'The Intelligent Investor'

The 1949 Classic: Still Relevant Today

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Benjamin Graham's The Intelligent Investor is commonly referred to as "the bible of value investing." It's a book filled with common sense, and it explores fundamental principles of research and analysis. Throughout its pages, Graham talks frankly about the risk/return tradeoff inherent in investing. He starts off his book by distinguishing between two groups: investors and speculators. At Crawford Investment Counsel ("Crawford"), we don't necessarily define ourselves as deep value investors, but we do employ a price-sensitive approach to purchasing high-quality, dividend-paying securities. With that being said, we find great wisdom in many of the chapters within The Intelligent Investor and feel that Graham's definition of investing, as opposed to speculating, nears perfection in articulating what it is that we're trying to do at Crawford.

Graham defines an investment operation as "one which, upon thorough analysis, promises safety of principal and adequate return." He builds upon this definition throughout the book, and he goes on to explain that an investment operation consists equally of three elements: 1) the thorough analysis of a company and the soundness of its underlying business model, 2) the deliberate protection against serious losses, and 3) the aspiration to adequate and not extraordinary performance. At Crawford, fulfilling our commitment to both safety of principal and adequate return is our priority. Our team of sector-specific equity analysts perform daily fundamental, bottom-up research on each business model just as Graham suggests. And our emphasis is on both return on investment and return of investment, consistent with the other two elements of the operation. In summary, our analysts focus on finding high-quality businesses with differentiated business models, consistent cash flow generation, low earnings variability, strong balance sheets, and shareholder-friendly capital allocation policies. As a product of our extensive research endeavors, we believe we can provide our clients with attractive, risk-adjusted returns over full market cycles. This measured approach helps us smooth out the investment ride. In particular, we seek to do what we can to protect portfolio values in the event of a downturn.

On the contrary, Graham defines speculation as quite the opposite of investing. He explains that as a speculative investor, one is essentially gambling that a stock's price will rise. The fact of the matter is: the gamble is contingent upon the belief that someone else will be willing to pay more for that security in the future. With this, Graham explains that a business's underlying fundamentals matter more than an investment's stock price or any other quotational value at a given moment in time. He explains that intelligent investors will invest in a company only if they

would be comfortable owning the stock if they had no way of knowing its share price. This view of ownership also points toward long-term investing as one of the more important ingredients of success. The idea is to avoid thinking about a short term in and out of a stock position and to think in terms of being one of its owners who can benefit from and grow with the company over the long run. This is Graham's way of saying that investing isn't about finding what's temporarily right, but rather, it is about finding what is sustainably, consistently, and predictably right over the long term. This mindset is philosophically linked to Crawford's quality orientation which is designed to narrow the range of outcomes, improve the likelihood of success, and again, smooth out the ride.

It takes considerable discipline, commitment, and strong conviction to overcome systematic behavioral biases when building an investment portfolio. One risk identified by Graham lies not in the economy or in specific investments, but rather, in ourselves. Investors often fall into the trap of thinking that they are investing when they are actually speculating. This trend emerges in statistics such as beta, downside capture, volatility, and sometimes underlying portfolio characteristics. By maintaining a dual focus on investing in high-quality businesses with a long-term horizon, we actually believe that we can exploit these systematic behavioral biases to our advantage. In fact, Crawford's approach seeks to find market inefficiencies and mispricing's that emerge as a product of the great degree of speculation present in the market. Like Graham, we believe that if we take our time and do good fundamental work, we will be in a better position to avoid paying too much for an investment.

Graham explains that there are pressures on most money managers to attempt to keep up with the market and mimic the representation in underlying portfolios. This can lead to performance-chasing and often an abandonment of risk controls. Conversely, intelligent investors acknowledge that they can't control the market's behavior and understand that they can better control the risk in their portfolio. This effort to control risk is a key piece of Crawford's value-add and is consistent with our belief that lower risk securities can provide very attractive returns with less market risk. We agree with Graham that investors need a focus not just on getting their analysis right, but also a margin of safety to ensure against loss if one turns out to be wrong.

In discussing what factors determine how much one is willing to pay for a stock, Graham mentions five elements. These elements are: a company's general long-term prospects, management quality, financial strength and capital structure, dividend record, and current dividend rate. Similarly, a number of the criteria Graham lays out for stock selection include: strong financial condition, earnings stability, dividend record, and earnings growth. At Crawford, we start with the dividend as a window into quality and pair this with a thorough analysis of a business's long-term prospects, management, and financial strength and capital structure, among other factors. Along with that, we have developed an internal valuation framework that informs our discovery process of "fair value."

Graham is famous for his quote, “The only indisputable truth is that the past teaches us that the future will always surprise us.” In closing, we believe that over the long term, quality is one of the most persistent and durable factors that contribute to strong investment returns with below-market risk. Since the future will always surprise us, we like the fact that our portfolio holdings tend to be much more consistent and predictable, or in other words, higher quality. This helps us avoid the emotional responses Graham so frequently warns against, and this is where we maintain our focus.

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