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Outstanding Investor Digest

PERSPECTIVES AND ACTIVITIES OF THE NATION'S MOST SUCCESSFUL MONEY MANAGERS.

Volume IV Number 2 March 6, 1989

Investors in this Issue:

Companies & Investments in this Issue:

VAN KASPER & COMPANY'S VAN KASPER REVIEW
"SMALL COMPANY NEGLECT TO END IN 1989. HERE ARE THE REASONS WHY."

In Van Kasper & Company's most recent Van Kasper Review, they comment on the magnitude of the current neglect of small cap growth stocks and the reasons why it's likely to end in 1989. While it's hardly a new notion, their evaluation is among the most interesting and persuasive we've come across.

The following excerpts were selected from that piece along with Van Kasper's latest list of recommended stocks.

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WALTER & EDWIN SCHLOSS ASSOCIATES, LP'S
WALTER & EDWIN SCHLOSS

Walter Schloss attended Ben Graham's finance course before World War II and went to work for Graham-Newman in 1946. Leaving to establish Walter J. Schloss Associates in 1955, he was joined by son, Edwin, in 1973.

As one of Warren Buffett's "Super-Investors of Graham and Doddsville" in his *Hermes* article of the same name, the Schlosses have run circles around the indexes. For the 33 years ended 12/31/88, Walter J. Schloss Associates earned a compound annual return of 21.6% per year on equity capital

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A CONVERSATION WITH
FPA CAPITAL'S ROBERT RODRIGUEZ
"A FEW DRASTICALLY DEPRESSED BARGAINS."

Robert Rodriguez was handpicked by Source Capital's George Michaelis to run FPA Capital Fund. Unlike associates Michaelis and Bill Sams (of FPA Paramount), Rodriguez is not yet among the managers regularly followed by OID.

However, Rodriguez's insights and ideas at his most recent annual meeting in Los Angeles caught our attention and our interest. We hope you find them as interesting and valuable as we did.

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TIGER FUND'S JULIAN ROBERTSON
LETTERS TO LIMITED PARTNERS
"WE'RE EXCITED ABOUT THE VALUES OUT THERE."

From Tiger Fund's inception on May 5th, 1980 through December 31, 1988, it's equity capital has compounded at better than 37% per year. Even after the allocation to general partner Julian Robertson, Tiger limited partners have earned a compound return of more than 30% per year.

Robertson's letters to his limited partners are nearly as impressive as his investment performance. The following excerpts were selected from Robertson's latest letters to Tiger

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WALTER & EDWIN SCHLOSS ASSOCIATES, LP'S WALTER & EDWIN SCHLOSS

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vs. 9.8% per year for the S&P 500 during the same period.

Here are Walter & Edwin Schloss Associates' annual return figures along with those of the S&P 500 for each of the 33 years ended 12/31/88. All performance figures were provided by Walter & Edwin Schloss Associates, LP.

Year	Gross Annual Return	Net Annual Return	S&P 500 Total Return
1956	+6.8%	+5.1%	+6.6%
1957	-4.7%	-4.7%	-10.8%
1958	+54.6%	+42.1%	+43.4%
1959	+23.3%	+17.5%	+12.0%
1960	+9.3%	+7.0%	+0.5%
1961	+28.8%	+21.6%	+26.9%
1962	+11.1%	+8.3%	-8.7%
1963	+20.1%	+15.1%	+22.8%
1964	+22.8%	+17.1%	+16.5%
1965	+35.7%	+26.8%	+12.5%
1966	+0.7%	+0.5%	-10.1%
1967	+34.4%	+25.8%	+24.0%
1968	+35.5%	+26.6%	+11.1%
1969	-9.0%	-9.0%	-8.5%
1970	-8.2%	-8.2%	+4.0%
1971	+28.3%	+25.5%	+14.3%
1972	+15.5%	+11.6%	+19.0%
1973	-8.0%	-8.0%	-14.7%
1974	-6.2%	-6.2%	-26.5%
1975	+52.2%	+42.7%	+37.2%
1976	+39.2%	+29.4%	+23.8%
1977	+34.4%	+25.8%	-7.2%
1978	+48.8%	+36.6%	+6.6%
1979	+39.7%	+29.8%	+18.4%
1980	+31.1%	+23.3%	+32.4%
1981	+24.5%	+18.35%	-4.9%
1982	+32.1%	+24.1%	+21.4%
1983	+51.2%	+38.4%	+22.5%
1984	+8.4%	+6.3%	+6.3%
1985	+25.0%	+19.5%	+32.2%
1986	+15.9%	+11.9%	+18.5%
1987	+26.9%	+20.2%	+5.2%
1988	+39.2%*	+29.4%*	+16.8%
1956-88	+21.6%	+16.4%	+9.8%

*— Figures for 1988 represent estimates.

A two-man firm with no employees whatsoever, the Schlosses occupy a small room within Tweedy, Browne's offices. Alongside other memorabilia is a letter from Buffett to members of the "Buffett Group" before its Hilton Head conference in 1976 (letter on opposite column).

With a long waiting list of individuals wishing to become limited partners, the Schlosses have the luxury of picking and choosing among them. Highly unusual within business generally and the investment field in particular, the Schlosses give preference to clients with a demonstrable need for their services.

Somewhat publicity-shy, the Schlosses consented to

(continued on next page)

Warren E. Buffett
1440 Kiewit Plaza
Omaha, Nebraska 68131

February 3rd, 1976

To the Hilton Head Group

Dear Gang,

Normally, when you get a letter from the wife, partner or secretary of Joe Glutz saying, "Of course, Joe is too modest to tell you about this himself, but I know you want to hear that...", it means that Joe is standing over the writer with a gun at his head, telling him not to look up from the xerox machine until the mailing has been completed.

This one is for real.

Today I received the 1975 annual letter of Walter J. Schloss Associates, which included a 20-year compilation of Walter's record since he left Graham-Newman. You may remember I went to work for Graham-Newman in 1954.

