# Foreword

This Book is „The Intelligent Investor“ by Benjamin Graham simplified and written to the Modern World. It's short and sweet and that's how it should be. This short book is designed to give you a rough understanding of the market and to put yourself in the shoes of heads like Warren Buffett and Benjamin Graham.

For a comprehensive understanding of financial matters, consider the following resources:

**1. The Psychology of Money:** Timeless Lessons on Wealth, Greed, and Happiness" - by Morgan Housel
This book provides insightful perspectives on how your beliefs and behaviors about money can shape your financial success.

**2. "The Little Book That Beats the Market"** - by Joel Greenblatt
A guide to stock market investing that presents a successful formula for picking stocks.

**3. **"The Intelligent Investor“** - by Benjamin Graham
Often regarded as the bible of value investing, this book offers timeless wisdom for investors.

**4. "The Warren Buffett Portfolio“** - by Robert G. Hagstrom
Delve into the investment strategies of Warren Buffett, one of the most successful investors of all time.

Additionally, watching videos on Warren Buffett’s/Charlie Munger's investment philosophy can provide practical insights and enhance your understanding of value investing. These resources are invaluable for anyone looking to navigate the complexities of the financial world with knowledge and confidence.

# Chapters:

# Glossary

Before you begin reading this text and embark on your finance journey, I would like you to familiarize yourself with these terms. They are essential not only for understanding this book but also for your future investing endeavors.

**Bonds:**

Bonds are essentially loans given by investors to entities like governments or corporations. When you buy a bond, you're lending money to the issuer of the bond in exchange for a promise that they will pay you back the original loan amount on a specific date, plus regular interest payments along the way.

**Dividends:**

Dividends are a portion of a company's profits that are distributed to shareholders.

**Investing and Speculation:**

These are two different approaches to buying and selling stocks, with investment focusing on long-term growth and speculation on quick, higher-risk returns.

**DJIA (Dow Jones Industrial Average):**

A widely recognized stock market index representing the performance of 30 large, publicly-owned companies in the United States.

**S&P 500:**

Another major stock market index represents the performance of 500 large companies listed on stock exchanges in the United States.

**Overhyped IPO:**

Refers to an Initial Public Offering that has gained excessive media and investor attention, often leading to an inflated stock price that does not reflect the company's actual value.

**Convertible Securities:**

Financial instruments like convertible bonds or preferred stocks can be converted into a predetermined number of common stock or equity shares.

**The margin of Safety:**

An investment principle where an investor only purchases securities when their market price is significantly below their intrinsic value to minimize the downside risk.

**EPS (Earnings Per Share):**

A company's profit is divided by its number of outstanding shares, indicating the profitability on a per-share basis.

**Convertible Bonds:**

Bonds issued by a corporation can be converted into a predetermined number of shares of the corporation's stock.

**Preferred Stocks:**

A type of stock that has a higher claim on assets and earnings than common stock and typically does not come with voting rights.

**Dilution:**

Refers to the reduction in existing shareholders' ownership percentage of a company due to the issuance of new shares.

**Tax Credits:**

Amounts that can be subtracted directly from taxes owed to the government.

**Depreciation:**

An accounting method of allocating the cost of a tangible asset over its useful life.

**Growth Rates:**

In the context of finance, this refers to the rate at which a company's earnings are expected to grow.

**Investmentfonds (Investment Funds):**

Collective investment schemes that pool money from many investors to purchase securities.

**P/E Ratio (Price-to-Earnings Ratio):**

A valuation ratio of a company's current share price compared to its per-share earnings.

**Valuation Method:**

Techniques to estimate the attractiveness of an investment or the fair value of a company.

**Net Working Capital:**

A measure of a company's liquidity and short-term financial health.

**Dividend Policy:**

A company's approach to distributing profits back to its shareholders in the form of dividends.

**Stock Dividends:**

A dividend payment made in the form of additional shares rather than a cash payout.

# Who are You?

So, let's start with the basics. Investing and speculation are two different approaches to buying and selling stocks. An investor looks for safety and a reasonable profit after careful analysis.

This kind of investment is based on the long-term performance of a company, where the investor expects the company to grow steadily over time. This approach was traditionally associated with buying bonds, but it has evolved to include stocks that meet certain criteria of stability and profitability. On the other hand, speculation is more about taking higher risks for potentially higher returns in a shorter time. A speculator often acts based on market trends or gut feelings rather than detailed analysis. In the past, all stocks were seen as speculative, especially after the coronavirus crash of 2020. Other Times: **1929** the beginning of the Great Depression, **1987** Black Monday, the largest one-day market crash in history, **2000** The dot-com bubble, **2008** Banking crisis. However, the perception changed over time, and now buying stocks is often considered investing, regardless of the approach.


The term 'investor' has broadened over time to include almost anyone buying stocks, which can be misleading. It's important to understand that not all stock purchases are investments in the traditional sense. Some may still be speculative, depending on the level of risk and the analysis behind the decision.
For those starting in the stock market, it's crucial to recognize the difference between investing and speculating. While investing typically involves a careful analysis and a long-term view, („Reading the Annual Reports“) speculating is more about short-term gains and is usually riskier („Trading“). The choice between the two should align with your financial goals, risk tolerance, and the level of research you are willing to do.

Remember, the stock market can be unpredictable. Whether you choose to invest or speculate, it's important to be aware of the risks involved and not to invest more than you can afford to lose. Remember, even after meticulous analysis, your stock can plummet by 80%. It's crucial to stay true to your core reasons for choosing this company if it doesn't change. The key to success in the stock market, especially for beginners, is to start with a clear understanding of your financial goals and the risks you are willing to take.

So first ask yourself who are you:

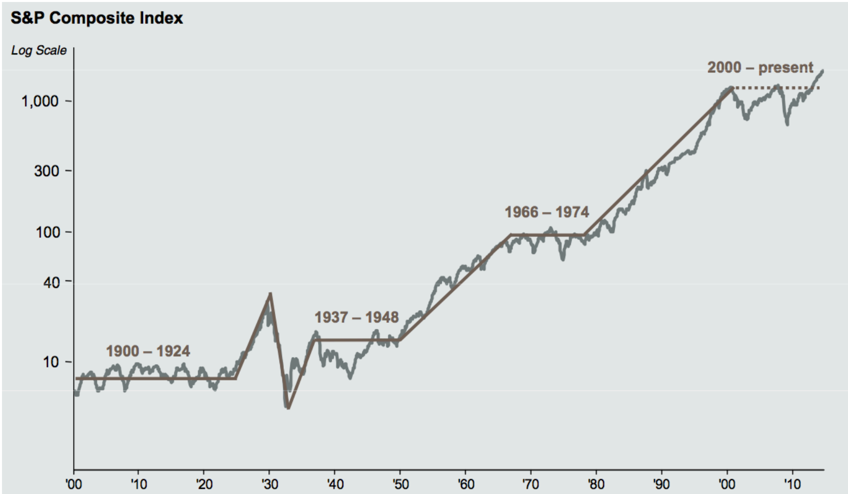
| Investor | Speculator |
|---|---|
| | |

# Understand the Latest History

An investor's stock portfolio is essentially a small sample of the broader and often intimidating stock market. To understand the market's attractiveness or risks at different times, it’s crucial to have a basic grasp of its history, especially the significant fluctuations in stock prices, earnings, and dividends over the years. Data going back a hundred years to 1871, though less complete in the early half of the century, can still provide valuable insights.

When examining stock market history, we can identify patterns and cycles of growth and decline over the decades. For instance, from 1900 to 1924, the market experienced mostly short, similar cycles lasting three to five years with an average annual growth of just 3%. The period from 1924 to 1949, including the 1929 peak and subsequent crash, was more erratic with a meager growth rate of 1.5% overall. In contrast, the post-World War II period, particularly from 1949 onwards, saw the beginning of the most significant bull market in history, with dramatic increases in stock prices. To understand these cycles, we look at indicators like the Dow Jones Industrial Average (DJIA) and the Standard & Poor's 500 Index, which track the performance of a selection of stocks and provide a sense of the market's overall trend. For example, between mid-1949 and early 1966, the DJIA grew sixfold, an average annual increase of about 11% not including dividends.

However, these impressive gains led to a dangerously optimistic assumption that similar high returns could be expected in the future. This optimism ignored the possibility that such growth rates might be unsustainably high. The subsequent declines in the market, including the major downturn between 1968 and 1970, were a strong reminder of this reality.




When evaluating the stock market level at the beginning of 1972, it's helpful to compare key financial indicators across different periods. These indicators include the ratio of stock prices to earnings (the price-to-earnings ratio) and the yield from dividends compared to bond yields. In 1971, for example, these ratios suggested that the stock market was not particularly attractive for conservative investors, especially when compared to the returns available from high-quality bonds.

Looking at the market's fluctuations historically, the situation in 1971 appeared to be a recovery from the downturns of 1969 and 1970. While many expected a return to a bull market, the volatility and rapid changes suggested potential risks ahead. The market's performance at this time didn't guarantee a continued rise, nor did it rule out the possibility of another significant decline.

