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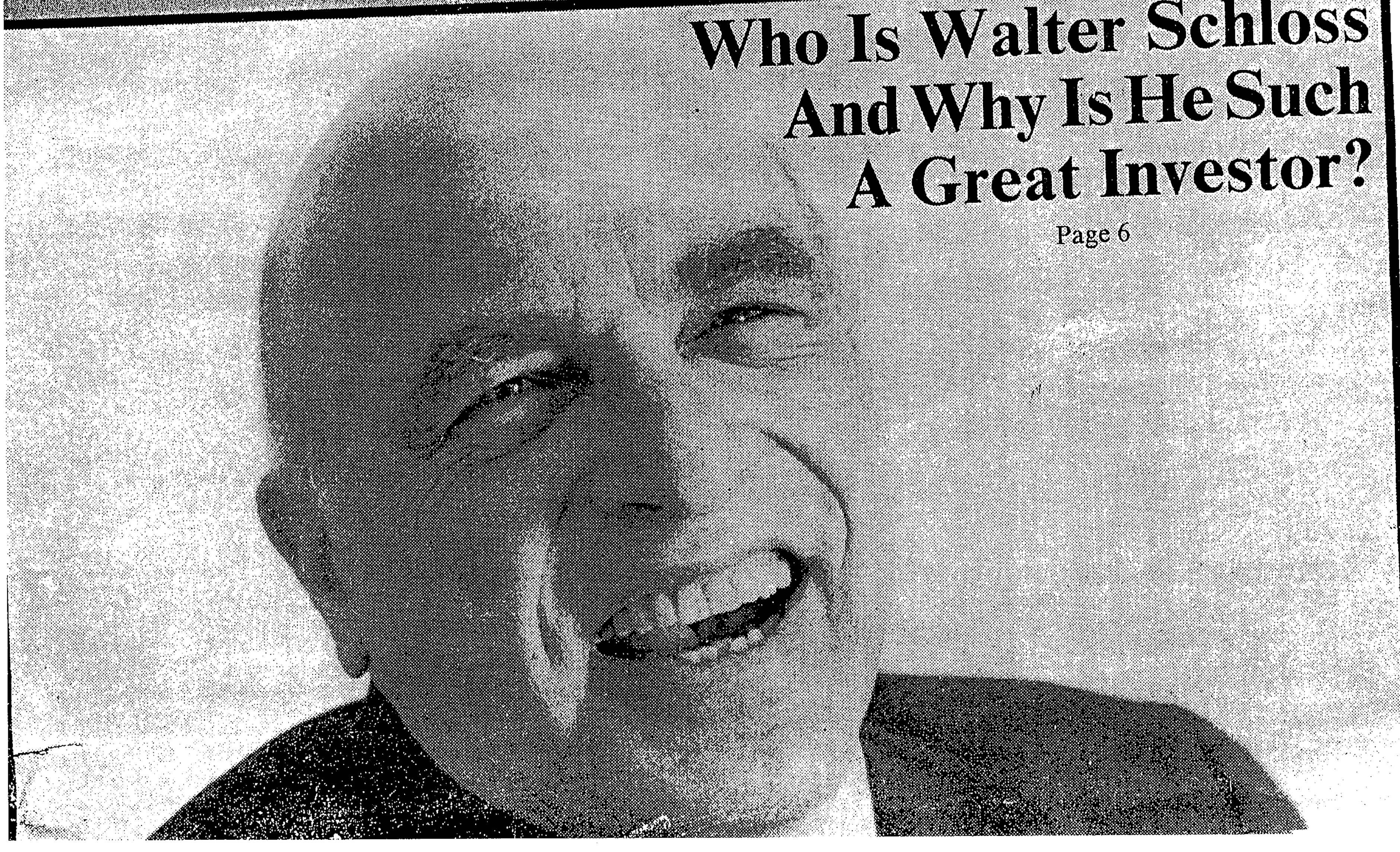
Who Is Walter Schloss And Why Is He Such A Great Investor?

Page 6



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The Right Stuff

Why Walter Schloss Is Such a Great Investor

WALTER J. Schloss doesn't set any store by pretense, or office politics, or frenetic trading, or tape watching, for that matter. The efficient market theory? You've got to be kidding.

Ben Graham's another matter entirely. And so, too, is making money. Something that Walter has been doing with phenomenal consistency for his partners since 1956, as the table reproduced over yonder demonstrates so admirably.