Walter left in 1955. And ... Graham-Newman closed up in 1956. I would prefer not to dwell on the implications of this sequence.

In any event, armed only with a monthly stock guide, a sophisticated style acquired largely from association with me, a sub-lease on a portion of a closet at Tweedy, Browne and a group of partners whose names were straight from a roll call at Ellis Island, Walter strode forth to do battle with the S&P.

On the following page is a re-cap of his yearly performance and calculations I have made regarding compounded results. The difference between the gross results and the limited partners' results is accounted for by the fact that, as General Partner, he takes 25% of the profits — a quaint, easy-to-calculate method of tribute not entirely foreign to many of you.

Walter has had five down years compared to seven for the S&P. His superiority in such down years would indicate that not only is he a man for all seasons, but that he has special strength when facing a head wind. Maybe all of you had better watch Ben Graham on Wall Street Week this Friday.

As for me, I'm going right out and buy some Hudson Pulp & Paper.

Best,

/s/ Warren

WALTER & EDWIN SCHLOSS ASSOCIATES, LP'S
WALTER & EDWIN SCHLOSS
(cont'd from preceding page)

an OID interview in an uncharacteristic lapse of judgement following prolonged begging by an unidentified ~~editor~~ party.

The following excerpts were selected from a series of highly enjoyable conversations with the Schlosses at their office in Manhattan. The first part of a two-part interview, we hope you enjoy it as much as we did.

OID: Thanks for agreeing to an OID interview. Where should we begin?

Walter Schloss: In The Merchant Bankers, there's a chapter I find particularly interesting. Mr. Warburg, who just recently passed away, lived in pre-Hitler Germany with his family. The Oppenheimers, the Mendelsohns and the Warburgs had been living there for many years.

When Hitler came to power, Warburg became very concerned. He arranged to meet with one of the top people in Hitler's government. Afterwards, he told his wife, "We've got to get out."

And they did. In 1934, they took their two children and they went to London giving up most of their wealth in the process. They were criticized by all of their friends. "Why are you leaving Germany?"

He gave up a lot to get out. But he saw what was coming. Most of the other people who were wealthy and had been living there for years just ignored it.

But Warburg was a non-conformist.

Edwin Schloss: Thankfully for him and his family, he was a contrarian.

Walter Schloss: Starting nearly from scratch, he didn't do very well at first. But then, after the war, he backed Reynolds in an aluminum deal that worked out very well and put him on the map. Anyway, he became very successful.

He made the point that it was good for families to lose their money every third generation. Otherwise they got too soft.

OID: Good thing for you, Edwin, that you're generation number two. Anyway, it sounds like a page straight out of Warren Buffett's book.

We understand that Peter Kiewit, whom Buffett often speaks of admiringly, had a father who felt the same way as Buffett does about the evils of inherited wealth.

As we recall, much to Kiewit's surprise some years after his father's death he received a delayed out-of-the-blue inheritance of a few million dollars. While it was peanuts compared to the estate his father had built and relative to the success he himself achieved, he said it made him feel like his father was extending his approval from the grave.

Walter Schloss: I've noticed that children of very successful fathers quite often don't get along with their fathers and leave. But in many cases where the sons and the fathers do get along, the sons do much better than the fathers.

Apparently, they use the springboard of the first generation. The father has a little store on the Lower East Side and through the son's efforts, it becomes Macy's.

Some of it has to do with the power of compound interest. If you start with a dollar and you double it every so many years, it builds up. In the first twenty years, it doesn't look like much but eventually it does.

OID: Compound interest — the eighth wonder of the world.

Walter Schloss: Government Employees' Insurance was a case in point. It started in 1936. Graham-Newman bought its interest in 1948 as I recall. But it took a long time to build up.

When Graham-Newman bought it, GEICO was ready to take off but they didn't know it. Nobody recognized that their gradual growth was about to accelerate. It was viewed as just a nice little company making money.

After they bought it, of course, it suddenly took off and their timing turned out to be brilliant.

OID: Better rich than right, I believe the saying goes.

As I mentioned to you in a prior conversation, Templeton's worst ten years investment-wise were his first ten years. And you told me that the same was true for you.

Walter Schloss: Yes, that's right. I think the first ten years you get kind of acquainted with what you're doing.

OID: So we shouldn't feel too bad about not knowing what we're doing in our fourth year at OID?

Walter Schloss: Hope springs eternal....

But I honestly don't see how you're going to be able to use this material — unless it's possibly to keep it in the file to blackmail me.

OID: As logical a business extension as any we've considered.

Walter Schloss: I especially liked your interview with Templeton. I think I made a xerox of it.

OID: We'll send you a bill.

Walter Schloss: It was excellent. At some point, you should put his and others into a book.

OID: At 32 pages an issue, some would say we already have.

Walter Schloss: But people have to be very humble about money if they want to keep it. They have to work at it. It doesn't just happen.

And different children have to be treated differently. Some people are even afraid of money. My mother, for example, would have been one of the worst investors and my father was a terrible investor.

And it's because they lived through fear — through the Depression. As a result, they allowed fear to make their judgements.

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WALTER & EDWIN SCHLOSS ASSOCIATES, LP'S
WALTER & EDWIN SCHLOSS
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OID: We didn't realize your parents were both pension fund administrators.

Walter Schloss: Don't laugh. We had a client who used to be the perfect contrary indicator. Everything was fine so long as the market was doing well. But when the market went down, he'd get very panicky. Finally, he'd call me and say, "Walter, I can't stand it. We've got to sell."

And it would invariably occur at market bottoms. I actually missed it the first time. But he did it several more times and I always knew it was the bottom of the market.

This man was very logical in his own business. But in declining markets, he would get very scared.

OID: What is he saying today?

Walter Schloss: Now he's made a lot of money so that he's no longer panicky. But I wish we had more like him.