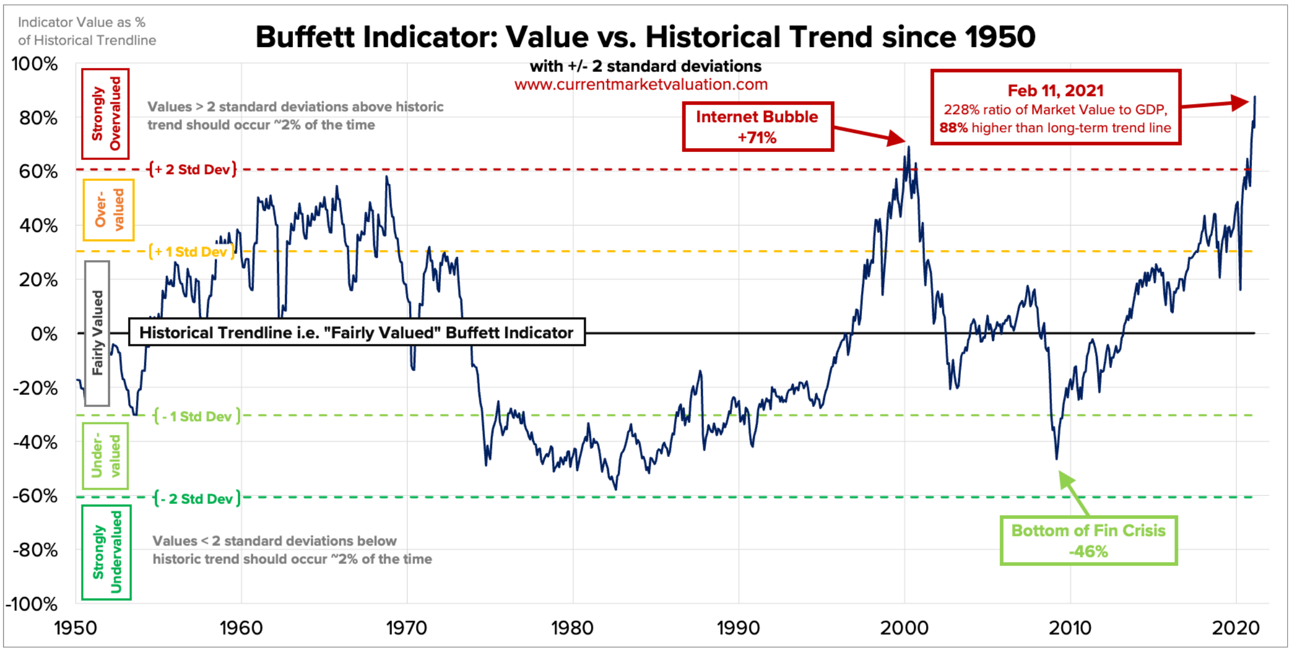
The year 1974 marked the beginning of an era characterized by economic growth and globalization. During this time, companies broadened their international presence, which, in turn, boosted their profits and elevated stock market valuations. This period was also defined by a shift towards deregulation and more market-friendly policies. These changes, including tax reductions and loosened business restrictions, were largely perceived as positive for corporate profits, subsequently attracting greater investment in the stock market.

Interest rates reached a record high of 21.46% in 1983, followed by a gradual descent to nearly 0% in recent times. Additionally, the baby boomer generation entering their prime earning years significantly influenced the market. This demographic shift resulted in a substantial increase in stock market investments, injecting a considerable amount of capital into the markets.
The 1990s saw the technology sector's rapid rise, which played a pivotal role during this period. Many companies, particularly in technology, healthcare, and finance, experienced marked growth in earnings, a trend often mirrored in their rising stock prices. Generally, this era was marked by strong investor optimism and positive market sentiment.

The advent of the internet and the tech boom, often termed the Dot-com bubble, further fueled this period. It led to hefty investments and speculative activities in technology stocks, pushing market indices higher. Between 1990 and 1999 the stock market grew 184% approximately. However, this bubble eventually burst in the year 2000. In 2008, the bank excessively leveraged its assets, often in the form of houses, beyond sustainable levels, leading to a collapse of its financial structure. Between 2000 and 2008 the stock market grew 13% approximately. The period from 2008 to 2023 encompasses the recovery from the global financial crisis, a long bull market, and more recent events like the COVID-19 pandemic and its economic repercussions. Between 2008 and 2023 the stock market grew 182% approximately.

For investors, especially beginners, understanding these patterns and indicators can be crucial in making informed decisions. While it's impossible to predict the market's exact movements, being aware of historical trends and current market conditions can help guide investment choices. It's important to be cautious and not overly optimistic, especially when the market is at a high level, as history shows that significant downturns can and do occur. A balanced and diversified approach, avoiding excessive risk, is usually the wisest course for most investors.

To gain an initial insight into the market's status, you can refer to the Buffett Indicator. This tool has repeatedly demonstrated its effectiveness in identifying times when the market is overvalued or undervalued.



# Your Portfolio 2023

When creating an investment portfolio, it's essential to consider the investor's financial position and risk tolerance. Traditionally, conservative institutions like savings banks and life insurance companies have primarily invested in high-grade bonds. However, a wealthy and experienced businessman might diversify into various types of stocks and bonds based on their attractiveness. Because there's no point in investing in bonds with a return lower than 3%.
The fundamental principle is that those who cannot afford to take risks should be content with modest returns. The desired return should be proportional to the investor's willingness to take risks and the effort they put into their investment decisions. The least effort and risk typically yield the lowest returns, while active and skilled investors can achieve higher returns.

For a defensive investor, the portfolio should be a balance between high-quality bonds and stocks. A basic rule is to invest no less than 25% and no more than 75% in either stocks or bonds. Ideally, a 50:50 split between stocks and bonds is suggested. However, if the stock market seems overvalued, it might be wise to reduce stock holdings below 50%. If the Bond market seems too low (2% or less), it might be wise to reduce Bond holdings below 50%. This balanced approach helps investors avoid getting swept up in market euphoria and making irrational decisions.

There are several types of bonds to consider:

(US or other countries) Savings Bonds: These bonds are extremely safe, offer reliable interest rates, and can be cashed in at any time. They are suitable for investors with modest means.

2. Savings Bonds:
    - **Duration:** Up to 30 years.
    - **Minimum Investment:** As low as $25.
    - **Risk of Losing Money:** Extremely low.
    - **Risk from Interest Rate Changes:** High.
    - **Early Withdrawal:** Limited options before maturity without penalty.
    - **Tax Exemptions:** Interest is exempt from state and local taxes, and federal tax can be deferred.
    - **Average Yield:** Depends on the series and issue date of the bond.

3. Treasury Bonds:
    - **Duration:** Typically 20 to 30 years.
    - **Minimum Investment:** Usually $100.
    - **Risk of Losing Money:** Extremely low.
    - **Risk from Interest Rate Changes:** High.
    - **Early Withdrawal:** Can be sold before maturity but may incur a loss or gain.
    - Tax Exemptions: Interest is exempt from state and local taxes but taxable at the federal level.
    - **Average Yield:** Varies with current market conditions.

4. Treasury Notes:

    - **Duration:** Between 2 and 10 years.
    - **Minimum Investment:** Usually $100.
    - **Risk of Losing Money:** Extremely low.
    - **Risk from Interest Rate Changes:** Moderate.
    - **Early Withdrawal:** Can be sold before maturity but may incur a loss or gain.
    - **Tax Exemptions:** Interest is exempt from state and local taxes but taxable at the federal level.
    - **Average Yield:** Varies based on current market rates.

5. Treasury Bills:

    - **Duration:** Ranges from a few days to 52 weeks.

- **Minimum Investment:** Usually $100.
- **Risk of Losing Money:** Extremely low.
- **Risk from Interest Rate Changes:** Low, due to short maturity.
- **Early Withdrawal:** Can be sold before maturity but may incur a loss or gain.
- **Tax Exemptions:** Interest is exempt from state and local taxes but taxable at the federal level.
- Average Yield: Fluctuates with the current market rates.
- **Risk of Losing Value due to Interest Rate Changes:** Very high.
- **Average Yield (as of Dec 31, 2002):** Approximately 1.2%.

6. Deposit Certificates (CDs):

- **Duration**: Typically ranges from a few months to several years.
- **Minimum Investment:** This can vary, often as low as $500 or $1,000.
- **Risk of Losing Money:** Very low; often insured up to $250,000 by the FDIC.
- **Risk from Interest Rate Changes:** Moderate.
- **Early Withdrawal:** Often possible with a penalty.
- **Tax Exemptions:** Interest is taxable at both federal and state levels.
- **Average Yield:** Varies depending on the term and financial institution.

Corporate Bonds: These are taxed at both the federal and state level. High-quality corporate bonds offer decent returns, but it's advisable to avoid lower-rated bonds due to increased risks.

Corporate Bonds:

- **Duration:** Typically ranging from 1 to 30 years.
- **Minimum Investment:** Often starts at $1,000 or $5,000, depending on the bond.
- **Risk of Losing Money:** Higher than government bonds. The risk depends on the creditworthiness of the issuing company.
- **Risk from Interest Rate Changes:** Moderate to high. Bond prices move inversely to interest rate changes.
- **Early Withdrawal:** Can be sold before maturity in the secondary market, but may result in a loss or gain depending on the market conditions.
- **Tax Exemptions:** Interest is taxable at both federal and state levels.
- **Average Yield:** Typically higher than government bonds, reflecting the increased risk. The yield depends on the issuing company's credit rating; higher-rated companies offer lower yields, while lower-rated ("junk bonds") offer higher yields.
- **Credit Ratings:** Issued by agencies like Moody's, S&P, and Fitch. Ratings range from high-grade (low risk) to non-investment grade or junk (high risk).
- **Types:** Include secured bonds, unsecured bonds (debentures), convertible bonds, and high-yield bonds.

For those seeking higher interest from bonds, high-yield bonds offer greater returns but come with higher risks. These are generally not recommended for the average investor.
Savings Accounts as an Alternative to Bonds: With current interest rates (2023, 3%), savings accounts in banks can be an alternative to short-term bonds.

Convertible Bonds: These will be discussed in a different chapter, offering unique opportunities and risks.

Call Provisions in Bonds: Be aware of call provisions in bonds, which allow the issuer to pay back the bond early. It's better to choose bonds with protection against early calls.

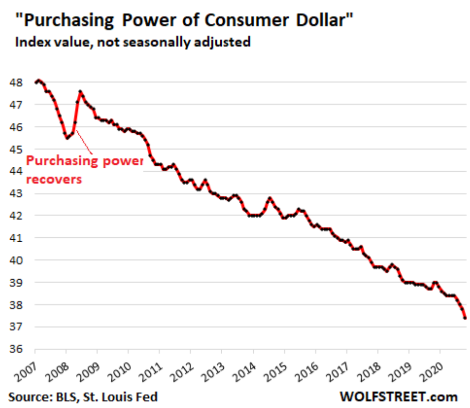
Preferred Stocks: These can be attractive when offered at a discount but generally lack the legal protection of bonds and the profit potential of common stocks. They are more suitable for corporate investors due to tax advantages.

