Walter J. Schloss

Walter Schloss, one of the country's foremost value investors, got his first job on Wall Street in 1934. Occupation: runner. He studied finance under the legendary Benjamin Graham and, following wartime service in the U.S. Army Signal Corps, joined his mentor's firm, Graham-Newman. Setting up on his own, he founded Walter J. Schloss Associates in 1955, and he has managed money—his own and his partners—ever since.

"Sixty-five years on Wall Street"
Remarks by Walter Schloss, founder Walter & Edwin Schloss Associates.

JIM GRANT: Ladies and gentlemen, may I interrupt the tart portion, please? So many good things have come to me and to the readers of "Grants" through Paul Isaac and one of them is a fellow that Paul referred to over the years occasionally as Uncle Walter. Little did I know that the gentleman to whom he was referring was and is one of the preeminent practitioners of the craft of value investing of our time or, indeed, of any other. His name is, of course, Walter Schloss.

Walter got his first job on Wall Street in 1934. He decided not to start at the top because it made a better story if he started as a runner. So he began as a runner and he studied finance under the tutelage of none other than Benjamin Graham. On December 8, 1941, not being otherwise occupied, he got in line to enlist in the United States Army. After his separation from the service at the end of the war he went back to finance, joined his mentor's firm, Graham-Newman.

In setting up on his own he undertook to manage money and has done it about as well as it can be done. And today, ladies and gentlemen, he is here with us.

Walter, would you come up here and tell us all about it?

WALTER SCHLOSS: I had a friend who was a therapist at a mental hospital and he asked me if I would talk to his patients about investments. And I said OK, and he introduced me and so I started to talk about investments. And after a few minutes a big fellow in the front of the audience got up and he said, "Shut up, you idiot and sit down!" I looked at my friend and I said, "What do I do?" He said, "Sit down. That's the most intelligent thing that fellow's said in months."

Well, I want to talk about Ben Graham because he was very helpful to me and I think it might be interesting to you to know how he started. Well, we know about his background in Columbia, but he got the job and became a manager of money because he was very intelligent about his investments and in the '20s he had a deal where he took 50 percent of the profits but he took 50 percent of the losses. And that worked great until 1929 when the market went down and obviously his stocks were affected, too, and he was not only affected by that, but many of these people then pulled out because they needed money for their own purposes or they had lost a lot of money other places.

So he figured out how he could possibly never have this happen to him again. He was very upset about losing money. A lot of us are. So he worked on a number of ways of doing this and one of them was buying companies below working capital and in the '30s there were a lot of companies that developed that way. And then in 1936 he formed a company called Graham-Newman, which was, I'd say, an open and closed end company in that he was able to open it up to his stockholders and he'd sell stock with the rights to buy

buy new stock below asset value. That is, if you didn't exercise your option you were able to sell the rights for money.

At the beginning of 1946, I was out of the Army and Graham hired me to work for him as a security analyst and Graham-Newman was then 10 years old and had a nice record. One of the reasons they had a nice record was that they bought these secondary stocks which had big book values but not particularly good earnings. When the war came along he was able to profit from this because the excess profits taxes really hurt the companies with small book values. But the big book value stocks were in the war and so they made a lot of money based upon the fact that they didn't have to pay these excess profits taxes. And those stocks went up and he did very well. Ben realized that most of them had gone to prices that were no longer cheap and so he sold a great many of them.

So, when I came to work for Ben, he had 37 stocks in his common stock portfolio. This was a really big investment company. They had $4,100,000 of which $1.1 million was in common stocks. I looked at the portfolio and I saw that of their 37 stocks that were in the portfolio on January 31, 1946 only two of them are still around. All the others were taken over, merged, disappeared. And the only two; one was Tricontinental Corp and the other one was McGraw Hill. He had very small amounts of these stocks and you figure $1,100,000 with 37 stocks, it wasn't very much.

They weren't all Industrials. He had investment company stocks and he had some American Surety, and other insurance company stocks. Basically the rest of his portfolio was made up of bankrupt bonds, against which he sold "when-issued" securities, some convertible preferred stocks where he shorted the common stocks against them. In those days, if the stock went up you took a long-term gain on the profit side for the preferred and you took a short-term loss on the short side, which was a pretty good deal for them and, of course, that isn't true anymore.