How does Walter (whose Walter J. Schloss Associates consists of just him and his son, Edwin) do it, year after year? By dint of singular devotion to the value-oriented investing principles laid down by Graham—adapted, of course, to current market conditions. Nothing fancy about it—no bonds, no options, no exotic hybrid securities. And, until his fellow Graham disciple, Warren Buffett, blew his cover in the latest issue of the Columbia Business School's magazine, unheralded. *(See page 13.)*

Fascinated by Walter's record, we gave him a call last week. Our questions had a lot to do with how—and what—he's doing with his money now. We found a self-deprecating and altogether charming fellow whose answers can be found below.

—Kathryn M. Welling

BARRON'S: Why don't we start with you telling us how you got into this business . . .

Schloss: I'll tell you a little about it. It's kind of interesting to me, I guess—nobody else.

Q: Let us be the judge.

A: I came to Wall Street in 1934. I'd just come out of high school; it was the Depression, and the family needed money. I liked Wall Street. I can't tell you why. But my mother was criticized by her friends for letting me come. They said, "There won't be any Wall Street by 1940." Which gives you an idea of the perspective back in those days.

Q: Where did you start out?

A: I worked as a clerk at Loeb, Rhoades, which was then called Carl M. Loeb & Co. I used to take courses at night at the New York Stock Exchange Institute. Ben Graham taught there, and I just fell in love with his point of view. All these smart Wall Street guys used to take this course. And Graham used to lecture on live stocks. He'd take Baldwin Locomotive, which was bankrupt. He'd show the bonds, which would be selling at a low price, and he'd show what their new securities would be worth. This was really where arbitraging between bankrupt securities and the new when-issued securities got started. They'd all go out and make a lot of money off Ben, and he didn't seem to mind. He was kind of a philosopher. And, basically, I agreed with his philosophy, even though I didn't have any money.

Q: So you took Graham's course for the love of learning?

A: Yes. Graham was writing his book on the stock market, and I remember helping him with one chapter. Then the war came along and I enlisted. He wrote to me while I was still in the service—and said, "Have you a chance to come to work for me?" The man he had doing security analysis was leaving to go to work for his father. So I went to work for Ben Graham at Graham-Newman on Jan. 2, 1946.

Q: You remember the exact date?

A: It was a great experience for me. In those days, nobody ever made very much money, except the bosses, but I enjoyed working there. Ben's book is called *The Intelligent Investor.* And I really want, in this interview, to urge the people to get hold of that book. For the average investor, there are so many books out there, and they all tell you to do different things, but this book is really helpful, particularly for investing in common stocks. Because if you don't have the right investment philosophy, you can get very badly hooked. And I

Schloss's Picks

Company	Ticker (Abbr.)	Exchange	
CPC Int'l	CPC (CPCInt)	NYSE	*"The downside's limited . . . So you buy it."*
Crown Zellerbach	ZB (CrwZel)	NYSE	*"It isn't exactly cheap. But it's a good value."*
Northeast Industries	NWT (NwtInd)	NYSE	*"Basically a good company, and there will be another deal."*
Northwestern Steel & Wire	NSW (NwStW)	NYSE	*"It does have problems. I can't say that enough."*
Potlatch	PCH (Potltch)	NYSE	*"The timber's worth a lot more than the market price."*
Stauffer Chemical	STF (StaufCh)	NYSE	*"Control was in the market. That made it more vulnerable."*
Texaco	TX (Texaco)	NYSE	*"You couldn't replace it for what it sells for."*
Union Carbide	UK (UnCarb)	NYSE	*"A good value stock. They had a terrible break."*
Western Pacific Indus.	WPI (WPacI)	NYSE	*"There's no particular point selling it. I have a big profit."*
Xerox	XRX (Xerox)	NYSE	*"It's got a lot of cash flow."*

think anybody who has any money to invest really should understand this approach.

Q: Is this a commercial?

A: No. But the book's published by Harper & Row; it's still in print; the last edition was '74; Graham died in '76. But the part on common stocks is just as valid today as it was then.

Q: Anyway, you went to work for Graham and. . .

A: It's a funny thing about Graham. I think he was like an undervalued security, if you want to know. People said, "Oh, Ben Graham, he's very smart." But then they'd go off and do their own little thing with computers, or whatever the popular thing was at the moment. They kind of forgot. They'd say, "Oh, we like undervalued stocks," but then they wouldn't buy them. Or they'd say, "It's a great idea, but the efficient market is taking care of it," or whatever. And I thought Graham's ideas made a good deal of sense.

Q: What did you do with them?