For beginning investors, the key takeaway is to balance risk and return, diversify between stocks and bonds, and understand the different types of investment options available, choosing those that align with their financial goals and risk tolerance.

Note: If interest rates were to decline to 1-0% in the future, bonds would become a less attractive investment option. This is because their yields would be significantly lower, reducing the potential income that investors can earn from them.

I emphasized the importance of including a significant portion of stocks in all investment portfolios. Common stocks were generally perceived as highly speculative and uncertain, primarily because they had fallen sharply from their 2000 and 2007 levels, but some recovered some not. However, instead of attracting investors with reasonable prices, this decline eroded confidence in stocks. Over the next 20 years, the market dynamics changed, making Tech stocks appear safer and profitable at record levels, but they also carried considerable risks (Hype).

Arguments for stocks in 2023 centered around two main points. Firstly, stocks offered substantial protection against the erosion of purchasing power due to inflation, a protection not offered by bonds.




Secondly, stocks historically provided higher average returns to investors through dividends, which exceeded the incomes from high-quality bonds, and a potential increase in market value due to reinvested earnings.

While these advantages were significant and led to stocks outperforming bonds over a long period, we always cautioned that these advantages could be lost if investors paid too high a price for their stocks. This was the case in 1929, 1987, 2000, and 2008 and it took 25 years for the market to recover from the substantial fall from 1929 to 1932. It Took After peaking in March 2000, it took the Nasdaq 15 Years to get back to that level. Even the most enduring brands were slow to recover. Qualcomm stock took 20 years to get back to where it was in early 2000. It took Microsoft roughly 15 years. During the financial crisis of 2008, it took Close to five years for the stock market to bottom out and start recovering. In the year 1957, stocks, due to high prices, lost their traditional advantage in dividend yield over bond interests. In the years 2000 and 2008, stocks lost their traditional advantage over bonds, but primarily due to falling yields, this shift did not have as significant an impact as it might have in other circumstances, largely because the overall decline in yields lessened the comparative disadvantage for stocks. It remains to be seen whether inflation and growth factors and the Fed can balance out this adverse trend in the future.

I believe that a defensive investor cannot afford to be without a significant portion of stocks in their portfolio, even if they might see it as the lesser of two evils compared to holding only bonds.

For selecting stocks in a defensive investor's portfolio, here are four simple rules:

- **Have adequate but not excessive diversification, which means holding at least ten and no more than thirty different stocks.**

- **Each company chosen should be large, prominent, and conservatively financed.**

- **Each company should have a long history of continuous dividend payments or net income/ Revenue growth, with the requirement that they have a 10-year Annual Report History.**

- **The investor should set a limit on the price they're willing to pay for a stock relative to its average earnings over the past seven years.**

Example:

To determine a reasonable price to pay for Intel's stock, Benjamin Graham's method can be simplified as follows:

- **Start with Intel's Earnings Per Share (EPS)**: This is the amount of profit Intel makes for each share of stock.
- **Calculate the 'P/E for No Growth'**: This is a base Price-to-Earnings (P/E) ratio, assuming the company doesn't grow. Graham typically used a base value of 8.5 for this.
- **Adjust for Growth**: Add Intel's growth rate (expressed as a percentage) to the base P/E ratio. For instance, if Intel's expected annual growth rate is 5%, you would add this to 8.5.
- **Factor in a Growth Multiplier**: Graham believed that a company's growth rate should have a greater impact on the P/E ratio. He suggested multiplying the growth rate by a constant factor (which he set at 2). So, if Intel's growth rate is 5%, you would calculate 5% × 2 and then add this to the step 2 result.
- **Consider the Average Yield of AAA Bonds**: This is the average return investors can expect from top-rated, extremely low-risk bonds. This figure is used to adjust the value you're willing to pay for the stock. The higher the bond yields, the less you should be willing to pay for the stock, and vice versa.

Putting it all together, the formula would be (2023):

Intel EPS ×(Intel 'P/E No growth'+(Intel Growth rate×Intel 2 g))× Intel 'Average yield AAA Bond:'

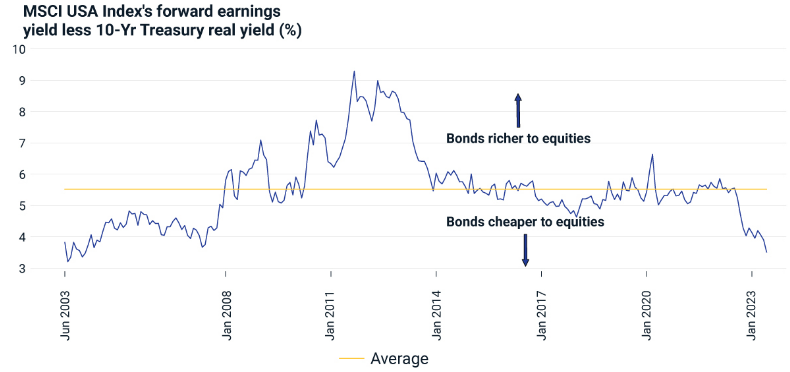
**Intel** = 4 ×(8,5+(5×2 )) x 4,4

**Value** = 72,35

So, you take Intel's current earnings per share, multiply it by the adjusted P/E ratio (which includes the base P/E ratio and the adjustments for growth), and then adjust that figure based on the current yield of AAA bonds. This gives you an estimate of a reasonable price to pay for Intel's stock.

We generally view growth stocks as too uncertain and risky for defensive investors. Although they can be attractive if their price isn't too high, growth stocks have historically been traded at high price-to-earnings ratios. This speculative element makes it difficult to succeed in this area.
The concept of "risk" is commonly misunderstood in investing. Risk, in our view, does not simply equate to the potential for a decline in stock prices, especially if these are temporary and the investor does not need to sell at that time. **Real risk involves the possibility of permanent loss of capital or a severe deterioration in a company's earnings power.**
Finally, the choice of securities and the desired return should be based not on the size of the investor's financial resources but on their financial knowledge, experience, and temperament. Investing is about matching one's capabilities and goals with appropriate investment strategies. If you're someone with a high temperament who frequently checks your portfolio and gets affected by its fluctuating values, then investing in growth stocks, which are prone to significant price swings, might not be suitable for you.

An "aggressive" investor should start with the same foundation as a defensive investor: a portfolio split between high-quality bonds and stocks bought at reasonable prices. Of course, if Bonds only yield 0-3% you can only have Stocks in your portfolio. You are open to exploring different types of securities Always ensure you have a sound and well-reasoned basis for your investment decisions. There's no single or ideal model for aggressive investing; it depends on



individual competence, interests, and preferences.

Aggressive investors should avoid top-grade preferred stocks, often better suited for corporate buyers, and be cautious with low-grade bonds and preferred stocks unless bought at steep discounts. They should also generally avoid foreign government bonds, even with attractive yields, due to their high risk and lack of legal recourse in case of default. The most effective strategy is to examine the historical performance of bonds over the past 10 to 20 years and assess the likelihood of default

For regular bond investments, aggressive investors might follow the model recommended to defensive investors: choosing between high-quality taxable bonds (yielding around 4.25%, 2023) and tax-exempt quality bonds (yielding up to 4.4%%). However, it's generally not advisable to buy lower-grade bonds just for their slightly higher yield.
High-quality bonds that have dropped in price offer opportunities for capital gains under favorable future conditions. However, it's a poor strategy to buy second-grade bonds or preferred stocks at full price, just for a higher yield, as there's a risk of substantial capital loss. Investors should look for significant potential gains in capital if they're taking on any risk.

When it comes to foreign bonds, historically they've been a poor investment. Buying foreign bonds can be a double-edged sword, offering a slight yield advantage but at the cost of higher risk, including political and currency risks.

## Stock issues

In the case of new stock issues, investors should exercise caution. New issues are often sold under favorable market conditions for the seller, making them less advantageous for the buyer.

## IPOs

The quality of companies offering initial public offerings (IPOs) can deteriorate as the market rises, with prices reaching unsustainable levels. Many IPOs can lose a significant portion of their value shortly after being listed. It's better to avoid IPOs during market booms and consider them only when the market is down, and they are undervalued.

In summary, it's not just about seeking higher returns but also about managing the risks associated with different investment choices.

## Trading

Day trading, where you buy and sell stocks within hours, is often a quick path to financial loss. While you might make money on some trades, you're likely to lose on others. Remember, your broker profits regardless of your success.

One of the hidden costs in trading is the "market impact" - the price change caused by your trading. For example, if you desperately want to buy a stock, you might end up paying a bit more than its current price. This extra cost is often invisible but real. If you buy 1,000 shares and unintentionally raise the price by just $0.05, that's an unseen extra cost of $50. **If you're inclined to gamble, consider playing blackjack, where the odds of winning are typically higher.**

Your Path:
As a professional investor, you're expected to put in more effort and attention to achieve better results than the average person. We've previously discussed investment strategies, especially in bonds, which are mainly suited for professional investors. Here are some opportunities you might find interesting:

- **Tax-free New-Housing Authority Bonds, backed by the U.S.**
- **Taxable but high-yielding New Community Bonds, also backed by the U.S.**
- **Tax-free Industrial Bonds issued by municipalities but serviced by payments from strong companies.**

On the other end, there are lower-quality bonds in "special situations," where the line between bonds and stocks blurs.
For stock transactions, professional investors typically follow four strategies:

- **Buying at low prices (in terms of purchasing stocks when they have low price-to-earnings (PE) ratios and sales-to-earnings ratios, and selling them when these ratios are high)**
- **Investing in carefully selected growth stocks.**
- **Buying undervalued securities.**
- **Investing in "special situations," like company mergers or acquisitions.**

When it comes to general stock market strategy, there used to be a simple approach: buy during market lows and sell during booms. However, market fluctuations over the last 30 years have shown that this strategy isn't as effective as it once seemed. It requires a special talent or intuition for trading, which is different from the intelligence I expect you to have.
You can adjust between a minimum of 25% and a maximum of 75% in stocks, depending on your belief in the market's risk or attractiveness.

Regarding growth stocks, most investors like the idea of choosing companies that have been successful in the past and are expected to continue growing. However, this is more complicated in practice. Stocks that have performed well in the past and seem promising for the future often trade at high prices. You might pay a premium for their anticipated success and still not get great results, especially if the company's growth slows down.

