WISDOM ON VALUE INVESTING

How to Profit on Fallen Angels

GABRIEL WISDOM

FOREWORD BY MARY BUFFETT AND DAVID CLARK,
AUTHORS OF *BUFFETTOLOGY*

Wisdom on Value Investing

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To every investor who deserves to prosper

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Foreword

My respect for the work and integrity of Gabriel Wisdom is immense. In a world where the term "investing" is often used to mask what amounts to dice throwing, Gabriel is the real thing: a value investor who has the intelligence and foresight to confront that world of fear we call a recession and make educated investment decisions that can pay off handsomely over time. He calls these opportunities "Fallen Angels," and in his new book, *Wisdom on Value Investing*, he shares with us the insights he has gleaned from years of successful bear market investing.

I'm Mary Buffett. During my tenure in the Buffett family, I was very fortunate to have known many great value investors. One of them, whom I met at Warren's home in Omaha, was a brilliant young analyst by the name of David Clark. I've had the good fortune of working with David to co-author the worldwide bestselling investment books *Buffettology*, *The Tao of Warren Buffett*, *Warren Buffett and Interpretation of Financial Statements*, and *Warren Buffett's Management Secrets*. Our books are all about the investment and management methods of Warren Buffett, a man many in the world consider the greatest investor of our time. The books have now been translated into more than eighteen languages around the globe.

Gabriel has written very well on the subject of value investing—so well that *Wisdom on Value Investing* has found a permanent place on my bookshelf, next to my four editions of Graham's Security Analysis and the last thirty years of Berkshire Hathaway annual reports.

So, with great pleasure, please let me recommend to you Gabriel Wisdom's new book *Wisdom on Value Investing*. As they say in Omaha, it's a keeper.

Mary Buffett

Gabriel Wisdom understands the true essence of value investing, not only in the terms of the originator of the concept, Benjamin Graham, but also in the language of its most successful practitioner, Warren Buffett. I have spent many hours talking to Gabriel over the years. He has a unique perspective honed through years of practice, which he graciously shares with us in his new book, *Wisdom on Value Investing*. These essential investing skills can be learned, if you're willing to change the way you think about risk, complacency, and fear. Gabriel's unique perspective enabled him to recognize the lurking danger of subprime mortgages and gave him the foresight to stay away from Fannie Mae and Freddie Mac when more notable players in the value game naïvely succumbed to temptation and had their heads handed to them.

It is not surprising that Gabriel finally put pen to paper, as he has many wonderful observations about how to make money using a "value approach." What is surprising is that *Wisdom on Value Investing* is written in a language that is understandable to even the beginning investor, yet I, too, find it a worthy and timely read, as I wade through the great many opportunities that Wall Street has now laid at our feet. For the average investor who lacks formal training in securities analysis, *Wisdom on Value Investing* offers a far more accessible and usable model to practice value investing than, say, the thousand-page tomes of Benjamin Graham.

Without hesitation, I recommend Gabriel's book *Wisdom on Value Investing* to both beginner and professional investors alike. I can't think of a better book to have at your side for making money in these turbulent times.

David Clark

Preface

The herd mentality works for animals by providing protection, efficiency and even companionship. Humans form herds, too—we flock to popular movies, buy whatever's in fashion, and live on top of each other in big cities.

Investing in the stock market is one place, though, where it pays to be a lone wolf. If you turn on the TV or pick up a newspaper during times of market turbulence you can watch investors act like lemmings marching to the sea. They buy or sell in unison, almost as if they were hypnotized. Unfortunately, they are also setting themselves up for failure, which in the stock market translates into losing money.

In *Wisdom on Value Investing: How to Profit on Fallen Angels*, I will lay out a different kind of vision for investing in the stock market, or any other market. My vision promises to put the reader on a unique path to success, far from the anguished cries of the investing masses. This book makes the argument that, rather than following fashion, the smart investor stays calm and waits patiently for the incredible deals that are certain to come along.

The best time to buy stocks—or anything else—is when no one else wants them. And the best time to sell is when everyone is clamoring for what you have.

Buy low, sell high. Sounds simple, right? It's not rocket science, but in reality, it's much harder. Even with discipline and a proven investment methodology, the odds are far better for rocket scientists, because the immutable laws of physics work every time. Successful investing requires more than mathematical formulas. For that reason, you will want to spend a little time every day reading through this book. Many of the concepts here involve a different way of thinking about investing, so I suggest you never read more than one chapter per sitting. Let the content percolate, take your time, and you'll begin noticing the differences in how you view and select stocks, bonds, funds, even real estate.

A philosophy I call the *Fallen Angels strategy* will give investors a leg up on the complex and difficult art of investing. It recognizes that markets rise and fall based on emotion, moods, and circumstances, and people who are aware of this phenomenon—and use it to their advantage—are in a position to make a lot of money.

The approach I espouse in these pages can help investors maximize earnings and minimize losses in any type of market, but it is especially needed today, when dark clouds hover over the economy and the gut reaction of many investors is to cut their losses and ride out the storm on the sidelines. By the way, regardless of when you're reading these words, dark clouds are hovering. They always have been, and most likely always will be. That's good news for you, now that you are on your way to becoming a better investor.