A: Then, Warren Buffett came to work at Graham. I'll tell you one story: First of all, Ben was a great believer in buying a diversified group of securities, so that he limited his risk. He was badly hurt by the Depression, and he didn't want to do that again. We basically followed the idea of buying companies selling below working capital—at two-thirds of working capital—then, when the stocks' prices went up to match working capital per share, we'd have made 50% on our money. And the firm averaged about 20% a year on that basis, and it was a great deal, as long as these stocks were around. But of course, in the 'Fifties, they started disappearing. Diamond T Motor Car, Easy Washing Machine—all these companies that were selling at big discounts disappeared.

Q: In other words, they were acquired, merged or liquidated and you, as shareholders, realized their values?

A: Mostly. They were mostly secondary companies; they were never the top-grade companies. And they tended to be ignored by the public because they didn't have any sex appeal, there wasn't any growth—there was always trouble with them. You were buying trouble when you bought these companies, but you were buying them cheap. Of course, when you got them too cheap, they maybe ended up going down the tubes. So you try to be a little careful. But people don't like to buy things that are going down.

Q: Understandable enough.

A: Basically, it's a contrarian philosophy, and people really like buying things that are doing well. But to make money, you have to spend a little time at it. It isn't just, "Oh, I think I'll buy this stock because it's got a nice name," or "my friend told me to buy it." This is a business, like any other business.

Q: You were going to tell us a story?

A: I was in Graham's office the day he first bought Government Employees Insurance Co., which is GEICO. Warren owns one-third of the stock today.

Q: His famous coup.

A: That's right. But the funny part is that I was in Graham's office when a phone call came from the lawyer, who said, "You bought your 50% of the company"—and Graham paid something like $750,000 for 50%, or something on that order. Anyway, he turned to me and said, "Walter, if this doesn't work out, we can always liquidate it and get our money back." He had no conception of the growth potential of this thing. He was just buying an insurance company cheap.

Q: He was worried about what he could lose?

A: Yes. Graham liked the idea of protection on the downside, and basically, that's what I do. I try not to lose money.

Q: Doesn't everyone?

A: One of the tricks of this business is, keep your losses down and then, if you have a few good breaks, the compounding works well for you.

Q: Isn't another trick figuring out what cheap stocks aren't simply going to get cheaper?

A: I'm not very good on timing. In fact, I've stayed away from it. I think it makes life much easier—people come to me and say, "Well, what do you think the market's going to do?" And I always say, "I've got no idea; your guess is as good as mine."

Q: So timing isn't everything?

A: Timing is a very—everybody tries to do it, so I stay away from the game that everybody's trying to do. If you buy value—and you may buy it too soon, as undoubtedly I do—then if it goes lower, you buy more. You have to have confidence in what you're doing.

Q: That takes courage, when a stock's heading south.

A: You have to have patience in this field. But quite often stockbrokers aren't too interested in a stock you can sit there for five years with.

Q: When do you sell?

A: There's a tendency, I think, to say, "Oh, the thing is up 50%; let's take our profit." When I buy a stock, I have kind of an idea where I want to sell it. But if you've been with a stock for five years—I would say our average holding period is four years—and things have been developing nicely, it may change your benchmark.

Q: For example?

A: We have a stock I bought a long time—14 years—ago, called Western Pacific Industries. They were having a lot of trouble; they had railroads and so forth. The thing was sitting around, and the stock was coming in by the buckets around 6. Nobody seemed to want it. Well, they bought a company called Veeder-Root in '74, and it really started to work. The stock went up and up, and in '79 they paid out a $23 cash dividend, which was a return of capital. The stock a couple of days ago was 112½. It doesn't pay a dividend, but they've been racking up very good profits, and I've just been riding it. Management has done a very nice job, and there's no particular point in selling, just because I have a big profit in it.

Q: What is it worth?

A: Well, I think it's worth more than this, so I'll stay with it. Now, that's more the exception than the rule.

Q: When did you set up your own firm?

A: In 1955, Graham said he was going to retire. He was going out to California. I think he was kind of bored. I said, "If he's going to retire, I might as well go into business for myself." So I got myself 19 partners, and they each put up $5,000. One guy put up $10,000.

Q: That's all?