OID: If you'll lower your minimums and accept IOUs, we'll volunteer to replace him. But you say he's not panicky today? Isn't that a bad sign?

Walter Schloss: Not really. He's got so much money now that if he called panicky today, I'd really be worried about him.

Edwin Schloss: If we get the call, we'll be sure to tell you.

OID: Please. We'll report it.

By the way, we mentioned you in a recent issue. I hope you won't find it in the least disparaging.

Walter Schloss: "Making Money Out of Junk, Part 2"?

OID: No, we just mentioned that you're up there in years, but still love what you do.

Walter Schloss: That's very nice, but I'm not that old. I'm only 72.

OID: If you'd invited us to your 70th birthday party, we wouldn't have made the mistake. Anyway, age isn't that important.

Walter Schloss: At my age, most people want to retire to Florida and play tennis and relax. But I get a great deal of pleasure from what I do.

OID: That's apparent.

Walter Schloss: First of all, I like working with Edwin. Second, it's intellectually stimulating.

Finally, I'm helping my partners. Many of them don't have that much money. So I'm making life easier for 50 or 60 people and I get pleasure from that. And I make money out of it, too.

It's fun — so long as it doesn't get too difficult. If it ever gets too difficult, we'll quit. Phil Carret is 90 years old and he still enjoys what he's doing.

Actually, for 105, I think I'm doing remarkably well.

OID: No question about it. We stand corrected. And we'll point out that you're an extremely young 72 in our next issue.

But changing subjects as quickly as possible, you worked with Ben Graham and Warren Buffett. A key principle of investing for each of them was the importance of not losing money.

Conversely, in a recent issue, hedge fund manager Randy Updyke spoke of a little known investor by the name of Lou Thomas who quietly built up an incredible 30-year record in quite a different way.

His philosophy was that you can't eliminate risk — that it's always going to be there. Therefore, what you try to do is be compensated for it by looking for maximum reward relative to risk and maintaining lots of diversification.

Walter Schloss: Beta on the upside but not on the downside.

OID: Exactly.

Walter Schloss: Albert Hettinger, ex-Lazard partner, did that. Bill Ruane talks about Hettinger being such a successful investor.

But Graham was concerned with limiting his risk and he didn't want to lose money. People don't remember what happened before and how things were. And that's one of the mistakes people make in investing as well.

In the last 15 years, it's been a remarkable stock market. But people forget what things were like during the 1930s. I think Graham — because he lived through that period — remembered it, was scared it would happen again and did everything he could to avoid it.

But in the process of avoiding it, he missed a lot of opportunities. That's one of the problems you always have — you don't really lose, but you don't really make, either.

I believe you should remember what took place — even if you weren't around at the time. One of the problems of a lot of the people who went through the Depression — Ben Graham, Jerry Newman and others — is that they keep on thinking that things will always be like that.

Even Graham used to say — and quite correctly — that you can't run your investments as if a repeat of 1932 is around the corner. We can have a recession and things can get bad. But you can't plan on that happening. People who did missed this tremendous market.

Some people can do it. Most people can't and I don't think they should try.

OID: Many would say the same of the 1973-74 period.

Walter Schloss: I agree. It was much like 1929. The only difference was that in 1929, the companies went bankrupt. In 1973-74, the stocks went from $70 to $3. They didn't go bankrupt. They just went way down.

And they went down very quickly — not as quickly as October of last year, but very quickly — and then up again.

I remember Londontown — which manufactured London Fog coats. The darned stock was selling at maybe $12 and went down to $5. It had working capital of $10 so we bought it.

And then it went back up — we sold it between $10 and $15. And then Interco took it over at $20.

Edwin Schloss: More than $20.

Walter Schloss: All in the space of two years. The profit potential in a market like that was really unbelievable.

OID: The good old days.

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WALTER & EDWIN SCHLOSS ASSOCIATES, LP'S
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Edwin Schloss: To a somewhat lesser extent, you had the same thing in the aftermath of the October break two years ago. The deep drop in prices whetted the appetites of the LBO and takeover guys.

Walter Schloss: As aided and abetted by low interest rates. Some of these companies were afraid of being taken over themselves. And one great way of avoiding being taken over is to leverage your own balance sheet by buying another company.

OID: A la Philip Morris.

Walter Schloss: Exactly. When Philip Morris bought General Foods for 4 times its book, it seemed like a high price. But, in retrospect, it seems like a pretty good deal, at least compared to Kraft. Everything's relative.

OID: Of course, compared to Kraft, almost anything would seem like a good deal.

Walter Schloss: I remember we owned stock in Schenley back in 1960 or so when it was selling below working capital.

I went to talk to their treasurer. At that time, their stock was selling at $20 and they had $33 of working capital, including a huge inventory. I was asking how good their inventory was. In the course of our conversation, he said, "We've spent $100 per share on advertising."

That advertising was on the books for nothing. And that's also true for Kraft. You have Philadelphia Cream Cheese and Miracle Whip. You couldn't replace those for almost any price. They've got a niche.

If somebody said, "Gee, I want to be in the businesses that Kraft is in now," it'd be a very difficult thing to do.

So even if book is only $20 and Philip Morris paid $106 a share for it, their book value and assets are only part of it. The rest is in the goodwill, the name — the franchise, if you will, as Warren Buffett would describe it.

OID: Your advertising comment is a very interesting one. Advertising clearly builds long-term value even though it's expensed each year. That may help explain why Buffett reportedly subscribes to Advertising Age and pays attention to advertising expenditures.

Philip Morris may have paid a multiple of book for General Foods but they paid only 50% of sales. They paid over 100% of sales for Kraft.

Edwin Schloss: I know what you're saying. But thanks to General Foods, Philip Morris had just about everything except cheese. In hindsight, Kraft was an obvious fit.

OID: Certainly a great franchise, but at what price?

Edwin Schloss: It's clearly late in the market cycle for food stocks. It's dangerous to play the game at these prices.