Anyhow, at that time my job was to find stocks which were under valued. And we looked at stocks selling below working capital, which was not very many. Among them, for example, was a stock like East Washing Machine A. The "B" stock was all owned by the management or owners. You might know that back in the '40s, a lot of companies were companies which were family controlled and there was a play about 10 years ago which some of you may have seen called "Other People's Money." It played Off- Broadway and it was about a little company in New England that struggled along, the family controlled it and they weren't making any money but they didn't want to put any more money into it because it was a marginal business. And what happened is a fellow from New York comes up in this play and he offers them a pretty good price to buy the company and the president doesn't want to sell. There are a lot of double crosses and it ends up that the family sells out to this guy from New York, who then liquidates the company, throws people out of work. But the family made money out of it.

I was reminded of that by some of the things that have happened over the years since then. In the case of Warren Buffett, who everybody knows or has heard of if they

don't know him, and Warren told me a story I thought was kind of interesting. He owned a lot of Berkshire Hathaway. He probably paid $8 to $10 a share for it. He went up to the management and he spoke to the president about his selling a block of stock back to the company. The company had previously repurchased stock. The president agreed to buy it from Warren at $11.50 a share.

Well, Warren got that tender offer The tender offer came in at 11 and 3/8ths and Warren was sore. And he bought control of the company. So sometimes if you miss something by an eighth of a point, you might think about that.

One of the experiences I had when I worked for Ben was that he had very strict rules. He wasn't going to deviate. I had a fellow came to me from Adams & Peck. I don't know if you've ever heard of Adams & Peck. It was an old line railroad brokerage company. Hetty Green would buy the Pittsburgh, Fort Wayne and Chicago Preferred, guaranteed for 999 years except that Penn Central went bankrupt. Adams & Peck was known as a purchaser of leased line companies. This fellow came to me, a nice guy, and he said, The Battelle Institute has done a study for the Haloid Company," a company in Rochester that had paid a dividend through the Depression, a small company that made photographic paper for, I think, Eastman Kodak. Haloid had the rights to a new process and he wanted us to buy the stock. Haloid sold at between $13 and $17 a share during the Depression and it was selling at $21. This was probably about 1947, '48 or something like that. I thought it was kind of interesting. You're paying $4 for this possibility of a copying machine which could do this. Battelle thought it was OK. I went into Graham and said, "you know, you were only paying a $4 premium for a company that has a possibility of a good gain," and he said, " no Walter. It's not our kind of stock." And, of course, it was Xerox.

So, you can see, he was pretty set. The only consolation I had on that one was that I was almost sure that if they had bought this stock at $21 and it had gone to $50, they would have sold it because they did not project what the thing could do. And one of the things about these undervalued stocks, which we talk about, is that you really can't project their earnings. There are stocks where there's growth and you project what's going to happen next year or five years. Freddie Mac or one of these big growth companies, you can project what they're going to do. But when you get into a secondary company, they don't seem to have that ability. You can't really say, "well next year they're going to do well because this year they did poorly and they're secondary stocks."

And one of the things we then try to do is to buy a secondary stock that's depressed. And today, because of the high level of the stock market, most everything's been picked over. You've got some analysts, thirty-four thousand chartered financial analysts, I mean, you have a tough time finding something to buy.

And I'll give you one which you probably won't like which would be typical of a under valued stock. And it's been mentioned before by others and it's a stock that was at one time in the Dow Jones Average. And it's come upon evil days and struggle and

nobody likes the industry and so forth. But the stock sells at about $21 a share and it has a book value of about $40 a share and it sold down, I think it's selling around $21 now. It got down to maybe $17 when the market broke a few months ago. It's a copper company called Asarco which just cut its dividend in half.

Now that stock has got a lot of assets in Peru. They have some big copper mines here. And nobody likes it because it doesn't have growth. And I think Asarco is cheap. But just because I say it doesn't make it so. And we own some and so I don't want you to think I'm pushing it just because I own it. But I thought you might be interested in the kind of stock I'm talking about.

So that's really what's been happening and we bought a lot of these for Ben Graham. We buy a lot of those under valued stocks and they'd work out and then we'd sell them. We had a company called Buda Co. and when I went in and they had only a few industrial companies, Jones and Lamson Machine Works -- it's up in Vermont -- but Jones and Lamson was a machine tool company and at the end of the war, there was no future. You know, how many machine tool companies do you want? And we had New Britain Machine and you could buy things where there was no good outlook and of course the great example, as you probably know, was one company that people liked sold at $45 a share with a book of 20 and then use the example of a company selling at $20 with a book value of $40, and of course it was the same company, it was Boeing Airplane. And Boeing Airplane, before W.W.II, sold at a big premium over its assets because it had a great future. But in 1946, nobody wanted Boeing Airplane because they didn't think they had much of a future.