A: We put up $100,000. It's kind of pathetic, when you think about it. Now you see fellows saying, "I won't start a partnership without $10 million." The

Walter J. Schloss

Year	S&P Overall Gain Including Dividends	WJS Ltd Partners Overall Gain per year	WSJ Partnership Overall Gain per year
1956	7.5 (%)	5.1 (%)	6.8 (%)
1957	−10.5	− 4.7	− 4.7
1958	42.1	42.1	54.6
1959	12.7	17.5	23.3
1960	− 1.6	7.0	9.3
1961	26.4	21.6	28.8
1962	−10.2	8.3	11.1
1963	23.3	15.1	20.1
1964	16.5	17.1	22.8
1965	13.1	26.8	35.7
1966	−10.4	0.5	0.7
1967	26.8	25.8	34.4
1968	10.6	26.6	35.5
1969	− 7.5	− 9.0	− 9.0
1970	2.4	− 8.2	− 8.2
1971	14.9 (%)	25.5 (%)	28.3 (%)
1972	19.8	11.6	15.5
1973	−14.8	− 8.0	− 8.0
1974	−26.6	− 6.2	− 6.2
1975	36.9	42.7	52.2
1976	22.4	29.4	39.2
1977	− 8.6	25.8	34.4
1978	7.0	36.6	48.8
1979	17.6	29.8	39.7
1980	32.1	23.3	31.1
1981	− 6.7	18.4	24.5
1982	20.2	24.1	32.1
1983	22.8	38.4	51.2
1984 1st Qtr.	− 2.3	0.8	1.1

Standard & Poor's 28¼ year compounded gain	887.2%
WJS Limited Partners 28¼ year compounded gain	6,678.8%
WJS Partnership 28¼ year compounded gain	23,104.7%
Standard & Poor's 28¼ year annual compounded rate	8.4%
WJS Limited Partners 28¼ year annual compounded rate	16.1%
WJS Partnership 28¼ year annual compounded rate	21.3%

During the history of the Partnership it has owned over 800 issues and, at most times, has had at least 100 positions. Present assets under management approximate $45 million.

people had confidence in me, so we started. And really, it kind of built up from there. And I like the low profile. I mean, this interview with you . . . I don't know if it's a good idea.

Q: We won't bite.

A: But basically, I like the idea of what I do, and I like working with my son, and we enjoy ourselves. And I think I'm helpful. I really didn't want to find a lot of enormously wealthy people and manage their money. Those fellows, they don't need me, they can do it themselves, or they hire all kinds of people. But the people we have, they're my folks. They need some help.

Q: And you've done very well by them, just buying and selling stocks.

A: I am a passive investor. There are people who are very aggressive; they try to buy companies. We just buy the stock, and if it goes to what we think is a reasonable price, we sell it and move on to something else. Graham made the point in his book where he said, "You buy stocks like you buy groceries, not the way you buy perfume." You're looking for value.

Q: Sounds very low key.

A: And value-oriented. I try to be removed from the day-to-day; I don't have a ticker-tape machine in my office.

Q: You don't?

A: No. I can read the papers, and there's an office nearby where I can go and watch it, but basically, I try to stay away from the emotions of the market. The market is a very emotional place that appeals to fear and greed . . . all these unpleasant characteristics that people have. Making judgments is very difficult. Knowing when to sell—making a decision to sell is the most difficult thing we do. Buying a stock is getting difficult, too. I might say, Warren Buffett hasn't helped. A good friend of mine, but all the publicity about value investing—it's become a very popular thing. A lot of people are doing it now, and not just talking about it. So it gets tougher and tougher.

Q: To find undiscovered value?

A; That's right. Everybody's looking for it, and there's a lot of money out there.

Q: Where are you finding value?

A: Those working capital stocks have all disappeared. And of course, when you have a lot of money to invest, you don't buy very small companies, because you can't buy enough of them. And many of those small companies are closely controlled, anyhow.

Q: What can you buy?

A: We happen to have Stauffer Chemical in our portfolio. When I bought it several months ago, somebody said, "Oh, how can you get involved in that kind of company? The agricultural chemical business is bad—" And I said, "Yeah, but they've had a good record over the years. They've got problems now, but. . . ."

Q: Then in walked Chesebrough?

A: Well, the stock moved up a little bit, and I noticed it was selling about 21. And suddenly they announced that they were selling out at 28. Now, was the stock worth 21, or was it worth 28?

Q: You tell us.

A: The market was saying it was only worth 21, because their earnings weren't that good. It paid a good dividend. But it obviously was worth more than that. And the fact that control was in the market made it more vulnerable. And I think maybe management recognized that and decided to make a deal. But the point is, if it hadn't worked that way, Stauffer was really a good company, and in a few years, it would have worked out satisfactorily. It happened to work out quicker, that's all.