Walter Schloss: People just weren't willing to pay those prices for great franchises in the past.

Also, anti-trust was enforced much more severely. If a company wanted to buy another company, anti-trust enforcement forced companies to buy market share the hard way. Most companies realized they couldn't do it.

Many years ago, when I was at Graham-Newman, U.S. Steel agreed to buy Consolidated Steel. Graham-Newman bought a lot of it — at least, it seemed like a lot then. Of course, it seems like a lot less today.

Anyway, the board began to worry about the possibility of enforcement action by the government enforcing anti-trust and canceling the whole deal.

So Graham said, "Well, I think the Supreme Court is going to rule 5-4 in favor of the company." And he named the justices who he believed would vote for it and the justices he believed would vote against it.

The board evidently decided that they needed a lawyer who specialized in anti-trust to come over and tell them what they should do. So they brought in this lawyer who determined that the Supreme Court would vote 5-4 against the merger and that it would therefore be disallowed.

At that point, despite this authority's opinion, Graham still thought he was right. Characteristically, he was very modest. He never pushed his opinion. And, after all, this attorney was an authority and he wasn't. So they compromised and sold half of their stock.

When the decision came down from the Supreme Court, sure enough, Graham was exactly correct and the authority was wrong. The Supreme Court voted 5-4 in favor of the merger and each of the justices voted exactly as Ben Graham thought they would.

OID: Fascinating.

Walter Schloss: Graham would often compromise if there was more than one opinion.

There's a lesson to be learned. If you truly think you're right and some lawyer tells you otherwise, stick to your guns — even if the other guy knows more. You've got to make up your own mind.

OID: Randy Updyke told us how he let his broker talk him into reducing his purchases of Chrysler at $3 a share.

Walter Schloss: I've never met Randy Updyke. But Tweedy, Browne had a closed-end mutual fund called Asset Investors. They bought all these undervalued stocks at discounts.

Because Tweedy was managing other money, they had to be very careful that they met all the myriad requirements for a mutual fund. As it turned out, Randy Updyke bought enough stock to make them a personal holding company.

At that point, they had to liquidate since they didn't want to be a personal holding company. So he really forced them into liquidating. And the stock had been selling at a discount to its asset value. Everybody could see the

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WALTER & EDWIN SCHLOSS ASSOCIATES, LP'S
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holdings.

OID: Very clever.

Walter Schloss: Apropos of that, while I was at Graham-Newman, a man called up and said he'd like to speak to Mr. Graham. Because he was out of town that day, I asked if there was anything I could do in his stead.

He said, "I just wanted to thank him. Every 6 months Graham-Newman publishes their portfolio holdings. And I've made so much money on the stocks that he had in his portfolio, I just wanted to come by and thank him."

That was one of the reasons I decided never to publish our holdings. We work hard to find our stocks. We don't want to just give them away. It's not fair to our partners.

OID: Spoilsport.

Walter Schloss: Also, Graham-Newman bought a lot of Philadelphia-Reading from the Baltimore & Ohio Railroad at $14. And the stock went down to $8. And all these people were buying the stock at $8 and $9 per share when Graham-Newman had paid $14. And Graham-Newman was doing all this work trying to turn it around.

Of course, it worked out very well. It went way, way up and Northwest Industries took it over. It eventually grew to several hundred dollars per share.

But I'll never forget the story of that guy wanting to thank Graham for all the money he made.

OID: One of our subscribers refers to Buffett as "Uncle Warren" for exactly the same reason.

Walter Schloss: If we like a stock and it goes down, we like to buy more. So if you talk it up and convince everyone that you're right, you can create competition.

One of the problems Warren has is that when he buys a stock and people find out, it automatically goes up 15-25% over what it would otherwise do. So he has to establish his positions quickly. That's why he buys those big blocks.

OID: Our most heartfelt sympathies. I think it was his partner, Charlie Munger, who said he likes having the problem of investing several billion dollars of their own capital. We should all be so lucky.

Edwin Schloss: Another problem — if we just mentioned one or two securities and someone bought them, we'd feel responsible if they went down. It's not exactly a diversified portfolio.

OID: If you'd prefer to name 25 or 30 bargains, we'll list all of them.

Edwin Schloss: How generous of you.

OID: Why did you start Walter J. Schloss Associates when you did?

Walter Schloss: The opportunity came along and it just seemed like the time to do it. It was a bit of a contrarian thing to do.

OID: Naturally.

Walter Schloss: My mother is a fairly good judge of things in which she's not emotionally involved. She's only begged me twice not to do things. The first was not to enlist right after Pearl Harbor. But I felt very strongly about doing my part and I signed up anyway.

The second time she begged me not to do something was when she begged me not to go into business for myself.

I didn't have any money but I had an opportunity. Someone said they'd put some money into my partnership.

Mother pointed out that I had two small children and shouldn't take the risk. Well, we are both pleased that she was completely wrong.

OID: And Ben Graham didn't like the idea either?

Walter Schloss: In 1955, Graham testified before the Fulbright Committee. The market had gone up to an all-time high — up to the 400 area vs. 381 in 1929.

And Graham and John Kenneth Galbraith both testified before the Fulbright Committee that the market was too high. Everybody else — about 18 others testified — thought the market was reasonably priced.

Graham was looking at it historically. Galbraith was just against the capitalist system generally, I think. But, anyway, they both testified against it.

And here I was — I admired Graham tremendously, and I was going into the business at just the time when he was saying the market was too high.

It was just one of those things. You do what opportunity allows you to do. It turned out to be a fabulous decision. I didn't know it at the time.

You really have to stick to your guns no matter what other people think.

It's also important to know what you know and what you don't know. Templeton, for example, does something that I think is brilliant that I'm incapable of doing — he buys securities all over the world.

I've found the few times that I've bought outside the United States, I've had my head handed to me — not every time, but most often.

OID: We achieve the same thing domestically.