So we would have liked to buy the Boeing when it was selling at $20 with a book of $40 but not the other way around. And I don't know many people here who tend to like to buy companies which are having problems. And one of the reasons is that if you buy a company that's having a problem and you have customers, they don't like that. They want to own companies that are doing well. And you're going against human nature when you buy companies which are having a problem and one of the things we do in our field is we buy stocks on the way down. So that if we buy a stock at $30 and it goes to $25, we'll buy more.

Well, a lot of people don't like it if you buy a stock at $30 for a customer and then they see it at $25. You want to buy more of it at $25. The guy doesn't like that and you don't like to remind him of it. So one of the reasons I think that you have to educate your customers or yourself, really, that you have to have a strong stomach and be willing to take an unrealized loss. Don't sell it, but be willing to buy more when it goes down, which is contrary, really, to what people do in this business. And Ben was really a contrarian but he didn't use those terms because he was really buying value. And when I went to work for him, there weren't any people doing this kind of thing, buying stocks on the way down.

But what I did do was I took six pages from the end of January 1946 and I made copies for people here. If you want to read it, I left it upstairs and you can see a kind of a history. This was the 10th year of Graham-Newman and I was working there. My first job at Graham-Newman was to prepare the annual report for that 10th year. And so you might find it interesting and if you don't, that's OK, too.

But is that about what you want to know from Ben? And I tried to follow Ben Graham's ideas of doing it that way. And of course it's much more difficult now because you don't have that group of companies selling below working capital. You find a company selling below book value, that's very unusual and usually the ones that do have a lot of problems so that people don't like to buy problems.

The big key thing in the way we invest is to buy against price and Graham said in The Intelligent Investor, a very good thing, you buy stocks like you buy groceries, not the way you buy perfume. Now, that doesn't seem so good today because the Gillettes and the Coca-Colas are the perfume stocks. But basically we like to buy stocks which we feel are under -valued and then we have to have the guts to buy more when they go down. And that's really the history of Ben Graham. That's it.

Oh, yes, Jim said that I should take questions and I will on the basis that I have the answers.

QUESTION: Now, it is often said that the market sometimes knows more than the investors. So when a stock goes down, could it mean that you've got the analysis wrong, you're not supposed to buy more, you're supposed to get out?

SCHLOSS: Well, that could happen. You have to use your judgment and have the guts to follow it through and the fact that the market doesn't like it doesn't mean you're wrong. But, again, everybody has to make their own judgments on this. And that's what makes the stock market very interesting because they don't tell you what's going to happen till later.

QUESTION: There were a group of you that all learned under Ben Graham and you all seem to be incredibly successful investors. What do you think is the common thread amongst all of you?

SCHLOSS: I think number one none of us smoked. I think if I had to say it, I think we were all rational. I don't think that we got emotional when things went against us and of course Warren is the extreme example of that. I think we were all nice guys and I think we were honest. I don't think we had -- you know, there are people who've made a lot of money who I wouldn't want to invest with because they just aren't trustworthy and you probably know who they are and some of those stocks sell at low prices because other people feel the same way. And I would say that this was a good group of people and Warren was very nice about inviting us every two years, we'd have a meeting somewhere.

The first meeting we had was back, and you saw it in "Forbes" magazine, back in 1968. Warren asked me, "would you like to go out to speak with Ben Graham." It was the only time we ever met with Ben Graham. And Warren said, "how about going to Las Vegas first?" I said, "fine, it's all right with me." And of course, in Las Vegas, the hotel rooms are very cheap. I don't think we gambled more than 20 bucks. Then we went to San Diego and I brought my camera with me. It was a little one. At one point I said to everybody that was there, "I'll take a picture of you."

I made the picture and sent it to everybody and when they had this thing in "Forbes", a few weeks ago, they said "picture courtesy of Warren Buffett." So that's the way it goes.

But, did I answer the question? Anybody? That's it? Oh, here.

QUESTION: At that meeting in 1968, that was in California, wasn't it?

SCHLOSS: That's right. It was down in San Diego.

QUESTION: And Graham gave you a 20 question true-false test, did he not?

SCHLOSS: I don't remember the answers but I know it was one of those tricky things.

QUESTION: You wouldn't have those 20 questions, would you?

SCHLOSS: No. I don't even remember what they were and I thought the test was sort of unfair, as I remember.

QUESTION: Japan today has a lot of cheap stocks, a lot of net nets but there seems to be little corporate governance. Would you bother?

SCHLOSS: Well, my problem with foreign companies is I do not trust the politics. I don't know enough about the background of the companies. I must tell you, I think the SEC does a very good job and I feel more comfortable holding an American company and I really don't speak Japanese and some of these companies are in Japanese and I just feel comfortable buying American companies.