Q: Where did you buy it?

A: My guess is that my average cost is around 19. It happened to be—which is unusual for us—a short-term gain, which I'm sorry about.

Q: But you'll take it?

A: Yeah, well, you know—I have to talk to my son about it. He may say, "Don't tender the stock," but I basically find that sometimes, if you say, "I'll wait a while," things don't always work out so well. I think our biggest position is Northwest Industries. I was very pleased that they were going to distribute Lone Star Steel, and they were going to get $50 a share, and everything was great. The stock got up to over $60 a share. And suddenly the deal fell through, and now the stock's selling at 53. Yet I think it's basically a good company. And I think there will be another deal.

Q: So you're not sorry you didn't sell?

A: Here's a case where you could have sold at 60, made your capital gain, and walked away. Instead, we said, "Look, there is this deal, and we'll just wait until it finishes." And it turned out that we miscalculated. Sometimes you get a little *too* smart. But this is the law of averages; sometimes deals don't work out.

Q: Where'd you buy your Northwest stock?

A: Let's see, I probably had it a couple of years. I would guess our average cost is about 40. It's not a tremendous hit, but 40 to 60 wouldn't have been bad either, you know.

Q: How much money are you managing now?

A: I'd say about $45 million.

Q: Small enough so that you have some flexibility—

A: I never thought I would have this much money. You know, you talk about small—Ben Graham had $5 million in Graham-Newman Corp.; he started up a partnership which had $10 million called Newman & Graham; and he wrote the partners, somewhere around '53, "We really can't use all this money, please take some of it back." It's funny, today, $45 million seems like a little bit. I really never thought of it in those terms. It's just been compounding, and the money built up, and the money's been reinvested. If you live long enough, you end up with a pretty big figure!

Q: And you're invested in how many issues now?

A: Oh, I guess 100. Which makes it somewhat unwieldy. The thing is, we don't put the same amount of money in each stock. If you like something like Northwest Industries, you put a lot of money in it. But we may buy a little bit of a stock, to get our feet wet, and get a feeling for it. Sometimes if you don't own a stock, you don't pay close enough attention. Then, also, we sell stock on a scale. Sometimes we sell some, and then the stock poops out on us, and then we're stuck.

Q: You mean you just hold on to them?

A: Sometimes we get into situations where we really don't sell at all. So we have more securities than I'd like to have, and yet, I feel comfortable owning them. Then, of course, you get a situation where you buy the stock, and it seems a good value, and it goes up a fair amount, and you like it better. You become a little more attached to it, and then you see some pluses that you may not have realized before.

Q: Have you added anything over the years to the Graham approach?

A: Well, orginally, I liked the idea of just buying working capital stocks. I think the first stock I bought was Fownes Brothers Gloves. It came out in 1946 at 8 or 9, with a book value of 2. Then, over the years, they built up so that by the time I got it, it had working capital of $6 or $7 a share and it was selling at $3. Which is kind of typical; people don't tend to sell their stocks to the public when they have a big book.

Q: Maybe you'd better define a "working capital" stock.

A: Suppose a company's current assets are $10 million; the current liabilities are $3 million. There's $7 million in working capital. And, they are, say, $2 million in debt. Take that off. So there's $5 million of adjusted working capital. And say there are 100,000 shares, so they've got $50 a share of working capital. Now, if that stock were selling at 30 bucks a share, it would be kind of interesting.

Q: But it must have some kind of problem.

A: They may be in a terrible business, a buggy-whip business. What do you do, you've got all this money invested—well, that happened to Cleveland Worsted Mills.

Q: Cleveland what?

A: Cleveland Worsted Mills. It was having a terrible time. But they had a lot of cash. I talked to them directly about it. They said, "There are a lot of things we could do. We could buy another company; we could liquidate; we could ask for tenders; we could just keep doing what we're doing." And the management owned a lot of the stock, and they were not going to throw it down the drain.

Q: That's always the big question: Will the shareholders ever see the assets?

A: And some people have made terrible mistakes that way. That's one reason you don't put all your money in one stock. But the Cleveland Worsted fellows did own a lot of the stock, and I guess they felt the thing to do was to liquidate—which they did. Now, that's unusual. Most companies don't liquidate. But they were in a poor business. So they did the sensible thing. But companies don't always do things in your interest, and you have to bear that in mind. Managements, you know, often think of themselves. It depends on the board. One of the things about business is, you try to get in with good people. You don't have to be smart. They don't have to be the smartest guys in the world, but you want them to be honest.