Walter Schloss: And the rules are different in different countries. I can't help but think about Cuba where Castro suddenly came in and confiscated everything.

While we in America have a little bit of an unstable economic situation, our political system is stable. We don't have to worry about confiscation.

OID: Except on the margin — with rent control, insurance premium rollbacks and the like.

Walter Schloss: Exactly. It's very interesting to watch what's going on in the insurance business in California. You just can't ask companies to take 20% off the top.

OID: If it were put to a vote, what price rollback wouldn't pass? There are more buyers than sellers of almost every product in the world. It smells like confiscation of property to me.

Still, we were hoping the trend would spread into other areas. After all, if there's a 50% rollback in prices for everything, we'd all be twice as rich.

Walter Schloss: Wouldn't it be great if things really worked that way? There's no reason anyone — insurance

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WALTER & EDWIN SCHLOSS ASSOCIATES, LP'S
WALTER & EDWIN SCHLOSS
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companies or anyone else — should just be required to lose a lot of money.

Yet, Fireman's Fund was in Massachusetts and wanted to withdraw from writing insurance there. Massachusetts wouldn't let them. Fireman's Fund had to sue to get out of doing business there.

In the end, they had to pay $43 million to withdraw from doing business there. And they were happy to get out at that price.

It was disgraceful. And, then, you hear about what a great manager Dukakis was. From the point of view of getting $43 million, maybe so. But from the point of view of doing business in the state, it's terrible.

Fireman's Fund isn't in business to lose money. Incidentally, we think it's a good long-term investment.

OID: Of course, the governmental interference will come home to roost when governmental inefficiency leads to higher rates and/or higher taxes.

Walter Schloss: Of course.

OID: The perspective on many issues is so different in New York and Massachusetts.

Walter Schloss: We've got a warped point of view here.

OID: Rent control, for example. To most people, rent control is not silly. We imagine you would agree that rent control is a terrible idea.

Walter Schloss: Except for my mother.

OID: And present company, of course.

Edwin Schloss: Having a sense of humor is terribly important.

Walter Schloss: One of the reasons why Warren is such an attractive personality is that he has such a great sense of humor and all those terrific stories.

But apparently, he was shy when he was young and decided that he wanted to overcome it. So he went to the Dale Carnegie course. One of the first things he did when he graduated was to propose to his wife.

I saw him in Omaha back in 1961 or 1962 when he got up before a Rotary Club and gave a brilliant speech culminating in asking for money. He was the youngest person there and it was very, very funny. I wish I'd had a tape recorder. It was great.

OID: If not for his investment successes, the world would have another Will Rogers. He has an ability to express things so concisely and yet humorously at the same time.

And what can you say about his annual reports?

Walter Schloss: Absolutely brilliant.

Actually, I think Ben Graham wrote better than Warren. He was very succinct in what he said, but he didn't have Warren's humor.

The difference is Graham didn't really like investments. He liked the challenge. He liked the game. He liked to make money. But he didn't really enjoy investments.

As he once told me, it was easier to make more money than to cut down on his expenses.

He was involved in a lot of things. He was involved with charitable organizations. He used to write articles for the Analysts' Journal, including their first issue. He used to write under the name "Cogitator."

And he did a lot of other things. He had a great idea about using commodities as a backing for currency. He wrote a book called Storage and Stability on the subject.

OID: What's a guy like you doing in a nice business like this?

Walter Schloss: Wall Street got very busy and I worked there during the summer of 1933. And I loved it.

So, in 1934, I went over to Salomon Brothers looking for a job. I can still remember the guy there telling me, "We're an old bond house. There's no future in here. Business is terrible. We're not hiring anybody."

Of course, that's the great Salomon Brothers of today.

OID: With foresight like that, it was probably their investment banking analyst you spoke with.

Walter Schloss: Probably. Anyway, I got this job as a runner with Loeb Rhoades for about a month. Then they put me in the cage. In those days, we counted the box every day with the partner in charge of the box.

Can you imagine each day counting every security at Carl M. Loeb & Co., later Loeb, Rhoades & Co.? It's hard to imagine today. I worked there for seven years.

During that time, I also went to school at night at what was then called the New York Stock Exchange Institute — now known as the Institute of Finance. The man who ran it was a fellow named Birl Schultz, who was a very lovely guy. His son was pursuing his Ph.D. at the University of Chicago. And Birl admired him tremendously. His name was George Schultz, our Secretary of State in the Reagan administration — only in America.

Ben Graham's brother, Leon, was a sweet guy, but he wasn't too good in his investments. So Ben supported him by giving him business from Graham-Newman. Anyway, Graham lectured at the courses I took at the Institute of Finance. He'd take all these live examples and use them to illustrate his principles. It was fascinating. And I liked what he did.

I went in the army. At the time, I had about $1,000. I gave it to Leon. When I came back, it was worth $2,000.

When I got out of the service, I got a note from Ben telling me that the fellow who was doing security analysis for him was leaving to work with his father and would I be interested in going to work with him. That's how I got the job with Ben Graham.

OID: Tell us about your duties at Graham-Newman.

Walter Schloss: I joined Graham-Newman on January 2nd, 1946, right after the end of World War II. The first thing I did was to prepare the results of the first ten years of Graham-Newman. Interestingly, Graham-Newman only operated for twenty years.

Graham had partnerships before that where he managed money for individuals. But during the late '20s. he managed partnerships where he got 50% of the profits, but he also took 50% of the losses.

What hurt him is that when the market went down in

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the 1930s, he was responsible for the losses. But what hurt more is that people pulled their money out so that he couldn't make it back.

OID: Ouch.

Walter Schloss: Anyway, I went to work for him for 9-1/2 years.

You know the Government Employees Insurance story, that they never should have bought it at all because it was illegal?

OID: We did a piece on GEICO recently but we're not familiar with that facet of the story.

Walter Schloss: It's still true today — an investment company can't buy more than 10% of an insurance company without the approval of the SEC.

