

## **MAKING THE MOST OF YOUR**

# **CABOT BENJAMIN GRAHAM VALUE LETTER**



### *Using Graham's Guide to Value Investing*

**Written by**  
**J. Royden Ward, Editor**  
**Cabot Benjamin Graham Value Letter**

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## INTRODUCTION

WELCOME. Our goal at the Cabot Benjamin Graham Value Letter is to provide you with exceptional stock recommendations by taking advantage of the knowledge and expertise shown to us by Benjamin Graham, the father of value investing.

During the past 45 years, it has been proven that value stocks have consistently outperformed growth stocks. The margin of outperformance has been approximately 9% per year – an enormous margin that should not be overlooked.

Benjamin Graham achieved returns of 20% per year during the 1930s, 40s, 50s, and 60s. Benjamin Graham's disciple, Warren Buffett, has used this approach for over 35 years and achieved similar results. As author of the Benjamin Graham Value Letter and a second-generation disciple of Benjamin Graham, I have achieved returns of over 20% per year for the past ten years. On the following pages we'll explain how you can take the advice set down by Benjamin Graham and apply it to today's value investing climate to build a portfolio of long-term winners.



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*In each issue of the Cabot Benjamin Graham Value Letter we apply Graham's theories of value investing to select quality stocks with the potential to double or triple your money. One of Graham's well-known factors in purchasing a stock was the "Margin of Safety." This method of selection is still used today by Warren Buffett, among others. Below we'll explain this theory and show how we use it and other Graham theories in the Cabot Benjamin Graham Value Letter to produce returns of 20% or more per year, with little risk.*

## **THE BASIC PRINCIPLE GRAHAM'S MARGIN OF SAFETY**

Graham's "margin of safety" simply means buying companies that are cheap relative to their intrinsic value. Using Graham's criteria, we determine these optimum buy prices for you.

### **Buy Price Criteria**

Our Buy Target is based on a combination of estimates derived from discounted earnings per share (intrinsic value) and the historic value derived from the historic results of the company. A company's intrinsic value is calculated by projecting current earnings forward 10 years, and discounting the forward earnings back to the present using the current 10-year Treasury Note rate of interest adjusted by the quality of the company. The historic value is calculated from the 10-year history of prices relative to revenues, cash flow, earnings, dividends and book value and projecting the ratios forward to derive an estimate for a current estimated Buy Target.

***"The prudent stock investor is one who buys only at prices amply supported by underlying value."***

**Benjamin Graham**

### **Sell Price Criteria**

The Sell Target is based on a combination of estimates derived from discounted earnings per share and from the 10-year history of prices relative to revenues, cash flow, earnings, dividends, and book value. Each stock is expected to reach its Sell Target within one to three years.

The targets are estimates of the stock prices per share at which you should buy and sell your shares to achieve results similar to Ben Graham. These targets are listed for every recommended stock in each issue.

## ACHIEVING GRAHAM-LIKE RESULTS

To achieve returns of at least 20% a year, we screen a database of over 1,700 stocks for the highest quality companies. This ensures that all our recommendations to you are strictly firms with solid balance sheets and track records of success.

In each issue of the Cabot Benjamin Graham Value Letter, you'll see two models with value recommendations, the Classic Benjamin Graham Value Model and the Wise Owl Model. The Models contain between six and ten stocks each, depending on the number of undervalued stocks that are worthy of our recommendation at that time. Typically there are two new stocks in each model each issue.

You should choose stocks from each model that fit your objectives. The two Models complement each other very well. The Classic Benjamin Graham Model tends to come up with lesser-known companies in a variety of industries, whereas the Wise Owl Model comes up with well-known quality companies that have a long history of steady growth. Combining the two approaches by placing equal weight on each approach makes a lot of sense.

The Classic Model contains stocks that are clearly undervalued according to guidelines set forth by Ben Graham over 75 years ago. The Wise Owl Model contains stocks that are high-quality companies with steady earnings growth. This system of analysis used for the Wise Owl Model was developed by Benjamin Graham and Dr. Wilson Payne in 1946 and further enhanced by Dr. Payne and myself in 1969.