Q: So Walter, where are you finding value today?

A: Well, we look at book value, which is a little lowering of our standards, because book values have some good and bad features. You look at the history of the company and see where it stands, what's happened to it over the years.

Q: What's good and what's bad about book value?

A: Book value is the company's total assets minus its total liabilities; what's available for the common stock. And of course, a lot of companies have lots of assets tied up in plant and equipment. Well, is it old plant, or is it new plant? I'll give you an example of a company we own. These are stocks which are, I think, good values, but I have absolutely no feeling about timing on them.

Q: Okay, shoot.

A: It's called Potlatch, and it's a timber company out on the West Coast. It's not spectacular, but it's got a lot of timber, and I think the timber's worth a lot more than the market price of the stock. Now, that's something you have to look at the figures for, see how much money they put back into these plants and so forth. One of the drawbacks to it, from some people's point of view, is that management owns about 40% of the stock. So a lot of people say, "Oh, I don't want that; it can't be taken over." But on the other hand, management has an interest in seeing that this company is a success.

Q: Interesting.

A: You don't have to just look at book value. You can look at what you think companies are worth, if sold. Even if it isn't going to be sold. Are you getting a fair shake for your money? Now, here's an example of a company which is not a book value stock, but which I think is a high-class company. It's the old Corn Products Refining Co., CPC International. I don't know if you know Skippy peanut butter and Mazola and Mueller's spaghetti—

Q: Never touch the stuff . . .

A: But those are nice consumer products. Basically, I like consumer stocks. My problem is that you pay too much for them today. They've been discovered, so it's tough. CPC is not the cheapest stock in the world, but it's got good value. It has a book of maybe 27, and it's got earnings of $4 a share, I'd say. It sells at 40; the dividend is $2.20, so it's selling at 10 times earnings. Well, you couldn't start the business today for that. And it's a nice steady business, not going much of anywhere, but what's the risk on the downside?

Q: You tell us.

A: The stock's never really taken off, so maybe you'd lose 10% on your money if you didn't sell it—but that risk seems somewhat limited. Of course, they have problems. They do business in Latin America. But they have good products. So you buy it. Somewhere along the line, things will work out better for you.

Q: What's the upside?

A: I would use a price of 60 maybe, or 55—somewhere in that area. But the thing is, it's the place to park money, too.

Q: Why park it?

A: If this market was very low, I'd say, "Well, CPC probably isn't a great stock to own. If the market is so cheap, you want to get something with a little more zip in it, or potential." In a market like ours, which is not that cheap—I wouldn't say it's way overpriced, because it isn't; it's in a reasonable area—there's more risk on the downside. CPC probably doesn't have that much downside risk, and therefore I feel comfortable with it. If the market should collapse, well, then maybe we'd sell it, assuming we'd be getting that price, and buy something that'd gone down a lot.

Q: Such as?

A: Stauffer Chemical was down—about two years ago, the stock was selling at $30 a share. It went down to $16 a share. That was a big decline. Our average cost is 19, so we didn't get in at the bottom. But compared to 28, it wasn't bad. Yet most people wouldn't look at the stock. Most people look at earnings, and earnings potential. Well, I can't get into that game. This is a small little outfit here, to try to compete with the big brokerage house analysts with all their connections and all their information. Perfectly legitimate information; they'll go to the plant, they'll talk to the competitors, it's a very time-consuming thing, but a big organization can afford it.

Q: And you just analyze the company's financial reports?

A: Yes, basically. We get a feeling, if we can, about what we think the company is worth. And make an investment if we think the price is reasonable. Selling is, of course, the most difficult, because—how high is up? When you sell something, and I've done it so often, you don't really like to look at it afterwards. I think we bought some Longines-Wittnauer Watch for $10 or $11 a share. It went up to $20, and I thought, "Oooh, that's a great price." This thing went up to $200 a share. . . .

Q: Ah, well.

A: I had some Clark Oil at 9, and sold it at 27, and then it got up to 260. So I mean—the gigantic moves that I missed! But I thought 100% and 200% profits were pretty good. I didn't realize the really great moves that some of these stocks could make.

Q: But these moves came in a really wild bull market, didn't they?

A: That's true. They were made in the '68 or '72 markets, which really were not good markets for us. Some of the things that took off just went through the roof, and I wasn't involved in them. That's life. You don't try to play the other guy's game. You play the things you do, that you feel comfortable with, and Edwin and I are comfortable with this kind of thing.