Edwin Schloss: But Graham-Newman didn't know it at the time.

Walter Schloss: They'd paid $750,000 for half of the company. Fred Greenman, who was Graham's attorney and an old friend, had brought the GEICO deal to them.

When Graham bought the stock, the SEC said, "You can't buy more than 10%. You violated the SEC laws, even if it was inadvertent."

Manny Cohen, a tough administrator at the SEC, said, "You've got to get rid of it. Go back to the people who sold it to you and see if they'll take it back."

So they went back to the family from whom they'd purchased the interest and tried to sell it back. But they said, "No. We don't want it. We sold it. Forget it."

OID: Amazing. And this was the best investment Graham ever made in his career by a wide margin.

Walter Schloss: Next, the SEC looked at the profit-sharing arrangement and asked themselves how they could make sure that Graham-Newman wouldn't get any profits out of it.

The answer that they came up with was to require Graham-Newman to distribute the GEICO shares to its shareholders at cost. So that's how Graham-Newman stockholders got their GEICO stock and became millionaires.

OID: Unbelievable. Graham describes how the deal almost fell apart over some minor provisions in The Intelligent Investor. But, in addition, Graham-Newman was also forced to try and sell its GEICO shares back at cost and they weren't allowed to benefit from the best investment they ever made?

Walter Schloss: Unfortunately, that's correct.

Even more ironic, the 25% of GEICO stock that was not owned by Graham-Newman and other outsiders was retained by the founders' family — when Leo Goodwin died, he left the stock to his son.

His son went into other ventures. But instead of selling his stock to finance them, he borrowed against his GEICO stock. When it collapsed in 1976, he was wiped out. The bank sold him out and he committed suicide.

Warren [Buffett] bought most of that stock when it went way down. And that's how Warren got the GEICO stock that Goodwin had owned.

So that's a short history of GEICO. The whole thing was pathetic in a way — some people became millionaires, some didn't benefit at all and others went broke.

OID: If you made a movie or wrote a book, nobody would believe it.

Walter Schloss: And Dave Dodd, the late co-author of Security Analysis, said to me when the stock was way down, "I've always lectured at my course at Columbia, 'Don't let paying taxes affect your judgement of when to sell.' And I didn't follow my own advice."

He had 125,000 shares of GEICO. And when it went up, he didn't sell it because he didn't want to pay the taxes.

OID: What a package of ironies.

Edwin Schloss: And that's not all of the ironies. My father sold his stock when I was born to pay for my birth.

OID: So you were a very expensive addition to the family.

Edwin Schloss: I know.

Walter Schloss: A great bargain, nonetheless.

When I first went to work for Graham-Newman, they were offering Graham-Newman stock to their stockholders at net asset value or a slight premium. At the time, I took all the money I had, which was about $3,000, and put it into Graham-Newman stock.

When Graham-Newman was forced to distribute it, I received GEICO stock. Subsequently, GEICO spun off Government Employees' Life Insurance.

When Edwin was born, I sold my GEICO stock to pay for his birth. Then, when my daughter was born, I sold my Government Employees Life Insurance stock to pay for hers.

So while it's true I didn't get Graham-Newman stock, I did get two children, which I thought was a good buy.

Edwin Schloss: And I'm working awfully hard to make that money back.

Walter Schloss: After-tax.

OID: No wonder you and Edwin work so closely together.

Walter Schloss: Not at all. But you never know how things are going to turn out. It could have gone the other way.

It's funny also that I would have been better off to sell my Graham-Newman stock and keep my GEICO stock. But because I was working at Graham-Newman, I didn't want them to think I was being disloyal.

Everybody was buying a share of Graham-Newman at $130 to $140 to learn what stocks they were buying. One firm actually wrote up Graham-Newman, recommending it. I never saw any other firm write them up.

So they had a one for ten reverse split. Following the reverse split, Graham-Newman stock was selling for around $1,000 a share.

So when I left Graham-Newman, I wanted to raise some money to put into my partnership. At the time, the premium was about 35%. So with net asset value between $900 and $1,000, I got about $1,300 apiece for my shares.

About a year later — and I never thought they'd do it — they decided to liquidate. Of course, the damn thing was

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only worth $900.

They asked me, "How'd you know?" Of course, I didn't.

OID: Sometimes it's better to be lucky than smart. Speaking of being lucky, how did you originally meet Buffett?

Walter Schloss: I met Warren in 1951, I believe, at an annual meeting of Marshall Wells in Jersey City. They were a wholesale distributor located in Minneapolis whose stock Graham-Newman owned.

I suppose they had the annual meeting in New Jersey because they wanted to have it where no shareholders were likely to attend.

OID: An all-too-common practice. We'll be interested to see where Philip Morris holds its next annual meeting.

Walter Schloss: So Warren showed up with a friend of his — Fred Stanback. He was going to Columbia Business School at the time. And Warren had an investment in Marshall Wells.

After the annual meeting, we went out to lunch. I liked Warren, he liked me, and we got friendly — all because we met at this Marshall Wells' meeting.

OID: Sounds like quite a coincidence, Graham-Newman and Warren Buffett simultaneously owning shares in an obscure wholesale distributor like Marshall Wells.

Walter Schloss: I think he saw Marshall Wells in Graham-Newman's portfolio — Graham-Newman reported its ownership of Marshall Wells stock in its list of holdings in its annual report. Whether he bought it because he saw it in the portfolio or because he liked it, I don't know. But they all saw the list.

In fact, Warren told me he was very upset at one point. Graham-Newman set up a partnership around 1953, sort of like ours. It was called Newman & Graham instead of Graham-Newman. It did the same thing Graham-Newman did except it was a partnership. Their minimum, as I recall, was $50,000, which was a fairly good sum in those days.

As it turns out, a couple of the limited partners contributed GEICO stock instead of cash and Graham was selling some of it. Meanwhile, out in Nebraska, Warren was buying it at the same time which was before he went to work for Graham. He saw Graham-Newman selling it.