Studies show that diversified investments in growth companies don't necessarily offer significant advantages over general stocks. In terms of finding bargains, we define a bargain as a stock or bond whose actual value is significantly higher than its market price. To identify such bargains, you can use two methods:

- **Valuation method: Estimating future earnings and multiplying by an appropriate factor.**
- **Assessing the value of the company for a private owner, focusing on the realizable value of assets, especially net working capital or operating assets.**

During market lows, there are plenty of bargain opportunities. Similarly, market mood swings create individual bargains at almost all market levels, due to temporary disappointments or long-term neglect.
For second-tier companies(„Tier 2 companies are the suppliers who, although no less vital to the supply chain, are usually limited in what they can produce.“), they are usually undervalued by the market. This offers opportunities for professional investors, especially during bull markets when these stocks can rise significantly. However, these stocks can be risky and require careful consideration.

Finally, "special situations" or conversions were once almost sure ways to make attractive returns. These include situations like corporate **restructurings or mergers**.
Our investment strategy essentially depends on whether you choose to be a defensive (passive) or aggressive (professional) investor. Most people should adopt a defensive approach, focusing on safety, simplicity, and satisfactory results. Aggressive investors can explore a wider range of securities, provided they do it wisely and at a bargain to ensure safety.
Remember, the world of investment is vast and complex, and these guidelines are just the starting point for those beginning their investment journey.

## 8 Rules of Market Fluctuations

Investing in stocks and bonds involves navigating the ups and downs of the market. As an investor, it's essential to understand that these fluctuations are a normal part of the investing process.

**Rule 1: Market Fluctuations**

When you invest in stocks, be prepared for their value to change over time. While these changes can be unpredictable, knowing this helps you avoid making impulsive decisions based on short-term market movements. For instance, if the value of your stocks goes down, it doesn't necessarily mean you made a bad investment choice. It's often just the market's natural ebb and flow.

**Rule 2: 3 Strategies for Investing in Stocks**

There are different ways to approach stock investments. One is buying stocks when their prices are low and selling when prices are high. Another approach is investing in companies that are expected to grow significantly - these are known as growth stocks. You can also look for undervalued stocks - shares that are selling for less than what they're worth. Lastly, some investors focus on special situations like mergers or acquisitions, where a company's stock price might be affected by these events.

**Rule 3: Handling Bonds in Investments**

Bonds are a bit different from stocks. If you invest in short-term bonds (around seven years or less), their value doesn't fluctuate as much as long-term bonds. With long-term bonds, you should be ready for more significant changes in their market price.

**Rule 4: Understanding Market Psychology**

It's easy to get swept up in market trends. When stock prices rise, you might feel tempted to buy more, and when they fall, you might want to sell. However, successful investing often means doing the opposite: buying when everyone else is selling (and prices are low) and selling when others are buying (and prices are high).

**Rule 5: The Importance of a Balanced Portfolio**

Maintaining a mix of different types of investments (like stocks and bonds) can help balance the risks. When stocks are not performing well, bonds might provide stability, and vice versa.

**Rule 6: Investment vs. Speculation**

It's crucial to distinguish between investing and speculating. Investing is about making thoughtful decisions based on a company's performance and potential. Speculation, on the other hand, is more about trying to predict and profit from market fluctuations, which is riskier and more uncertain.

**Rule 7: Long-term Perspective in Investing**

Being a successful investor often requires a long-term perspective. It's about being patient and not reacting hastily to market changes. Over time, markets have shown a tendency to go up, so holding onto your investments through the ups and downs can be a wise strategy.

**Rule 8: The Role of Company Management**

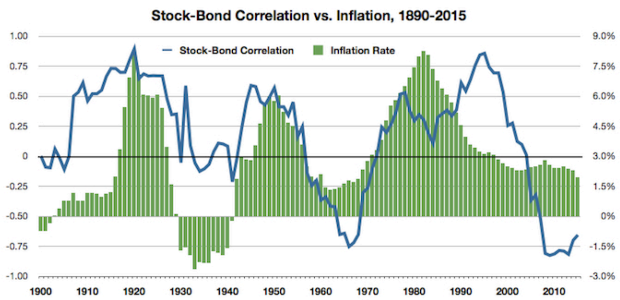
When investing in stocks, consider how well a company is managed. Good management can lead to increasing stock prices over time, while poor management might do the opposite.

Given the inherently unpredictable nature of the market, no investment strategy can guarantee success all the time. The key is to stay informed, be disciplined in your approach, and not let emotions drive your investment decisions. Remember, investing is a journey. It's about understanding the market's nature, being prepared for its fluctuations, and making informed decisions based on thorough research and a clear understanding of your financial goals.

# What to do in today's Inflation.

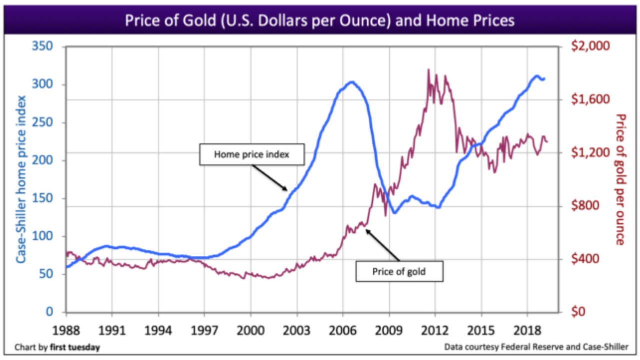
Inflation is a key concern for anyone involved in investing, affecting both the value of money and investment returns. When prices rise due to inflation, those with fixed incomes or investments like bonds can find their purchasing power decreasing. However, stocks offer a potential hedge against inflation, as companies can increase prices and potentially grow their profits and dividends over time.
Historically, financial experts have often favored stocks over bonds during inflationary periods. This is because bonds, with their fixed returns, can lose value in real terms when inflation is high. Stocks, on the other hand, are seen as having the potential for price appreciation and increasing dividends, which can offset the effects of inflation.

Looking back, inflation has always been a part of the economic landscape, varying in intensity over the years. There's no clear pattern or predictability to inflation rates, but it's reasonable to assume a moderate rate based on historical averages. An important consideration is that while inflation can erode the value of fixed-income investments like bonds, it doesn't necessarily guarantee better returns for stocks.




The relationship between inflation and stock market returns is complex. For example, during periods of high inflation, stock prices and profits haven't always increased. Many factors, including wage increases and the need for more capital, can offset any gains from inflation. Rising costs can sometimes hurt companies' profitability.
Also, the increase in company debts over the years is a significant concern. This increased borrowing can become a heavy financial burden, affecting company profits and, by extension, stock prices. It's a misconception that inflation automatically benefits companies or their shareholders.

For those considering investments as a hedge against inflation, traditional wisdom suggests **real estate** and tangible assets like **gold** and the newer one **Bitcoin**. However, these too come with their risks and complexities. Real estate can be subject to significant price fluctuations and is not easily diversified for small investors. Gold, historically seen as an inflation hedge, hasn't always performed well when adjusted for storage costs and the lack of interest income. Bitcoin presents an intriguing concept, yet it's important to remember its value heavily relies on belief. Without this collective trust, it's susceptible to rapid declines since it lacks inherent protection and serves primarily as a medium for transactions.




Unlike gold, which has tangible uses, or real estate that offers living space and social prestige, Bitcoin's utility is limited. Therefore, it stands as my least preferred option for combating inflation.

In summary, there's no one-size-fits-all answer to investing in times of inflation. Diversification remains key. A balanced portfolio of stocks and bonds and „real estate" can help mitigate the risks associated with both inflation and market volatility. While stocks are generally considered a good defense against inflation, they don't come with guarantees and can be risky, especially at high market valuations. It's important for investors, especially those just starting, to understand these dynamics and not put all their investment in one type of asset.

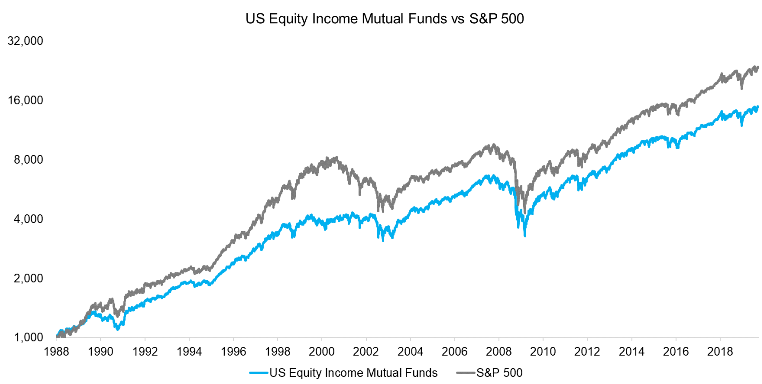
# Investmentfonds

Investment funds are a popular choice for people looking to save money over many years. These funds, also known as mutual funds, come in two main types: open-end and closed-end funds. Open-end funds, the most common, allow investors to buy and sell shares at their net asset value. Closed-end funds have a fixed number of shares and their prices fluctuate in the market like regular stocks.

The mutual fund industry is quite large. By the end of 2022, there were 8,762 funds registered with the Securities and Exchange Commission (SEC), with a total asset value of 32.96 trillion. Out of these, 8,322 were open-end funds with assets of $50.6 billion, and 441 were closed-end funds.

Funds can be categorized based on how they distribute their investments. Balanced funds hold a significant portion in bonds (usually a third or more), while stock funds invest mainly in stocks. There are also bond funds, hedge funds, and other variations. Funds can also be categorized by their primary goals, such as income, stability, or growth. Today's most popular investment vehicles are hedge funds, which aim to identify unique opportunities in the market to either short-sell or invest in.

When buying shares in mutual funds, investors might pay an upfront sales charge (load) on top of the share value, often around 5%-8,5% for small purchases. Some funds, known as no-load funds, don't charge this fee, instead, earning from management fees.
Most mutual funds operate under specific tax rules, avoiding double taxation on earnings for their shareholders. They distribute most of their income (like dividends and interest) and can also distribute realized capital gains from selling investments.