***"For the enterprising investor...his operations for profit should be based not on optimism but on arithmetic."***

**Benjamin Graham**

By selecting stocks from both Models, you will be able to create a balanced portfolio that best fits your personal objectives. I recommend you buy equal numbers from each Model. Or if you have specific goals, for example, you might want to pick the most undervalued stock from each model. This can be done by comparing the current price with the Maximum Buy Price for each stock. Or you may be looking for the highest dividend yield. In this case you would choose from the Classic Model. The Benjamin Graham Classic criteria is a minimum yield of 0.1%. But many of the recommendations yield 2% and more.

It is best to wait for your chosen stock to dip below the suggested Maximum Buy Price before buying. You may miss out on a stock or two, but it is better to move on to another stock than to buy a stock that has limited potential.

You won't be paying high brokerage fees or churning your portfolio. The target holding period is from one to three years. All stocks recommended are given a Minimum Sell price. When this price is reached, we will alert you in both your issue and e-mailed mid-month update. You'll always know exactly what actions to take.

## INVESTING IN ECONOMIC DOWNTURNS

Benjamin Graham's secret to building wealth during economic downturns is to buy low and stay fully invested. An investment at a sufficiently low price in a sound company will return exceptional profits to patient investors. Investors who build diversified portfolios containing undervalued, underappreciated companies will fare quite well during cyclical periods of economic weakness.

*"You are neither right nor wrong because the crowd disagrees with you."*

**Benjamin Graham**

## HOW YOU CAN MAKE THE MOST OF THE CABOT BENJAMIN GRAHAM VALUE LETTER

### Objective

The Cabot Benjamin Graham Value Letter is written for investors who are seeking steady, above-average returns without incurring a lot of risk. To accomplish our goal, we present two diversified models each month containing up to ten stocks each. Our first model is The Classic Benjamin Graham Value Model which appears on pages 2 and 3 each month. Our second model is The Wise Owl Model which appears on pages 4 and 5.

### The Classic Benjamin Graham Value Model

The Classic Benjamin Graham Value Model contains our buy recommendations for quality companies whose stocks are clearly unappreciated and undervalued. Quite often, the company's management team is underperforming and is not taking advantage of opportunities. We advise investors to buy these companies and to patiently hold until positive developments begin to appear. There is no specific time frame. However, most stocks will reach their Minimum Sell Price within two to three years.

An important feature of our evaluation system is the Maximum (or Max) Buy Price and Minimum (Min) Sell Price that we calculate for each stock. The chart at the right illustrates how to use our Maximum Buy and Minimum Sell Prices. In the example, the buy range is \$30 or below. After purchase, the stock should be held while it is between its Max Buy Price (\$30) and its Min Sell Price (\$60). The stock should then be sold when it reaches its Min Sell Price of \$60.

#### The Classic Benjamin Graham Value Model Price Objectives



It is best to invest in a variety of stocks in the Model to diversify your portfolio. We recommend that you buy the stocks that are selling at or below our Maximum Buy Price. If a stock is selling above its Maximum Buy Price, you should consider placing a limit order with your broker to buy the stock at a limit equal to our Maximum Buy Price. (A limit order is placed to buy a stock at a specified price, and is not executed until the stock trades at the buy price limit or below. Limit orders can also be used when selling the stock at our Minimum Sell Price.) After purchasing a stock, if the price falls 10% or more below the price that you paid, don't be alarmed. We recommend that you consider buying additional shares at the lower price.