And he said, "Gee whiz. I don't understand it. Graham is selling it and I'm buying it. One of us is wrong."

Of course, it was Graham-Newman who was wrong. But they were doing it because they wanted to get cash in lieu of the stock which they had taken in.

OID: The fact that Buffett once monitored the portfolio activities of Graham-Newman for investment ideas definitely eases my own conscience for monitoring his.

Buffett has been quite vague about his duties at Graham-Newman. What did you guys do there exactly?

Walter Schloss: As I recall, Warren came to work with Graham in 1953. Basically, we were just looking for undervalued stocks. We'd go through Standard and Poors' manuals.

I also had the job of placing orders. But we weren't that active — sort of like we are here.

OID: The fact that you and Edwin share a single phone is a dead giveaway there.

Walter Schloss: We try to keep a low overhead.

Newman & Graham actually wrote a letter to their partners in 1954 because they thought the market was too high — "Take back some of your money. We have too much to work with."

They only had about $12 or $14 million altogether.

OID: Hard to imagine today.

Walter Schloss: Even then, I can recall thinking that it may be time for me to leave. They were buying American Telephone. I thought I could do better than that.

One of the stocks I looked at was Lukens Steel. Lukens Steel was selling at $19 or $20 and it was earning $6 a share. So I ran into Graham's office and showed it to him. He agreed it was a good idea and we started to buy some.

Then, he went out to lunch with a guy who asked him what he liked. And Ben told him that we were buying a little Lukens Steel. So the guy went out and bought a lot of Lukens Steel and pushed the price up. Graham was a little too generous with his ideas.

Another example was in The Intelligent Investor. When it came out, Graham had bought Northern Pacific and was going halves with Baruch. The idea was to buy control of the company because it was so cheap.

But after they bought 50,000 shares and Baruch bought 50,000 shares, Baruch got cold feet. Graham went out there as their largest shareholder and let them know he wanted to be a director. But Northern Pacific made it clear that they didn't want him to be a director, for whatever reason, and Graham didn't push his way on.

The Intelligent Investor came out the next year and said it's a cheap stock at $16.

Norton Simon who ran Ohio Match went out and bought 171,000 shares. The stock went from $21 to $28 or $29 and Graham didn't want to follow it up.

Norton Simon, however, was a pretty aggressive guy. He went on the board of Northern Pacific with 171,000 shares — I believe between 1.7 and 2.2 million shares were outstanding.

Then they struck oil in the Williston Basin and the stock price shot right up. Ben didn't buy it because they were going to find oil in the Williston Basin. He bought it because it was a cheap stock.

But lots of times when you buy a cheap stock for one reason, that reason doesn't pan out but another reason does — because it's cheap.

OID: Simply more potential for good than bad.

Walter Schloss: That's true. As a matter of fact, Graham mentioned the fact that they had recommended it at $16. And by the time his subsequent edition was published, it had gone down to $11-1/2.

He said the fact that it went down to $11-1/2 at one point didn't mean that it was a bad investment at $16.

OID: An awfully important point to remember and an easy one to lose sight of.

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Walter Schloss: Of course, it worked out very well.

Edwin Schloss: Maybe you should mention the example that Ben Graham gave about the two companies.

Walter Schloss: In Security Analysis, Graham used a great example of two companies — one popular and one unpopular selling at wildly different valuations.

One was a very popular company with a book value of $10 selling at $45. The second was exactly the reverse — it had a book value of $40 and was selling for $25.

In fact, it was exactly the same company, Boeing, in two very different periods of time. In 1939, Boeing was selling at $45 with a book of $10 and earning very little. But the outlook was great. In 1947, after World War II, investors saw no future for Boeing, thinking no one was going to buy all these airplanes.

If you'd bought Boeing in 1939 at $45, you would have done rather badly. But if you'd bought Boeing in 1945 when the outlook was bad, you would have done very well.

OID: In other words, it wasn't an earnings play but an asset play.

Walter Schloss: Exactly. It was an asset play. In 1945, they had all the assets but the earnings outlook was terrible.

Edwin Schloss: It's a wonderful example.

Walter Schloss: It was a great example.

While at Graham-Newman, I can also remember buying Brewster Aeronautical. Why? Because Brewster Aeronautical could liquidate at something like $5.75 and we could buy it at $5.

Well, we did buy it at $5 or $5.25. And the profit was maybe 50¢ a share over a period of time — it was really a lousy investment. We made 10% over two years or so. It was such a sweat and the margin was so small.

But they were shooting for this kind of guaranteed return. They didn't want to lose money.

There weren't that many liquidations floating around. And because interest rates were so low in those days, 5% per year returns were considered very good.

OID: On a relatively secure basis.

Walter Schloss: That's right. But even then, you weren't always sure because there could have been government claims against them.

Of course, if I had bought the stock, there would have been government claims or they'd have found some other liability.

OID: Your 30+ year record of outperforming the market by a factor of better than two wouldn't seem to support that statement. On the other hand, our purchase of Allied Bancshares...

Walter Schloss: One of the great sayings is that you never really know all about a stock until you own it. And that's very true.

You're looking at the stock originally as an outsider and you don't get emotionally involved. After you get into it, that changes. You see the flaws much more clearly.

Of course, after you've owned something for awhile, you find that there are a lot of opportunities you didn't see at first. We bought Western Pacific when it was coming in by the bucket at $6 to $6-1/2 per share. In retrospect, we didn't buy nearly as much as we should have. I never thought they'd have all these great things happen.

Micky Newman did a great job with that company. At the time, it looked like just another stock without much risk down from $23 with a lousy outlook and so forth.

And then Micky Newman facilitated Western Pacific's purchase of Veeder-Root. They made the counters for gasoline pumps.

When oil prices went up and the gas thing hit, it took off. The counters had never before been over 99¢, so that 2 digits had always been fine. When everyone had to replace their counters, Veeder-Root became a real big winner.