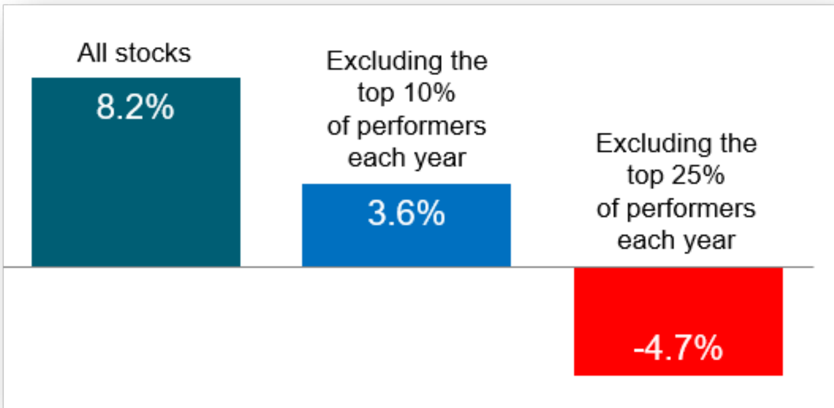

The performance of mutual funds compared to the general market has been a topic of debate. In general, mutual funds have encouraged saving and investment habits, saved many private investors from costly mistakes, and provided returns comparable to direct stock investments. However, their actual performance doesn't seem to significantly outperform the stock market as a whole.
The trend of 'performance funds' emerged in recent years, with young managers promising superior returns. Initially successful, many of these funds later faced significant losses, mirroring the speculative bubbles and busts of the past.

For investors choosing between open-end and closed-end funds, closed-end funds often trade at a discount to their net asset value, offering a potential advantage over open-end funds which typically sell at a premium.
Investing in mutual funds requires careful consideration of past performance, management quality, and investment goals. While no investment is without risk, mutual funds offer a diversified approach that can be suitable for long-term investors.

# Advice from People

Investing in securities is unique because it often relies heavily on advice from others. Many investors are amateurs and believe that professional advice can help in selecting stocks and bonds. However, investing based on someone else's advice to make money can be somewhat naive, as it's quite different from seeking professional advice in other business areas.

Investment advice comes from various sources, such as family or friends, bank advisors, brokerage firms, Online, financial newsletters or magazines, and investment advisors. Each source has its approach, and the investor's strategy should be aligned with the nature of the advice they are receiving. For those who must rely on others for investment management, sticking to normal, conservative investment strategies or knowing the advisor well is crucial.




**If you owned all stock over the 26-year period from 1994 to 2020, the return would have been 8.2%. However, if you excluded just the top 10% of performers each year, you would have earned only 3.6% a year — that's a decrease of 56%. If you excluded the top 25% of performers each year, you would.**

The relationship between an investor and **their advisors** can become less conventional as the investor gains knowledge and experience. In this case, the investor transitions from a defensive to an aggressive investor.

Professional investment advisors, including established wealth management firms and bank trust services, are modest in their promises. They focus on preserving capital and achieving acceptable returns, rather than promising extraordinary gains. Their main value to clients is often in preventing costly mistakes.

Financial services offer **newsletters** and advice on market prospects and individual securities. They cater to a different audience than investment advisors, providing information for those who manage their finances or advise others. These services range from market prediction using technical methods to providing valuable economic intelligence.

Most stock ownership information and advice come from **The Internet.** Journalists often pursue the latest trending topics to attract views and readers; therefore, one should approach their advice and predictions with a healthy dose of skepticism. Brokerage firms provide analyses and recommendations, often for free to their clients, whom they refer to as clients to imply a more professional relationship.

Investors should use their intelligence not only in formulating their financial strategies but also in handling details, such as selecting a **reputable broker.** We recommend purchasing your stocks through a major bank, such as a national bank, to reduce the risk of default. As an aggressive investor, you can certainly opt for affordable alternatives like online brokers to buy and sell stocks at a lower cost.

**Investment banks,** involved in creating stock companies and selling new stock and bond issues, have a fundamentally different relationship with investors. The investor's protection comes less from the bank's scruples and more from the investor's critical judgment.
Especially in speculative market phases, investors should be cautious about new stock issues offered at high prices.

Finally, advice from **family and friends** should be approached critically, as it's often as challenging to find good non-professional advice as it is to select the right securities themselves. Aggressive investors will want to understand the details behind recommendations and have a say in the decisions. In contrast, defensive investors should make it clear they are only interested in high-quality bonds and leading company stocks at reasonable prices. Investors should always align their actions with their knowledge and experience, only relying on others' recommendations when they are sure of the advisors' integrity and competence.

# Stock Analysis

Financial analysis is a well-established profession with a focus on evaluating stocks and bonds. Analysts examine a company's past, present, and future to assess its financial health and potential for growth. They use various techniques to adjust and interpret the data in financial statements, even when these have been audited and certified.

The analysis of bonds and preferred stocks involves checking if a company has historically earned enough to cover its debt and dividend obligations. Analysts use certain criteria like profit coverage ratios, company size, stock equity ratio, and asset values. These standards, though somewhat arbitrary, have been reliable in predicting a company's ability to withstand future economic uncertainties.

When analyzing common stocks, analysts aim to estimate a stock's value based on future earnings and then compare it with its current market price. This process involves forecasting future sales, prices, and profit margins based on economic predictions and then applying a "capitalization factor" to these estimates. This factor can vary greatly depending on the stock's "quality," with high-growth companies often being valued much higher than others.

Various factors influence this capitalization rate, including the company's long-term prospects, quality of management, financial strength, dividend history, and current dividend yield. The valuation of growth stocks can be particularly tricky, as their worth is highly dependent on future growth expectations. This leads to a potential paradox: **the more a stock's value is based on future predictions, the more vulnerable it is to errors.**

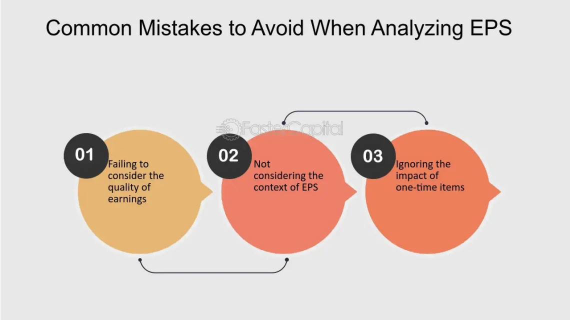
Analysts also consider the industry or sector a company belongs to, as it can significantly impact its performance and stock price. However, predicting future industry trends is difficult, and even comprehensive studies can miss crucial developments or misinterpret market signals.
In practice, analysts often divide their valuation process into two parts.
First, they calculate a value based on past performance, assuming future performance will mirror the past. Then, they adjust this value to account for anticipated future changes.

Despite the complexities and uncertainties involved, financial analysis remains an essential tool for investors. It provides a structured way to evaluate investment opportunities, although it should be approached with caution and understanding of its limitations. For beginners, a good starting point is understanding the basics of financial statements and the key factors analysts consider in their evaluations. If you're looking for a precise method of valuation, you'll find it at the top, indicated by the title *Intel*.

# EPS

When it comes to earnings per share (EPS), investors should be cautious. Firstly, don't overemphasize the EPS of a single year. Secondly, be aware of potential pitfalls in long-term EPS. While quarterly and annual EPS figures are often highlighted in financial circles, they can sometimes be misleading.

For instance, when analyzing AT&T, the reported EPS for 2022 Q4, 2022 was $0.60, but this figure was before extraordinary expenses. After accounting for these and dilution effects, the actual EPS was ($3.20). Such adjustments are crucial for understanding a company's true earnings.




In the case of AT&T, extraordinary expenses were significant and included costs related to the closure of certain operations and contractual obligations. These expenses, though they occurred in 2022. Sometimes, companies use creative accounting within legal limits, like writing off future losses in advance, which can paint an overly optimistic picture of future earnings.
Investors should also be aware of factors like tax credits from past losses, dilution from convertible securities, and methods of depreciation and expense booking, which can significantly impact reported earnings. For example, changing from an accelerated to a straight-line depreciation method can artificially boost reported profits.

The average earnings over a longer period, such as seven to ten years, can offer a more stable and realistic view of a company's performance, smoothing out the fluctuations of business cycles. This approach also integrates extraordinary items, providing a fuller picture of a company's historical performance.

Growth rates based on past performance can be calculated by comparing the average EPS of the last three years with that of ten years prior. However, these historical growth rates might not always be relevant for future projections. For instance, AT&T had an excellent past growth rate, but its future outlook as perceived by the market was less optimistic.

In valuing a company like AT&T, one approach is to calculate the "value of past performance" and then adjust it based on expected future changes. This method can be more informative than just looking at recent EPS figures. However, determining the future is challenging, and even well-established companies can have unpredictable EPS trends.
In summary, when beginning to invest, it's crucial to look beyond just the EPS figures and consider a range of factors, including how earnings are calculated, the company's historical performance, and potential future changes. Understanding these elements will help in making more informed investment decisions.