Q: How do you know when to sell?

A: That's the hardest. Take Clark Oil. At 27, that stock had tripled. And what did they have, a bunch of gas stations in the Midwest; they sold gas for a couple of pennies less than the average gas station. They started with one; they had 3,400. The man who controlled it was an old man; what was he going to do with it. The big companies? If they wanted to, maybe they could have cut their prices. And normally, in the past, the people who made money in the oil business were the producers, not the refiners. So I sold it, and I told you what happened.

Q: What do you think of the oils these days?

A: The big oil companies today are obviously worth more than they're selling for. I mean, Texaco is obviously worth more than $35 or $36 a share. People think, "Oh, that can't be taken over," so they don't pay more than that for it. But it pays a $3 dividend; there are a lot of assets. People worry about what the price of oil will be in the future. There are lots of reasons why one won't do it, but it's got a nice return while you're waiting and it's a big company and you couldn't replace it for what it sells for.

Q: What's your upside target?

A: If Texaco went to $45 a share, what would one do? That'd be a nice profit, up 10 points. But when it gets up there, you start thinking, "Well, it's selling up here for a reason." It starts feeding on itself. That's why it's much more difficult to know when to sell than when to buy.

Q: Walter, what other values do you see in the market now?

A: I gave them to you. That was it!

Q: That's it?

A: I don't think the market is so cheap that there are that many things around to buy now. Although I'll ride what I have. I'll give you one more that I think is good value—Crown Zellerbach.

Q: Around 34, Crown Zellerbach isn't exactly cheap.

A: But it's good value. You have Jimmy Goldsmith interested in it, you've got the poison pill, they're trying to keep him out . . .

Q: What's its book?

A: Oh, its book is around 34, but I've probably got it worth about $100 a share, with all their timber reserves and everything.

Q: You think Jimmy Goldsmith will win?

A: I don't really have an opinion on it—he probably won't, because they've made it difficult. But basically, all these companies have assets.

Q: How about some more examples?

A: We tend to be more, I wouldn't say, into "heavy industry," but industries which are having problems. Northwest Industries—Lone Star Steel—here's a company which used to earn a lot of money, and nobody seems to want it anymore. It's a pretty good company, in a not-so-good industry. We tend to be involved in that kind of thing, rather than in a go-go—I don't want to be in the computer industry, or things like that, where I don't really understand those companies. There are so many of them, and they all seem to have the same kind of names—ComputerLand, etc.

Q: You don't think there are some cheap stocks now in high-tech?

A: I don't understand high tech. I'm sure there are probably good buys in some of these companies that have been beaten down, but if you really don't know, it's better not to get involved.

Q: What else are you in?

A: We have a stock that has gone through a lot of problems, and it may not make it for us. That is Northwestern Steel & Wire. Northwestern Steel has got a high book—it had a pretty good record over the years, but they got themselves into problems now. I don't know whether they're going to dig out of them or not. Maybe things will turn around a little better for them.

Q: What's troubling it?

A: I blame both labor and management, over the years. Labor, because they demanded these high prices for their wages; and management, for giving it to them, and passing it on to the consumer. Now they're having trouble competing with the Japanese. I go along with a lot of the Reagan Administration's points of view, but I would like to see them slap some tariff increases on a lot of Japanese products. I bet you the next day, the Japanese would suddenly allow our products into their country. I'm sort of incensed about what the Japanese have gotten away with over the years. And I think the basic industries are important for America to have.

Q: Are you holding out much hope for Northwestern Steel & Wire?

A: I don't know. The stock has taken an awful beating. The workers know that; it's to their advantage to work as well as they can. They spent a lot of money on a Northwestern Steel & Wire plant, and you'd think that those fellows would all want to be successful. But I do think there's unfair competition from Third World countries.

Q: So you're not buying more Northwestern Wire stock?

A: No, we're not really buying anything at the moment. And we don't have a profit in Northwestern Steel & Wire that we own. It does have problems. I can't say that enough. On the other hand, I do think it's got a lot of value there. It may be that there'll be more mergers in the steel industry.

Q: What do you figure the value of Northwestern is?

A: More than the present market price. There are a lot of imponderables. This is not a company that's being liquidated; this is a company that is a going concern. You'll have to see how things develop. Hey, listen, if I had known a lot of the problems they had, I might not have bought it in the first place!

Q: What else do you own?