OID: Tell us about Ben Graham.

Walter Schloss: Graham was a sweet fellow. Actually, he was too sweet. People took advantage of him.

I think he was more interested in ideas. And if he could come up with a new way of doing something that interested him, he'd fool around with it — games, lecturing, writing — he was a renaissance man.

Edwin Schloss: He even wrote a play about Wall Street.

Walter Schloss: He had several marriages and several children. But basically, he was a man of ideas.

At the end of his life, he was translating Latin into Greek. He liked intellectual challenges. I think Wall Street was a challenge.

Then, he discovered he could make good money by just buying stocks at 2/3rds of their working capital. My job was really finding those working capital stocks and then recommending which ones we should buy.

After he found out he could make money this way, he kind of lost interest. It seemed like a good game. If he were alive today and couldn't find working capital stocks, he'd very likely be looking around for something else.

I always thought he was much better at picking stocks than fooling around with predictions of the Dow Jones. He always liked to figure out where the Dow Jones should be selling at. But that's another business.

OID: And many would say an impossible or irrelevant business at that.

Walter Schloss: It probably is.

But he was a nice man to work for — again, probably too nice. I'll give you an example.

There was a company called Associated Telephone and Telegraph that had a preferred stock which was in arrears for something like $80 a share. It was the Theodore Gary Telephone Company which was located in the Midwest.

Leon Levy wrote it up, recommended the stock and sent a copy to Graham-Newman. I looked it over and thought it was good value.

Then I discovered that the Department of Justice had a whole bunch of stock that they had confiscated. So I went into Graham and told him about it. To make a long story short, we bid for it and bought it for around $123 a share.

Six months and a day later, since that was long-term for tax purposes, the stock was selling at $153. And it still had this $80 in arrears.

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Graham called the company and asked them if they were planning on retiring the stock. "Oh no," they said. "We have no plans for that."

So we wound up selling our position to them at $153 or $155 which I thought was wrong. There was nothing like it. It was unique. They were paying their $6 or $7 dividend, and there was no reason why we should sell it.

But Graham wanted the quick profit. Percentage-wise he was right. But it seemed to me that it was unique and that we shouldn't sell it.

Two months later the company called it. I was sore. And I said to Graham, "I think these guys could be sued because they're calling the stock. I can't believe they didn't know what they were doing. Can I get a lawyer in on it?"

He said, "Sure."

So I reviewed the facts with an attorney and he said, "I think you've got a good case."

I told Graham what the attorney had told me. And he got red in the face. I'd never seen him red in the face. "Walter," he said, "I don't want to get involved with this thing. Forget it."

He just didn't want to get involved in a lawsuit. I felt like we were being taken advantage of — and I still think so. Sometimes you have to sue just to keep your self-respect.

OID: Unfortunate, but probably true.

Walter Schloss: Another time, I recommended we buy a company called Haloid. It had the rights to a promising new process called xerography. It'd been paying a dividend all through the 1930s. I went into Graham and said,

"You know, you're not paying a hell of a lot for a process with this much potential."

He said, "Walter, I'm not interested. It's not cheap enough at $21."

Of course, that was Xerox. And you know the rest of the story.

OID: One of the most successful companies of all time — at least for a good long while.

Walter Schloss: In the same vein, we had some American Research and Development stock. They were spinning off all of these little companies. And someone came into Graham-Newman and recommended that we should get into these little spinoffs.

One of those companies turned out to be Digital Equipment which, of course, was one of the biggest winners of all-time. Needless to say, the same was true of xerography and Xerox.

The only thing I should add is that if Graham-Newman had bought Xerox at $21, I can almost guarantee that we would have sold it at $50. The fact it went to $2,000 would have been beside the point.

OID: And he's in good company. Didn't Buffett miss out on Control Data despite being related by marriage to its founder back in the early days?

Walter Schloss: Yes, Ed Norris. And Buffett mentioned to me that he once urged one of his relatives not to put money into it.

He also discouraged her from borrowing against it to pay for a vacation to Europe after Norris had persuaded her it was worth borrowing against. Warren was appalled that she was going to borrow money against it.

OID: Of course, it could have turned out like GEICO. A dip could have made her lose everything.

And, as Buffett has frequently observed, there's no penalty for being selective. Isn't it OK to pass on Xerox if that's your discipline and you stick to it?

Walter Schloss: That's true. He had a discipline and knew what he wanted. They had this formula and it worked. They couldn't lose, really.

When Warren came in, he originally did that as well. But, of course, they ran out. And he said he liked buying good businesses.

Warren came about his approach through experience, seeing what happened the other way and seeing he could do much better his way. Like he's said, he doesn't want to row upstream. Of course, he was right.

Edwin Schloss: On the other hand, we're experts at it.

OID: Thanks for taking the time to speak with us.

Walter Schloss: It's really our pleasure. We get a few other publications. But I don't think there's anybody around like you — I don't know anyone else who has your niche. What you're doing is very good.

Edwin Schloss: It's excellent.

OID: Thank you for the compliments. You've now ensured yourself prominent placement and favorable editorial treatment.

Edwin Schloss: And a lifetime subscription.

OID: You drive a tough bargain.

Walter Schloss: I know it's a lot of work. You must enjoy doing it.

OID: We're certainly not in it for the money.

Walter Schloss: Of course, that's the key to anything you do — loving what you're doing. If you like something and you're good at it, it's really very nice.

OID: Absolutely. Besides, how else would we have the opportunity to sit down with you two?

Walter Schloss: That's right. If you were a broker and you called us on the phone, we'd probably tell you we're too busy. You see how busy our phone is.

[Editor's note: The single phone in their two-man office rang only several times each afternoon I was there. On hearing the phone ring at one point, Walter quipped, "It's the second call of the day. I wonder what's going on."

The call turned out to be from his wife.

Next issue, we'll bring you the second and final installment of our interview with the Schlosses.]

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