# Example of Analysing a Company

In this chapter, we're going to analyze four publicly traded companies: 3M, Tesla Inc., Nividia, and Walmart Each company is different, and their financial and operational data vary enough to make this comparison interesting.
First, let's look at the key details of each company at the end of 2022:

- 3M. Is Involved in various businesses. Its stock price was $94, with a total market capitalization (including bonds and preferred stocks) of about $54 Billion. In 2022, its net income was about $5.7 Billion, with an average earnings per share (EPS) of 10-9$ from 2018-2022. P/E Ratio: 10

- Tesla Inc. is a manufacturer of electronic Cars. Its stock price was significantly higher at $226, and the total market capitalization was a massive $747 billion. Its net income for 2022 was around $12,56 Billion. P/E Ratio: 79

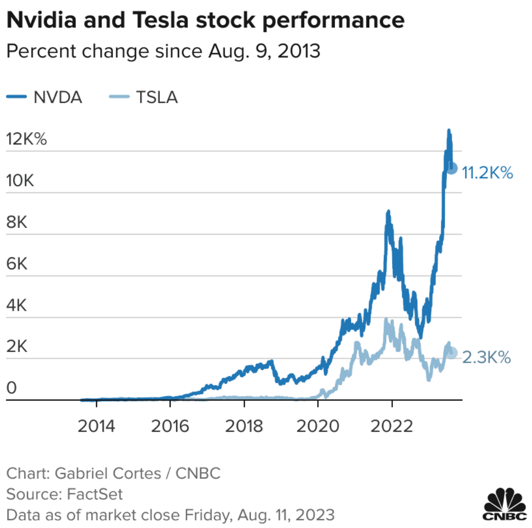
- NVIDIA Corp: is a Chip producer. Its stock price was $426, and it had a market capitalization of $1,14 Trillion. For 2022, its net income was about $9.7 Billion. P/E Ratio: 64

- Walmart: A Shop around offering a wide variety of products at low prices, aiming to attract a large customer base. Its stock price was $143, with a total market capitalization of $418 Billion. The net income for 2022 was around $13.6 Billion. P/E Ratio: 25

When we analyze these companies, we notice that their price-to-earnings ratios (P/E ratios) and stock prices vary more than their operational performance or financial position. 3M and Walmart had moderate P/E ratios around 15, while Tesla and NVIDIA Corp had much higher P/E ratios, indicating they were favored by the market due to their superior growth in recent years.

Key elements to consider in their performance:

- Profitability: All companies showed satisfactory returns on their book value, with Tesla and Nvidia being particularly impressive.
- Stability: Stability is measured by the least decline in EPS over ten years. Tesla and Nvidia showed reasonable stability, while 3M and Walmart showed excellent stability.
- Growth: Growth rates were satisfactory for 3M and Walmart and impressive for Tesla and Nvidia
- Financial Position: All companies had a healthy ratio of current assets to liabilities. Nvidia had a significant amount of convertible preferred stocks.
- Dividends: 3M and Walmart had a consistent history of dividend payments.
- Past Stock Performance: All four stocks showed impressive growth over 10-20 years, with Nvidia showing the most dramatic rise.




General Observations:

- Tesla: Despite its large market cap, it's worth noting that high valuations come with high risks. Its prospects seem bright, but the market valuation of over 1 billion dollars is a point to consider.

- NVIDIA Corp: Expected to grow significantly, its high P/E ratio suggests high expectations for future growth. However, it's important to note that rapid growth from a small base can be challenging to sustain.

- 3M and Walmart: These companies seem undervalued compared to their operational performance. They meet the criteria for a conservative investment strategy, offering reasonable safety at their current prices.

Final Thoughts:

Investors might find Tesla and NVIDIA Corp more attractive due to their market momentum and growth history. However, for a conservative investor, 3M and Walmart could be safer choices, offering value for their price. The choice between 'value stocks' and 'glamour stocks' often depends on an investor's individual preferences and approach to investing.

# Stocks

In this section, we'll explore some techniques for stock analysis, focusing on the defensive investor. The defensive investor follows a conservative approach, typically investing in high-grade bonds and a diversified list of leading stocks, ensuring that the price paid for stocks is not excessively high.

There are two main approaches for the defensive investor to create a stock portfolio. Is first is to mimic the Dow Jones Industrial Average (DJIA) by buying a cross-section of leading stocks, including both popular high-growth companies and less popular, cheaper ones. Investing in a low-cost ETF such as the SPDR S&P 500 ETF, Invesco QQQ Trust Series, iShares Core MSCI, or Vanguard Growth ETF can be a strategic move. These ETFs include a range of leading stocks, offering a diversified portfolio with exposure to various market segments. This approach simplifies the investment process while providing broad market coverage.

The second approach involves setting specific criteria for each stock purchase to ensure a minimum quality of past performance and current financial health. We recommend seven criteria for selecting individual stocks:

- **Sufficient Size of the Company**: Exclude small companies to avoid excessive volatility. For instance, industrial companies should have at least $100 million in annual sales.
- **Sufficiently Strong Financial Condition**: For industrial companies, current assets should be at least double the current liabilities or a past growth of 15% which will continue.
- **Earnings Stability**: The company should have a history of profitability, with no losses in the past ten years.
- **Dividend Record**: The company should have a consistent history of dividend payments for the last 20 years if it is not growing anymore.
- **Earnings Growth**: Earnings per share should have grown by at least one-third over the past ten years.
- **Moderate Price-to-Earnings Ratio**: The current price should not be more than 15 times the average earnings of the past three years.
- **Moderate Ratio of Price to Assets**: The current price should not be more than 1.5 times the book value.

Applying these criteria at the end of 2023 to the Market, only a few companies met all conditions, suggesting that it's challenging for many stocks to meet these stringent requirements Example: („Richardson Electronics, Ltd“) end of 2023. However, there's a good selection of utility stocks that generally meet these criteria, providing a simpler choice for the defensive investor. These stocks often show good performance records, less price fluctuation, and offer higher dividend yields.

## Banks and insurance

Regarding financial companies, such as banks and insurance companies, they typically don't differ significantly in performance from other sectors. However, due to their unique characteristics, they should be evaluated with specific attention to their financial health and price-to-earnings ratios.

In conclusion, while every investor wants their portfolio to outperform the average, it's challenging even for skilled analysts to consistently pick stocks that beat the market. Stock prices reflect both known facts and future expectations, making predictions difficult. Analysts often focus either on forecasting future performance or on finding stocks with a margin of safety in their current price. The latter approach, focusing on value and safety rather than on potential high growth, is more in line with the conservative strategy of the defensive investor.

# Choosing Stocks

Explanation for Beginners:

When it comes to selecting stocks for professional investors, there are several key aspects to consider. This chapter aims to guide you through these considerations, emphasizing that while average results are easily attainable, surpassing them is a more complex task.
Understanding Average vs. Above-Average Results:

To achieve average investment results, one can mimic the composition of major stock indices like the DJIA (Dow Jones Industrial Average). This method doesn't require special skills. However, to attain above-average results, investors need a deeper understanding and more sophisticated strategies.

**The Challenge of Outperforming the Market:**

One of the core challenges for professional investors is consistently outperforming major indices, such as the S&P 500. Despite having access to vast resources and expert analysts, many investment funds struggle to beat these benchmarks over the long term. This difficulty underscores the complex and unpredictable nature of the stock market.

**Market Predictability:**

There's a theory that stock prices incorporate all available information, reflecting a company's past, present, and the market's expectations for its future. This implies that significant price movements are driven by new, unforeseeable information. Consequently, predicting these movements is often more about luck than analytical prowess, challenging the effectiveness of even the most thorough stock analysis.

**Strategy of Undervaluation:**

A strategy often overlooked by mainstream Wall Street involves focusing on undervalued sectors or companies. This can mean buying stocks priced lower than their net working capital, which historically has been a successful approach. It requires identifying stocks that are not in the limelight but have solid financials, offering a good value proposition.

**Special Situations and Transformations:**

This chapter also touches upon 'special situations' - unique opportunities arising from corporate events like mergers, acquisitions, or company liquidations. These situations can present profitable opportunities, but they are also fraught with higher risks. They demand a keen understanding of

the specific details of each situation and often, a significant amount of patience as these investments may take time to yield returns.
Successfully navigating through these special situations requires experience and sound judgment. Many proposed mergers or acquisitions fail to materialize, leading to potential losses. The ability to discern which opportunities have a high likelihood of success and which are too risky is crucial.

**Market Dynamics and Investor Psychology:**

Market dynamics and investor psychology play a significant role in stock selection. The stock market can sometimes highly value companies with strong brand recognition or high growth prospects while undervaluing solid companies going through temporary challenges. In conclusion, for professional investors, successful stock picking is not just about analyzing numbers and trends. It involves a nuanced understanding of market psychology, a keen eye for undervalued opportunities, and the ability to manage the inherent risks. It's a blend of art and science, requiring a balanced approach to both analytical and behavioral aspects of investing.

# Convertible Securities

Convertible securities, like convertible bonds and preferred stocks, have become prominent in finance. They offer investors a blend of safety (like a bond) and potential growth (like stocks). For companies, issuing these means borrowing money at lower costs. However, the reality is more nuanced. When an investor opts for convertibles, they might be giving up some investment quality or yield. Similarly, a company issuing these might dilute the value of its existing shares. In essence, while convertibles can be attractive, they don’t guarantee success and need thorough evaluation specific to each issue.

## Convertible Securities – Risks and Returns:

Historically, convertibles issued during market highs have tended to yield poor returns, primarily because market downturns make conversion less attractive and can also impact the underlying security's safety. An ideal convertible security would be well-secured and can be converted into an attractive stock at a price close to the current market value. However, such opportunities are rare in new issues and are more likely found in older issues that have developed favorable conditions over time.

Convertibles can affect the value of a company's common stocks. Issuing convertibles during mergers or acquisitions often appears positive initially, as it shows earnings growth and proactive management. However, there’s a downside: the dilution of current and future earnings per share due to the potential conversion of these securities into common stock. This dilution can significantly impact a company's valuation, especially in rapidly expanding firms.
Nowadays, it's often seen that convertible preferred stocks are more attractive than the corresponding common stocks. Holders of common stocks can benefit by switching to these preferred stocks, enjoying higher dividends and a more secure position.

## Stock Rights – A Cautionary Tale:

Stock rights, which are long-term options to buy common stocks at set prices, have grown in popularity but are viewed critically. They are often seen as creating artificial market values and can be misleading for investors. There's no real justification for their existence except for the extent to which they can mislead speculators and investors. They should ideally be heavily regulated or limited.

Practical Implications of Stock Rights:

While stock rights can offer opportunities for gains or losses, they come with limitations and often do not bring substantial benefits to the company that issues them. In the bigger picture, their issuance, especially in large numbers relative to a company's total capitalization, can be a sign of a company's overly complex capital structure, which might not be a good indication of financial health.

**In summary**, both convertible securities and stock rights have their own sets of complexities and require careful consideration from investors. While they offer unique advantages, they also come with inherent risks and potential impacts on a company's stock value and overall financial health.