This book is intended as a resource for investors of all stripes: those who have been at the game for a while and are looking to gain an edge on the competition, and others who are dipping their toes in the market for the first time. I hope it will help people save for their retirement or their children's education, or increase their standard of living.

Although the Fallen Angels philosophy sounds simple—because it is—putting it to use is hard. Consistently successful investors have gained the self-discipline to resist the pushes and pulls of the market, and make their decisions based on well-researched, clear-eyed reasoning.

They have learned to spot the true losers and winners, and how to tell them apart. In the following pages, I will lay out the methodology for determining when a company has true potential, and when it is worth investing in a Fallen Angel whose stock price has plunged. The studious, thoughtful investor will be able to use these tips and strategies in the real world of stock market investing to build a robust, profitable portfolio.

We all can learn a lot by studying the actions and motivations of the superstar investors of our time, and those who came before us. During my years in the investment business, I have observed many of the most gifted money managers in action, and I noticed that they have a lot in common. For example, they are always looking to buy when the market is down, when the goods are on sale. But there is a method to their madness, a strategy they stick to and have confidence in even when the going gets tough. Their discipline extends to knowing when to sell their holdings.

I'll examine the traits of top investors, along with common mistakes made by even the greatest, in the coming pages. I'll also explore the essential differences between "fallen" and "falling" when it comes to publicly traded companies, and how learning that distinction can lead to increased personal wealth. For good measure, I'll include case histories of some of the most famous Fallen Angels to illustrate my points.

Three main factors cause the stock prices of otherwise solid companies to fall: business and economic cycles, which are as regular and dependable as the tides and sometimes affect only certain sectors of the economy; what we call "recoverable calamities," short-term events that lead to investor panic; and the broader market downturns known as recessions or depressions. In all of these cases, the stock values of good, solid companies can suffer, producing bargains for the educated, non-panicked investor.

Investors need to learn how to determine the intrinsic value of a company, independent of what the market says through its up-and-down price fluctuations. I'll cover a number of ways of assigning value that, taken together, provide a sound basis for investment decisions.

It pays to keep in mind that when an investor buys stock, he or she is actually buying a share of ownership in the company. Although stock market investors don't actively manage the companies they own, or participate in their daily operations by delivering goods or designing new products, they need to know that the companies are on a strong financial footing, with opportunities for growth and an absence of debilitating debt.

Time is on the side of a successful investor. By holding on to stocks during economic cycles, investors can watch their book value double in four to six years while at the same time providing a current income stream.

Time is important in another way, as I will explain. Investors must look to the future, and anticipate the trends and cycles in both the market and the demographics of the population that will have the greatest impact on their investments.

Along the way, I will share my own story. I made the transition from a pioneering rock-and-roll FM radio guy in the late 1960s to investment professional. Some might find that an unusual career progression, but believe it or not, the germination of what would later become my investment philosophy came from those heady days of protest and psychedelic music. From my DJ's seat, I watched the crowd mentality at work as legions of young people listened to the same music, wore the same clothes, and smoked the same substances.

The air may be clearer on the floor of the New York Stock Exchange, but the underlying dynamic is largely the same—people are hardwired to do what others around them are doing. And that, in a nutshell, is why the Fallen Angels strategy works so well for investors who are prepared and willing to blaze their own trail.

Gabriel Wisdom

Acknowledgments

I want to thank journalist Joe Tash, without whom I could not have completed this book. Joe provided structure, discipline, and some really creative ideas about understanding investing. He became my interviewer, copywriter, and my best student. Not bad for a guy who as a young adult, "found [him]self homeless for a short time, and while [he] was sleeping in an abandoned Cadillac, the car was stolen." The thieves let Joe gather up his belongings and get out of the car before they towed it away.

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My (trophy) wife Diana and our combined families, including my three daughters, Phylisa, Juliana, and Danielle.

G. W.

Wisdom on Value Investing

CHAPTER 1

Ten Traits of the World's Greatest Bargain Hunters

If you expect to be a net saver during the next five years, should you hope for a higher or lower stock market during that period? Many investors get this one wrong. Even though they are going to be net buyers of stocks for many years to come, they are elated when stock prices rise and depressed when they fall. This reaction makes no sense. Only those who will be sellers of equities in the near future should be happy at seeing stocks rise. Prospective purchasers should much prefer sinking prices.

Warren Buffett

Successful investing isn't rocket science; it's harder.

Michael J. Moore, portfolio manager

The world's greatest investors are like rock stars. Masters of the universe, from a distance the great ones are larger than life. They possess an almost magical ability to extract great sums of wealth from thin air. And they make it look easy, or the result of plain old-fashioned luck. Perhaps that's why the conventional wisdom holds that "investing is not rocket science." However, the assumption that anyone, regardless of training, can make money using money is false. My colleague and business partner Mike Moore likes to say that if investing were rocket science, it would be far easier to succeed as an investor than it actually