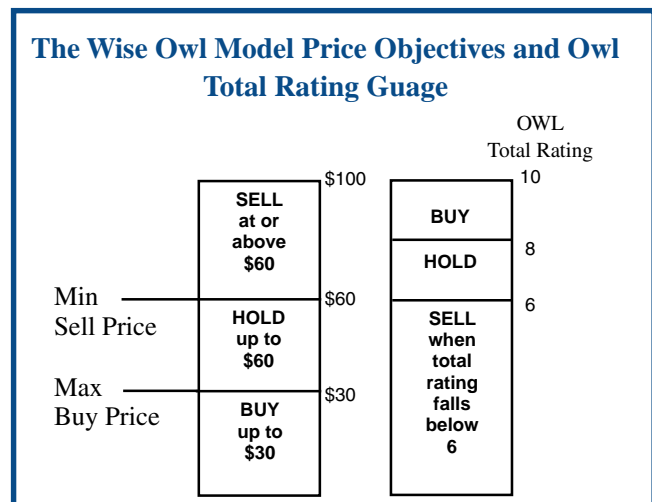
### The Wise Owl Model

The Wise Owl Model contains our buy recommendations for quality companies that have demonstrated strong, steady earnings growth. In addition to high quality and strong growth, we seek stocks that are also undervalued, that have demonstrated strong price and earnings momentum, and that are recommended by the leading independent research services. We have quantified these attributes into four categories for you: Owl Quality Rating, Owl Value Rating, Owl Growth Rating, and Owl Technical Rating. We have further simplified our analytic process by consolidating these four categories into one Owl Total Rating. The Total Owl Rating is our measure of each stock's appreciation potential (10.00 is best). We advise investors to buy stocks with Owl Total Ratings between 8.00 and 10.00 that are selling at or below their Maximum Buy Price. There is no specific time frame. However, most stocks will reach their Minimum Sell Price within two to three years. It is best to invest in as many of the stocks in the Model as is practical for diversification purposes.

We recommend that you sell a stock when one of three conditions are met:

1. If the stock reaches its Minimum Sell Target, sell.
2. If a stock's Owl Total Rating falls below 6.00, sell.
3. If a stock disappears from the Highest Ranked Stocks on pages 8 through 11, sell.

As an example, in the chart to the right, the stock should be purchased when: (1) its price is \$30 or below, and (2) its Owl Total Rating is between 8.00 and 10.00. A stock should be held while it is in between its Max Buy Price (\$30) and its Min Sell Price (\$60) and its Owl Total Rating is 6.00 or higher. A stock should then be sold: (1) when it reaches its Min Sell Price (\$60) or (2) its Owl Total Rating falls below 6.00 (red area), or (3) the stock disappears from the Highest Ranked Stocks pages.



## GETTING STARTED

### Organize Your Portfolio

You need to commit part of your portfolio to Benjamin Graham value stocks. Establish a percentage or dollar amount for this purpose and stay with it. You should commit at least enough of your portfolio to accommodate investments in 10 or more of the stocks recommended in the Benjamin Graham Value Letter. Randomly picking a few stocks from our recommended lists often produces unsatisfactory results.

### Create A New Portfolio

Creating a portfolio and maintaining it is quite simple. After deciding how much of your funds to commit to value stocks, you can then determine how many stocks you want to own. We recommend about 10 to 12 stocks for commitments under \$100k and about 30 to 40 stocks for commitments over \$500k. If your portfolio commitment is between \$100k and \$500k, you can interpolate to get the approximate number of stocks that you should own. Once you have determined how many stocks that you want to own, you can divide the total amount of your funds by the number of stocks to calculate how much to invest in each stock. You should plan to leave about 2 to 5% in cash as a cushion. Now you are ready to invest.

### Buy Equal Amounts From Each Of The Models

If you are going to buy 12 stocks, pick 6 from the Classic Value model and 6 from the Wise Owl model. When choosing stocks, you should diversify your portfolio as much as possible. Don't place more than 20% of your funds in an industry sector. When a chosen stock on either of the recommended buy lists drops below our Maximum Buy Price, it should be purchased right away, without waiting for your next issue of the Benjamin Graham Value Letter.

### Commit Your Funds Slowly

We highly recommend dollar-cost averaging into the models. Use a 3-month time frame and invest equal amounts each month. As an example, if you decide that you want to invest in a total of 15 stocks, your goal should be to invest equal dollar amounts in 5 different stocks in each of the next 3 months. If there are less than 5 undervalued stocks available in any month, stretch out the time frame to 4 months or even longer. Don't overweight any stocks – it rarely works out well.

### Monitor Your Stocks

Our Minimum Sell Prices are 3-year objectives. Be ready to hold your stocks for periods of 2 to 3 years. In the interim, there will be a lot of ups and downs. Ride them out. Each stock should be held until it reaches its Minimum Sell Price. Occasionally, we will clearly state in the Letter when a stock should be sold before it reaches its Min Sell Price.