# Case Studies in Investing

1. Wilko (hardware retail chain): The Dangers of Ignoring Financial Health

Penn Central's collapse in 2023 is a prime example of what happens when investors and analysts overlook basic financial distress signals. Despite being a major player in the hardware industry, its bankruptcy sent shockwaves across the financial world. One key mistake was the market's failure to respond to the company's inability to cover its interest expenses adequately (£625 million of debt). A closer look at its financials would have revealed that its earnings were insufficient to cover these costs, a classic sign of financial distress. Despite reporting profits. This situation highlights the importance of thorough financial analysis, beyond just following market trends or superficial metrics, especially in sectors as critical as hardware.

2. Toys "R" Us: Rapid Expansion and the Perils of High Debt

The story of Ling-Temco-Vought is a cautionary tale of how unchecked expansion, primarily through debt, can lead to a company's downfall. The company's expansion was characterized by a massive increase in debt, ballooning to a staggering $5 billion. This debt-fueled growth was unsustainable, leading to significant financial troubles by 2017. The company's stock price plummeted, and it suffered and they went bankrupt. This case underscores the risks associated with aggressive expansion and high debt levels. It shows how companies, in their quest for rapid growth, can overextend themselves financially, leading to instability and potential collapse. The lesson for investors is to be wary of companies that grow primarily through debt, as this can often be a red flag for future financial problems.

3. Kraft Heinz's 2015: A Misguided Venture

Kraft Foods and Heinz merged to form a new entity. The resulting company struggled with around $30 billion in debt. This massive debt, combined with changes in consumer preferences and intense competition, led to significant financial challenges, including a substantial write-down of its brand value in 2019.

4.WeWork IPO: The Overhyped IPO and its Aftermath

AAA Enterprises' journey from a Coworking Space business to a public company is a classic example of an overvalued IPO. Initially, the company saw its stock price reach unrealistic heights, driven by excitement and speculation($47 billion). However, this euphoria was short-lived. dramatic drop in valuation to around $10 billion. The IPO than never happend. This case highlights the dangers associated with overhyped IPOs. Often, these IPOs are driven more by market excitement than by the company's actual financial health or business prospects. As a result, investors who buy into the hype can face significant losses when the company's true financial situation comes to light. It underscores the need for investors to approach IPOs with caution, looking beyond the initial excitement to assess the company's real value and long-term potential.

Conclusion: Lessons for Investors

These four case studies offer valuable lessons for investors, especially those new to the investing world. They illustrate the importance of conducting a thorough analysis of a company's financial health, being cautious of companies with high debt levels, understanding the risks associated with ambitious acquisitions, and approaching IPOs with a critical eye. By learning from these examples, You can make more informed decisions and potentially avoid the pitfalls that have ensnared others in the past.

# Comparative Analysis of Eight Corporate Pairs

This chapter presents a unique approach by comparing eight pairs of publicly traded companies that, at first glance, might seem similar but reveal significant differences in character, financial structure, business policies, performance, and approaches to investment and speculation in recent financial history.

- **AvalonBay Communities vs. Wework**

These two companies, both in real estate, exhibit contrasting business models. AvalonBay Communities, a reliable trust, showed prudent investment and moderate growth, consistently paying dividends. In contrast, Wework. They demonstrated reckless expansion and financial complexities, venturing into financial strain.

- **Tesla vs. Ford**:

Both operating in the Car industry, the younger Tesla was valued higher despite smaller revenues, thanks to higher profits and growth. However, its higher stock valuation raised questions about its attractiveness compared to the more affordably priced Ford.

- **Pfizer vs. Moderna**:

Pfizer vs. Moderna. Pfizer, with a long history and consistent dividends, is favored for stability and profitability. In contrast, Moderna, known for its rapid growth, especially with its COVID-19 vaccine, presents a higher growth rate but also greater volatility, reflecting a similar dynamic between profitability and growth potential.

- **Zoom vs. Levi Strauss**:

Zoom vs. Levi Strauss. Zoom, with explosive growth during the pandemic, gained a high market valuation. Meanwhile, Levi Strauss, representing steady progress in the competitive apparel industry, reflects Blue Bell's solid yet less flashy financial performance.

- **International Flavors & Fragrances vs. International Harvester Co.**:

Surprisingly, the smaller International Flavors & Fragrances was valued higher than the well-known International Harvester. This was due to the former's exceptional profitability and growth, starkly contrasting with Harvester's mediocre performance.

- **McGraw Edison vs. McGraw-Hill, Inc.**:

These two unrelated companies had vastly different market perceptions. McGraw Edison's stock was reasonably priced considering its steady dividends and financial stability. In contrast, McGraw-Hill, despite being a strong company, faced speculative risks due to the stock market's fluctuating optimism and pessimism.

- **National General Corp. vs. National Presto Industries**:

National General, a conglomerate, was highly valued despite less revenue and net income than National Presto, which had a simpler capital structure and consistent performance. The market's higher valuation of National General raised questions about its inflated worth compared to the more straightforward and reasonably valued National Presto.

- **Berkshire Hathaway Inc vs. Alphabet**:

Comparing Berkshire Hathaway and Alphabet could illustrate disparities in valuation. Berkshire, with its diverse investments and emphasis on long-term value, contrasts with Alphabet's tech-focused, innovative growth. Despite different sectors and strategies, market valuations reflect investor sentiment and future potential, which might favor Alphabet's growth prospects in the tech industry over Berkshire's broader investment approach.

**Conclusion for Investors**: This analysis demonstrates that the stock market's valuation of companies can vary significantly based on factors like growth, profitability, and market sentiment. For new investors, it's crucial to understand that higher growth and profitability can lead to higher stock prices, but these valuations need to be justified by actual performance. On the other hand, companies with steady dividends and stable financials might be undervalued, presenting potential investment opportunities. Always approach investing with a balance of optimism and realism, focusing on underlying value rather than market hype.

# Management

We've consistently advocated for shareholders to adopt a smarter and somewhat aggressive stance towards company management. We encourage rewarding those who deliver evident performance while demanding clear explanations for subpar results and supporting efforts to improve or replace unproductive management. Shareholders have the right to question management's competence when results are unsatisfactory, worse than similar companies, or lead to long-term poor stock performance.

Poor management often leads to low stock prices, attracting companies interested in diversification. Many such acquisitions occur, sometimes with management's consent or through direct stock purchases, bypassing current management. The offer price usually reflects the value that competent management could achieve, forcing complacent shareholders to sell – sometimes to individual entrepreneurs or investor groups.

Typically, weak management is replaced not by regular shareholders' actions but by majority shareholders or a cohesive group of large shareholders. Today, this happens frequently enough to alert typical corporate management and boards: poor operational results and consequent low stock prices might lead to a takeover. As a result, boards are more vigilant, ensuring top-tier management is in place.

However, not all poorly managed companies benefit from this trend, and management changes often come after prolonged poor performance, driven by shareholder dissatisfaction, leading to low stock prices and enabling outsiders to gain control. The idea that regular shareholders could significantly influence management and policy improvements has proven too idealistic. Those shareholders savvy enough to impact annual meetings don't need advice on what issues to raise with management. For others, any advice would be futile. We encourage shareholders to scrutinize proxy solicitations from fellow shareholders if they wish to address unsatisfactory management situations.

# Shareholders and Dividend Policy

Dividend policy used to be a contentious issue between ordinary or minority shareholders and management. Generally, shareholders preferred generous dividends, while management favored retaining profits to "strengthen" the company, asking shareholders to sacrifice current interests for long-term benefits. The primary argument for lower dividends is not that the company "needs" the money but that **reinvested earnings** can directly and immediately benefit shareholders through profitable expansions.

Historically, weaker companies often needed to retain profits instead of paying out the usual 60 to 75% as dividends, impacting stock prices negatively. Nowadays, it's strong, growing companies that, with investor and speculator approval, keep dividend payments low or pay no dividends. The principle of "profitable reinvestment" has gained ground. Higher growth rates in the past have made investors and speculators more willing to accept a policy of low dividends. In many cases of growth favorites, the dividend rate, or the lack thereof, had no impact on the stock price.
An example is Texas Instruments, Inc., whose stock price rose from $5 in 1953 to $256 in 1960, with earnings improving from 43 cents to $3.91 per share, without paying any dividends (though dividends were planned for 1962, by which time earnings per share dropped to $2.14 and the stock price plummeted to a mere $49).
Another extreme case is Superior Oil. In 1948, it reported earnings of $35.26 per share, paid a $3 dividend, and traded at $235. By 1957, with no dividends paid, its stock soared to $2,000! However, by 1962, the stock fell to $795, despite earning $49.50 per share and paying a $7.50 dividend.

Investor sentiment towards dividend policies in growth companies is inconsistent. Companies like Intel and Alibaba illustrate contrasting views. Intel, seen as no growth stock, traded at 20 times its 2024 earnings. Its stock was favored for investment and speculation. In contrast, Alibaba's dividend yield was hardly considered. And Took the stock price down.
The market's stance on corporate dividend payment policies seems to be evolving: where growth is not the highest priority, stocks are seen as "income shares," and the dividend rate remains a key part of the stock price. On the other end, stocks categorized as fast growth are primarily valued based on expected growth rates over the next decade, with little thought given to cash dividends.

While this trend may accurately describe current tendencies, it's not a definitive guideline for all stocks, or even most. Many companies pursue a middle path between growth and stability, making it challenging to determine the significance of the growth factor, with market views potentially shifting radically year-to-year.

We believe shareholders should either demand a normal payout of profits (about two-thirds) or that the company demonstrates that reinvested earnings have led to satisfactory growth in earnings per share. However, in many cases, low payouts are the reason for a stock price below its true value, and shareholders have every right to question and possibly complain.
A stingy dividend policy is often imposed on companies with weak financial strength, where all profits (plus depreciation charges) are needed to pay off debts and secure working capital. If this is the case, shareholders have little to object to, except possibly criticizing the management for allowing such a situation. However, sometimes relatively "poor" companies keep dividends low to fund expansion, which seems illogical at first glance and requires extensive explanation and convincing justification before shareholders should accept it. Past experiences show no reason to believe that owners will benefit from expansions funded with their money in companies with meager results and management continuing as before.