I will say that we have bought British companies. But the others I've tended to stay away from because I just don't understand their politics. There's always something that comes up that you never knew about. And I think of Cuba, of course, where there were American companies in Cuba and then suddenly they had communists there.

So I feel comfortable with the American companies. I understand the economics of it and the politics and while things can change, I feel more comfortable with them.

QUESTION: People like to try and find comparisons between today's market and markets in the past. Do you see any repetition in history, any year that this year's evaluations remind you of?

SCHLOSS: Well, I'll tell you, at the end of last year I refused to accept money for our partnership because I felt I had no idea what the market was going to do, trying not to figure out where the market was going to go, I couldn't find anything to buy. My son couldn't find anything to buy. So he said well, if we can't find anything to buy, why should we take our clients' money. So we didn't. And to that extent, I thought last year the market was over valued.

Now you have a two tier market. You have some of these stocks that have really taken a beating, down 50, 60 percent and the other stocks up near their highs. So you look at the ones that are depressed and then you say well, maybe these things can come back. You know, people tend to like to buy companies that are doing well. They hate companies that are doing badly. If I take a tax loss this year it will offset my gains, you know, all the different reasons. So sometimes the stocks that are going down go down more than they should. It's simply because people are trying to save some money by selling it to take the tax loss.

So I would say that this is one thing. Each market is different, you know? In 1962, the market was crazy for some of the low priced stocks. They went up, they had new issues coming out and the prices were ridiculous and I didn't do anything about it except that I didn't own them. And some of the ones that are going up a lot we sold and then they went back down again and one of them I remember, which was called Fownes Brothers Gloves, which has long been gone, but the stock, I think, I paid, the first stock I bought back in 1955 when we started the partnership at 2-1/2. Tweedy Browne bought it for me, and it went up to $23 and I sold it. I had a lot of it and we sold it. And then I couldn't buy it back. It didn't go down as far and it dried up. So sometimes, it finally did sell out around $32 a number of years later. But sometimes you have to take advantage of the opportunity to sell and then say OK, it'll go higher.

And I will say this, since we sell on a scale, most of the stocks we sell go up above what we sold them at. You know, you never the get the high or you never get the low.

QUESTION: What is your sell discipline, actually, and how has it changed?

SCHLOSS: Sell is tough. It's the worst, it's the most difficult thing of all and you have an idea of what you want to sell it at and then you sometimes are influenced by the changes that take place. We owned Southdown. It's a cement company. We bought a lot of it at 12-1/2. Oh, this was great. And we doubled our money and we sold it at something like $28, $30 a share and that was pretty good in two years. When next I

looked it was $70 a share. So you get very humbled by some of your mistakes. But we just felt that at that level it was, you know, it was not cheap.

QUESTION: Has your approach changed significantly?

SCHLOSS: Yes, it's changed because the market's changed. I can't buy any working capital stocks anymore so instead of saying well I can't buy 'em, I'm not going to play the game, you have to decide what you want to do. And so we've decided that we want to buy stocks if we can that are depressed and have some book value and are not too, selling near to their lows instead of their highs and nobody likes them. Well why don't they like them? And then you might say there may be reasons why. It may simply be they don't have any earnings and people love earnings. I mean that's, you know, the next quarter that's the big thing and of course we don't think the next quarter is so important.

QUESTION: Tweedy Browne is very quantitative, And Buffett's more qualitative. Where are you in that spectrum?

SCHLOSS: I'm more in the Tweedy Browne side. Warren is brilliant, there's nobody ever been like him and there never will be anybody like him. But we cannot be like him. You've got to satisfy yourself on what you want to do. Now, there are people that are clones of Warren Buffett. They'll buy whatever Warren Buffett has. Fine. I don't know, I don't feel too comfortable doing that and the other thing is this. We happen to run a partnership and each year we buy stocks and they go up, we sell them and then we try to buy something cheaper.

Now, if we buy a stock, I mean had only Warren Buffett stocks, and the stock was Freddie Mac and it goes from $10 to $50. Boy, that's a great deal. We sell it. But if you don't sell it and then the market changes and Freddie Mac goes down from $50 to $25, my partners they lost 50% -- that year we lost 30% of our money on our securities. They'd all pull out because you can't lose 30%. And Charlie Munger actually lost 30% of his money two years in a row when he was managing his own money.