A: Well, we have some Xerox. Now, Xerox has gone up somewhat. Xerox has got problems, but it's got a lot of cash flow. And Union Carbide. These companies have huge assets; they've got problems. How are they going to work their problems out? I don't know. But the public doesn't seem to like to buy problems. Take Union Carbide. It's a good value stock. But they had a terrible break with Bhopal. That happens once in a while when you're invested. You buy something, then something terrible happens and hurts the market price. But it doesn't really change the valuation; just the way people look at it.

Q: Xerox has been on the sick list for a long, long time now.

A: In retrospect, management probably shouldn't have bought Crum & Forster. But they maybe felt they gave it some stability. The thing about buying companies is that when a big company buys, it pays a pretty good price for what they're getting. If you're on the receiving end, that's great. But if you're buying a company and paying a big premium for it, that creates a lot of problems later on. Obviously, a company's not going to sell out if they think the price is too low. So the company that's buying has to be pretty sure that they're getting good value for what they're paying. So that's why I'm really not much of a buyer of companies; I like to be the guy on the other end, being taken over.

Q: What makes you think Xerox is a value?

A: It's a high-tech stock, and I really shouldn't be involved in it. It just pays $3, a pretty good dividend, and it seems to be a generic name. It has a huge cash flow, and I don't know what they're going to do with that. But I assume that they won't do something silly, although I must say I think they probably have in the past.

Q: So there's a little bit of an act of faith at work here?

A: Yes. I really shouldn't be involved in an act of faith, but one of the problems is, there aren't as many cheap stocks as there used to be.

Q: Why not just hold cash?

A: We've never really done that. We've been always fully invested. Which may be good, and may not be good—it's psychological. I find I'm more comfortable being fully invested than I am sitting with cash.

Q: How about another name?

A: I gave you a pretty good run-down there. We do have Florida East Coast Industries.

Q: There's a new name!

A: But we paid a lot less than the present price, so I don't recommend anybody buying Florida East Coast Industries now. They've got a huge amount of real estate in Florida. It's one that I'm going to ride, because I think the values are there, but I can't tell you when. And there's a risk if things don't go right, maybe it'll go down a lot.

Q: Will they ever sell that real estate?

A: Sooner or later, they should do something with that real estate. They certainly aren't giving the stockholders any type of return or dividend. They do have a very profitable railroad, and we should be treated, somewhere along the line, as stockholders, even though St. Joe Paper controls it—though I may be mistaken. So I would own it, even though I wouldn't recommend buying it.

Q: It's trading where these days?

A: Around 40.

Q: Where did you buy it?

A: The last I bought was at the equivalent of 6. We did buy the stock cheap. I like to diversify, and I didn't have any real-estate stocks.

Q: Walter, have you ever dabbled in options or anything like that?

A: Never bought an option—well, I can't say never. I did it once. The market was, I thought, very low, and I bought an index option. I decided I was never going to do it again. I don't sell short, I don't do anything with futures—those are all exotic areas that may be good for the brokers; I do not think they're good for us.

Q: You don't write options against stocks in your portfolio, either?

A: Right. Because that freezes me. If the market goes up, then I can't do anything about it. I like maneuverability. And dealing with the options I find a distraction. Life is—you gotta limit yourself a little bit.

Q: We get the sense that you have a kind of "fair-to-middlin'" view of where the market's going this year . . . ?

A: I have no opinion on the market. Graham used to have this theory that if there were no working capital stocks around, that meant the market was too high.

Q: Why's that?

A: Because historically, when there were no working capital stocks, the market collapsed. That worked pretty well till about 1960, when there weren't any working capital stocks, but the market kept going up. So that theory went out. I simply say, if there are not too many value stocks that I can find, the market isn't all that cheap. If it were very cheap, there'd be all these stocks floating around. On the other hand, I don't see the market way overvalued. If the market were way overpriced, I wouldn't own any stocks.

Q: But you said you've never gone to cash.

A: I never have. There's always a first time. I mean, if the market really went crazy, and you'd say, "Well, I just have to sell, the prices are just out of this world. Xerox is 125. . ." That kind of thing. But I haven't ever had that position up to now, and I see no reason to think it'll happen. We just keep on slugging away, trying to find cheap stocks. It's just a little tougher.

Q: You and an increasingly large crowd of "value" investors.

A: Kind of scary, the fact that so many people are focusing on Ben Graham's approach, and all these people are writing it up. That may be an indication—what do they say about the front cover of Time, or Business Week? "Watch out . . ."

Q: You're safe, Walter. This is* Barron's. *Thanks loads. ■