and brought it back.

We are bargain hunters in the stock market instead of the retail trade or similar areas. As Ben Graham said, we buy stocks like groceries not like perfume, or as they say, "a stock well bought is half sold". One reason why we don't disclose our holdings is that we don't want competition. If the stock goes lower, which is quite possible, we'll want to buy more.

We don't want to lose money, although, we do from time to time. We have found that if we are somewhat contrarian, we seem to do better than if we purchased companies that are doing well today. When we buy depressed stocks, we seem to reduce our stress. Some people seem to thrive on stress, but we feel in the long run it is bad for them. I note that Peter Lynch of Fidelity Magellan Fund did brilliantly, but after 10 years or so, he retired because it became too difficult to keep up the pace. I've been managing our fund for 40 years and Edwin has been with me for 23 years, and we aren't stressed out yet and we hope we never will be.

We do it our way for several reasons: it fits our personality; it avoids stress, and for me, I remember the Depression of the 1930s very clearly and how it affected our family. People who have been laid off in recent years won't forget what has happened to them and

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their families, and it will affect how they or their children will act in the future. As they say, if the other fellow is laid off it's a Recession, but if you are laid off it's a Depression. I never want this to happen to my family, and so Edwin and I look for ways to protect us on the downside and, if we are lucky, something good may happen. We are basically passive investors. We expect corporations to treat us fairly, which, unfortunately, doesn't always happen. Since Edwin and I work together, we, obviously, have similar points of view, but Edwin is more aggressive in searching out for new investment opportunities, although, he tries to stay within our parameters.

When we buy into a company that has problems, we find it difficult talking to management as they tend to be optimistic. Very rarely will an officer say, "We are doing badly, the outlook is poor and we are very pessimistic about our future". We aren't too good, generally, in interpreting what managements say, assuming we get to top management rather than stockholder relations people.

There is a saying that the less risk you take the better you sleep. Someone may say, "Why not buy short term treasuries?". There is no risk, but little gain. If we are managing other people's money, we have to take some risk. We have another problem managing other people's money, although, we have a good chunk of our own included in our fund. Every year we pay out our realized gains, most of it in long term capital gains, as our average holding period is 4 years not forever, the way some funds operate. Since many of our limited partners want to reinvest, it doesn't seem right that they buy

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into a fund with large unrealized gains. In addition, some of the partners can use the income but are reluctant to sell part of their holdings if we have no distributions. This way we just give them a good return.

We want to buy cheap stocks based on a small premium over book value, usually a depressed market price, a record that goes back at least 20 years, even though, the company may be somewhat different then than now, and one that doesn't have much debt. We don't like a lot of debt and we don't think most value investors care for it either. Price is the key factor in the purchase of a stock compared to what we think the company is worth.

A few months ago, I was down in Jamaica and I started talking to a lady from Atlanta. I mentioned Coca Cola and she said that her grandmother had a little coffee shop there during the Depression. She sold the shop and took the money and invested it in Coke. She said that her father owned the stock today, never sold any and that it was worth millions. The punch line is that she told me that they are hanging onto Coke because it's going to be worth $600. a share adjusted for future splits. She made this statement before the recent 2 for 1 stock split this year. It's kind of hard for me to imagine that Coke will be selling for $800 billion dollars, but then many years ago I didn't think the Dow-Jones Industrials would sell for over 5600 in my lifetime.

We are not handling large sums of money and, therefore, we don't have the pressure that the big money managers have. We try to do what is comfortable for us so that we don't develop ulcers. It is important to know what you like and what you are good at and

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not worry that someone else can do better. If you are honest, hardworking, reasonably intelligent and have good common sense, you can do well in the investment field as long as you are not too greedy and don't get too emotional when things go against you.

We want to continue to do what we have been doing over the years. When Howard Browne, Chris Browne's father at Tweedy, Browne let me have a desk in his office, he never thought I'd still be there 40 years later. Chris, I'd like to hang around for a while longer as its brought me luck and good fortune. Maybe that's part of behavioral economics.