## Dividends and Stock Splits:

Investors must understand the difference between a stock dividend and a stock split. A stock split restructures the share capital, usually issuing two or three new shares for each old one. Stock splits are unrelated to specific reinvested profits and aim to achieve a lower stock price, presumably more appealing to existing and new shareholders. A stock dividend, on the other hand, is paid to shareholders to provide a material or representational value of specific profits reinvested over a short period, typically up to two years.

Today, it's common to name such a dividend at its approximate value when announced and to transfer the same amount from retained earnings to capital accounts. Thus, the amount of a typical stock dividend is relatively small, usually no more than 5%. Essentially, a stock dividend has similar effects to paying out an equivalent cash amount if accompanied by the sale of additional shares to shareholders at the same total value. However, a pure stock dividend has a significant tax advantage over the combination of cash and rights offerings, a common practice among utility companies.

The NYSE has set 25% as a practical dividing line between stock splits and stock dividends. Those with 25% or more don't need to transfer their market value from retained earnings to capital accounts. However, some companies, particularly banks, still follow the old practice and declare any stock dividend they choose, such as a 10% dividend unrelated to recent earnings, confusing the financial world.

We have long advocated for a systematic and formulated approach to distributing cash and stock dividends. Under this approach, stock dividends are regularly granted to capitalize all reinvested earnings or a specific portion. A policy covering 100% of reinvested earnings was followed by companies like Purex and Government Employees Insurance.

Academic authors generally reject stock dividends of any kind, arguing they are merely paper giving shareholders nothing new and only causing unnecessary costs and complications. We see this as a doctrinaire view ignoring the practical and psychological realities of investing. A regular stock dividend, say 5%, merely changes the "form" of the owner's investment: he now holds 105 shares instead of 100. Without the dividend, the original 100 shares would represent the same ownership stake now held by 105 shares. But this change in form is meaningful and valuable. If the shareholder wants to cash in on reinvested profits, he can sell the new share received instead of "breaking up" the original certificate. He can also expect to receive the same cash dividend on 105 shares as previously on 100. A 5% increase in cash dividends without the stock dividend would be less likely.

The benefits of regular stock dividends become most apparent when compared to utility companies' practice of generous cash dividends followed by raising the same money by selling additional shares to shareholders through rights offerings. Shareholders should be in the same position receiving stock dividends instead of the popular combination of cash dividends followed by rights offerings, except for saving the income tax otherwise payable on the cash dividend. Those seeking maximum cash income without additional shares can achieve this by selling their stock dividends – as if they were selling their rights.

The total tax savings from replacing stock dividends with the combination of stock dividend-plus-rights offerings is enormous. We urge this change in utility companies, despite the tax disadvantages, as it seems unfair to levy a second (personal) income tax on profits not received by shareholders, as the companies reclaim the same money by selling new shares.
Efficient corporations continuously modernize their facilities, products, accounting, managerial training, and employee relations. It's high time they also reconsider their most important financial practices, with dividend policy not least among them.

# Margin of Safety


In the world of investing, if there's a secret to success that can be summarized in just three words, it would be 'margin of safety.' This concept is a thread running through all investment strategies, sometimes obvious, sometimes less direct. The margin of safety is the buffer investors rely on to protect themselves from the uncertainties and fluctuations of the investment world.

Experienced investors understand the importance of the margin of safety in choosing healthy bonds and preferred stocks. For example, if a railroad company consistently earns more than five times its fixed costs before taxes over several years, its bonds can be considered a true investment. This excess earning capacity is the margin of safety, protecting the investor from losses or discomfort in case of a future income reduction.

The idea is not to predict the future accurately but to ensure that even if future earnings slightly decline from the past, the investor remains protected. For bonds, the margin of safety can also be gauged by comparing the company's total value against its debts. If a company worth \$30 million has \$10 million in debt, there's a theoretical buffer for value reduction before bondholders face losses.

Translating this concept to common stocks, a stock can offer a margin of safety similar to a good bond in certain conditions. For instance, if a company only has common stocks and is trading at a price significantly lower than the amount that could be secured by its assets and earning capacity, it offers both the security of a bond and the additional advantages of a stock – higher income potential and capital appreciation.

In typical common stocks, the margin of safety lies in an expected earning power significantly above the prevailing rates for bonds. Over ten years, this excess earning power can create a substantial buffer, minimizing the risk of loss under favorable conditions. In a diversified portfolio of stocks, if each stock has a margin of safety, the overall probability of positive results is high. **However, the real danger in stock investment is not paying too high a price for good stocks but buying stocks of poor quality during favorable economic conditions.** The largest losses for investors often come from investing in low-quality stocks when times are good, mistaking current profits as a sign of enduring earning power. These investments lack a true margin of safety, and losses are likely when economic conditions change.

The philosophy of investing in growth stocks partially aligns with the margin of safety concept. Growth stock investors rely on expected earnings higher than past averages, effectively replacing past performance with future expectations in calculating the margin of safety. However, the risk lies in the market's tendency to price these stocks without a conservative estimate of future earnings.

The concept of margin of safety becomes clearer when applied to undervalued or 'bargain' stocks. Here, the margin of safety is the favorable difference between price and estimated value, providing a buffer against miscalculations or misfortunes. In such cases, even a slight decline in earning power won't prevent satisfactory investment outcomes.

In summary, intelligent investing aligns closely with business principles. It requires knowing what you're doing, not entrusting your investment to others unless you can supervise their performance or trust their capabilities, and ensuring a reasonable chance of a fair return. It demands courage to rely on your knowledge and judgment and recognize that achieving satisfactory investment results is more attainable than many realize, while extraordinary success is harder than it appears.

# Key Rules for Taxation of Income from Investments and Securities

General investment taxation landscape is a vast and complex due to the diversity of countries and tax laws within each continent. However, I can provide a broad overview of the typical taxation scenarios investors might encounter in each continent. Keep in mind that this is a generalized summary and may not accurately represent the specific tax laws of each country within a continent.

## North America (USA and Canada)

1. **Income Tax on Investments:** Both countries tax income from investments such as dividends, interest, and rental income.
2. **Capital Gains Tax:** Capital gains are taxed, but usually at a lower rate than ordinary income. In the USA, the rate depends on the holding period.
3. **Tax-Advantaged Accounts:** Both countries offer tax-advantaged retirement accounts (e.g., IRAs in the USA and RRSPs in Canada).
4. **Withholding Taxes:** Both countries withhold taxes on certain types of investment income, especially from foreign sources.

South America

1. **Varied Capital Gains Taxation:** Capital gains taxes vary significantly across South American countries.
2. **Income Tax on Investments:** Most countries tax investment income like dividends and interest.
3. **Tax Benefits for Local Investments:** Some countries offer tax incentives to encourage local investment.

Europe

1. **Capital Gains and Dividend Taxes:** Most European countries tax both capital gains and dividends, though rates and rules vary.
2. **Tax Treaties:** Many European countries have tax treaties to prevent double taxation, especially within the EU.
3. **Wealth Taxes:** Some countries (like France and Switzerland) impose taxes on overall wealth, including investment portfolios.

Asia

1. **Diverse Tax Systems:** Asia's tax landscape is very diverse, with some countries having no capital gains tax (e.g., Singapore, Hong Kong) and others imposing significant taxes.
2. **Income Tax on Investments:** Generally, countries in Asia tax income from investments, but rates and rules vary widely.
3. **Tax Incentives:** Many Asian countries offer tax incentives for investments in certain sectors or regions.

Africa

1. **Capital Gains Taxation:** Many African countries tax capital gains, but rates and enforcement vary.
2. **Income Tax on Investments:** Dividends and interest income are generally taxable.
3. **Tax Incentives:** Some countries offer tax incentives to attract foreign investment.

Australia and Oceania

1. **Capital Gains Tax:** Australia, for example, taxes capital gains, with concessions for long-term holdings.
2. **Income Tax on Investments:** Investment income is generally taxed.
3. **Superannuation Funds:** In Australia, these funds offer tax-advantaged ways to save for retirement.

General Notes:
**Tax Treaties:** To avoid double taxation, especially for international investors, many countries enter into tax treaties.
**Local vs. Foreign Investments:** Tax treatment can vary significantly for local versus foreign investments.
**Frequent Changes:** Tax laws can change frequently, so it's important to stay informed about the current regulations in the specific country of investment.

This overview is quite broad and is meant to provide a general sense of the tax environment for investments on each continent. But there are ways to pay less taxes on stock Gains („Like having it bought by your Company“). For specific investment decisions and tax planning, consulting with a tax professional knowledgeable about the particular country's laws is always recommended.

# Endnotes

This Book is „The Intelligent Investor“ by Benjamin Graham simplified and written to the Modern World. It's short and sweet and that's how it should be. Now you have a rough understanding of the market and can put yourself in the shoes of heads like Warren Buffett and Benjamin Graham. **And don’t forget this Quote: “The market is there to serve you, not to advise you.“**

If you liked this book, please follow me on Instagram, YouTube, and TikTok via: Roko_Inv

Bye and Happy Investing

Our Contract,

As an investor, I, [Your Name], commit to saving money for many more years. I understand that there will be times when I might want to buy stocks or bonds because their prices are rising, and times when I might want to sell them because they are losing value.

I hereby declare that I will not let others make financial decisions for me. I also commit to never buying a stock just because its price is going up, and never selling a stock just because its price is going down. Instead, I will invest [Insert Amount] $ every month through an automatic deposit plan or a cost-averaging plan into the following investment funds or diversified portfolios:
[List of Investment Funds or Portfolios]
Additionally, I will invest extra amounts whenever I can afford it (and can afford to lose it in the short term).

I declare that I will hold each of these investments until at least the following dates (which are at least ten years from the signing of this contract): [Insert Dates], 20XX. The only exception allowed under this contract is a sudden financial emergency, such as for health reasons, loss of my job, or planned expenses like a down payment for a house or education costs for my children.

By signing this contract, I confirm that I will adhere strictly to its terms but will revisit this document whenever I am tempted to sell any of my investments.
This contract is valid when countersigned by at least one witness. It must be kept in a safe place that is easily accessible for future reference.

Signed by:
[Your Signature]
Witnesses:
[Witness Name]
Date: [Date]
[Witness Name]

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