### Establish Strict Rules For Selling

We recommend 2 sets of rules for selling stocks - one for each of the lists. For The Classic Benjamin Graham Value Model stocks, you should continue to hold the stock until it reaches its Minimum Sell Price. We publish the current Min Sell Prices of all previously recommended stocks on page 2 of your Letter. The sell rules are different for The Wise Owl Model, because we

use the Owl rating system to help determine when to buy or sell. You should continue to hold a stock until it reaches its Min Sell Price or its Owl Total Rating falls below 6.00 or it falls off the Highest Ranked Stocks listing on pages 9 – 12. On page 8, we inform investors when a Wise Owl stock should be sold. But you should keep track of the Min Sell Price to be ready to sell at mid-month if necessary. If you aren't sure if you should continue to hold a stock, email us. We'll get right back to you.

## **Restock Your Portfolio**

After you have sold a stock, simply replace it with a new one from the current models. If your sale creates excess funds, you can add part of the sale proceeds to one of your smaller holdings. This will keep your portfolio in balance.

## **CONCLUSION**

Our main goal, as we said at the beginning, is to provide you with exceptional stock recommendations using the techniques pioneered by Benjamin Graham. Our second goal, no less important, is to give you the *confidence* to buy those stocks and the *patience* to hold them to fruition. If we can achieve those goals, we're confident you'll achieve yours, and together we'll have a long and prosperous relationship.

## **ABOUT YOUR EDITOR**

### **J. ROYDEN WARD**

Mr. Ward has over 30 years of investment research, portfolio management, writing, and publishing experience as a registered investment advisor.

He was a pioneer in developing a computerized Model that utilized the formulas developed by Benjamin Graham using a unique ranking system for criteria.

Roy's extensive experience and knowledge will give you the confidence to invest in undervalued stocks featured in The Classic Benjamin Graham Value Model and The Wise Owl Model shown in each issue of The Benjamin Graham Value Report.

He graduated from Babson College, Babson Park, Massachusetts. Since then he has directed all facets of the investment divisions for several financial planning/investment advisor organizations. He has successfully managed and monitored the performance of 300 individual accounts for conservative and aggressive investors using stocks, bonds and mutual funds.

For seven years, Roy authored the Owl Investment Advisor. The Advisor, featuring the Wise Owl Model, was used by professional money managers seeking a reliable guide to classic value investing.

Since December, 2002, J. Royden Ward has offered his system to the public via The Cabot Benjamin Graham Value Letter. The Letter offers both The Classic Benjamin Graham Value Model and The Wise Owl Model to the individual investor seeking a guide to profitable value investing.

## **ABOUT BENJAMIN GRAHAM**

### **1894-1976**

Benjamin Graham is widely acknowledged as the father of modern security analysis. He grew up in New York City and graduated from Columbia University. When he graduated, he was offered teaching positions in English, mathematics and philosophy. But as fate would have it, he started his career on Wall Street working for Newburger, Henderson and Loeb as a runner delivering checks and securities. His talent was soon recognized and within a few months he was writing one of its daily market letters. Mr. Graham soon became one of Wall Street's most successful investors and later co-founded Graham-Newman, investment advisors.

His reputation as the father of value investing can be dated from 1928 when he started teaching Advanced Security Analysis at his old college. He had been thinking of writing a book, and he reasoned that the best way to accomplish his goal was to prepare and teach the material in a classroom setting.

The notes from the course were transcribed by David Dodd and formed the basis of the investment classic Security Analysis which was published in 1934. His timeless Security Analysis and The Intelligent Investor are still considered the "bibles" for both individual investors and Wall Street professionals.

Graham's classes were often attended by financial analysts who freely acted on the tips given by Graham. In fact, many admitted that his courses were so profitable that they attended them over consecutive years. Graham influenced subsequent investment gurus Warren Buffett, Mario Gabelli, John Neff, Michael Price and John Bogle. His classes and the Graham and Dodd book were the foundation of a whole new approach to the investment industry based on principles that appealed to common sense but were at the same time exceedingly effective. "Understand the difference between price and value" and "always allow for a margin of safety" are two examples.

## **PUBLISHER**

### **CABOT HERITAGE CORPORATION**

Cabot Heritage Corporation was founded by Carlton G. Lutts in 1970 and is currently run by his son, Timothy W. Lutts. The company has been independent from the start with the sole mission of helping subscribers make successful investment decisions.

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