So that you have to be a little aware of the emotions of the people who have invested with you. And they trust you but they don't like to lose 30 percent of their money. And we won't lose 30 percent of our money. And if you buy these high grade companies which have a growth factor, they can take a beating and our investors are not sophisticated and therefore we try to protect them because we get a percentage of the profits but we take a percentage of the losses. But they don't really, they aren't really happy if they lose that kind of money. So I don't feel comfortable with them.

But there are people that have made a great deal of money with them. So, again, you have to invest the way that's comfortable for you. And the way that's comfortable for us is to buy stocks where we have a limited risk and we buy a lot of stocks. Well, Warren, as somebody said, owning a group of stocks is a defense against ignorance,

which I actually think that's to some extent true because we don't go around visiting companies all over the country and Peter Lynch did. He was killing himself. He was seeing 300 companies a year and he was running from one company to another and what's that going to do?

We're not set up that way. And Graham wasn't. And Graham's argument was that the directors of these companies are responsible for their success. If the company isn't doing well, change the management, do things that make the company do a better job. And it takes longer that way. No company wants to lose money continually. They're going to do something, but you do get changes in the way companies are operated. No company wants to lose money continually - they're going to do something about it. They'll either merge or they'll change the management. So we do not spend a great deal of time talking to management or talking to our partners - We don't want to talk to our partners at all.

Emotionally, I find the stock market can be very unpleasant and I don't want to listen to people's cries. If they're unhappy -- you may not be in that position to do that, but we are and I just don't want to listen to them. If they don't want it, out. But we do the best we can for what we are doing and I feel that you have to understand where we're coming from and basically trust us because we've been doing this now for 40, about 43 years. So they just have to stay with us, hopefully.

QUESTION: Are you taking new money and if so when did you start?

SCHLOSS: Well, no, every year we would take, if we had room, we would take partners, if they were limited partners, but we wouldn't take corporations and you have to limit it cause it can really take up...

QUESTION: Well, last year you said you had not...

SCHLOSS: Last year we decided not to take anybody.

QUESTION: But this year are you taking...

SCHLOSS: Well, if they have a million dollars and they cry, yes. No, but we don't have to yet. I don't know if we have room or not, because we are kind of full up. But that, we try to be a little flexible if we can.

QUESTION: How much turnover have you had?

SCHLOSS: You mean about the stocks?

QUESTION: Yes.

SCHLOSS: I guess 20 or 25 percent a year. About every four years we turn over. We want to get long-term capital gains and when you buy a depressed company it's not going to go up right after you buy it, believe me. It'll go down. And therefore you have to wait a while for that thing to go around and it seems about, four years seems to be about the amount of time it takes. Some take longer. We have one stock, actually, and peculiarly enough, I bought this from Warren Buffett. He owed me a favor and he had a group of stocks -- very small amounts of each one -- and he came to me back in 1963 and he said Walter, would you like to buy these companies. I forget their names. Genessee & Wyoming Railroad I remember was one of them. And there were a few others like that.

And I said well, Warren, what are you, what price are you carrying them for? And he told me. He said I'll sell 'em to you at the price I'm carrying them for. I said OK, Warren, I'll buy it. That doesn't sound like a lot, but in those days it was, you know, $65,000. It wasn't a lot of money but those five companies, and we sold everything over the years. They all worked out beautifully and we have one left and it's called Merchants National Properties and they just had a tender offer. I paid $14 for the stock and they had a tender offer. They want to buy this, they're not going to buy our stock, at $553 a share. So you can see in these little companies there was a great chance to make money. But that's almost 35 years ago.

QUESTION: Buffett keeps talking about like a handful of thick bets. It sounds like you don't do that.

SCHLOSS: Oh, no, we can't. Psychologically I can't, and Warren as I say, is a brilliant, he's not only a good analyst, but he's a very good judge of businesses and he knows, I mean my gosh, he buys a company and the guy's killing himself working for Warren. I would have thought he'd retire. But Warren is a very good judge of people and he's a very good judge of businesses. And what Warren does is fine. It's just that it's not our -- we just really can't do it that way and find five businesses that he understands, and most of them are financial businesses, and he's very good at it. But you've got to know your limitations.

QUESTION: Are you involved with commodities at all and if so...do you see silver as under-valued?

SCHLOSS: You know, I have no opinion about any commodity or where it's going to go and Asarco is a commodity company in copper. I have no idea if copper can keep going lower. But I just think that the stock is cheap based upon its price, not necessarily because I know what's going to happen to the price of copper any more than silver. I have no opinion on any of those things. It saves me a lot of time.

QUESTION: Do you sell short?

SCHLOSS: We did it a couple of times and we're always very upset after we do it. So I'd say not anymore.