



What's Your REAL Investor Profile?

Special Report from the Benjamin Graham Library

Today, investors are usually designated aggressive or conservative, depending on the types of stocks they invest in. But the usual designations of aggressive and conservative don't make sense to a follower of Ben Graham. Here's why.

Ben Graham wrote in *Security Analysis*, "An investment operation is one which, upon thorough analysis, promises safety of principal and a satisfactory return. Operations not meeting these requirements are speculative."

In fact, if any one of these three factors is lacking, according to Graham, whether it be thorough analysis, promise of safety of principal or promise of satisfactory return, then the holding is a "mere" speculation.

That means buying a stock on a tip from your brother-in-law is speculation.

Buying a stock because of its price action, without a thorough study of a company's fundamentals, is speculation.

And buying a stock just because you like its company's products is speculation.

Thus, by Graham's definition, a lot of what passes for investment is speculation. And because of human nature, it will always be so.

As to investors, those whose operations pass the three criteria mentioned in the second paragraph, Graham describes two types.

Defensive Investor

The defensive investor is concerned primarily with preserving capital, and secondarily with achieving freedom from effort, annoyance and the need for making frequent decisions.

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The defensive investor thus is more attracted to bonds, to mutual funds, and to high-quality, dividend-paying stocks of established companies. He may engage in dollar-cost-averaging, adding a fixed dollar amount to his account every month or every quarter, and thus buying more shares when prices are low and fewer shares when prices are high.

He may even practice market timing, taking advantage of the broad swings of the market by selling out as the market enters levels of high valuation, and buying in again as the market declines to levels of low valuation. But in every case, he does so after thorough research, having concluded that the risk of losing capital is minimal.

Enterprising Investor

The enterprising investor is characterized not by his willingness to take more risk – no, if he takes more risk he falls into the category of speculator. Rather, he is characterized by his willingness to devote more time and care to the selection of sound and attractive investments.

As to results, he expects to achieve better results than the defensive investor. Again, not by taking more risk, but by doing more research.

The way Graham sees it, there are five ways the enterprising investor can do better than the defensive investor.

Five ways to achieve above-average returns:

- 1) He can trade more, using the movement of the general market to determine when to be more invested, and when to be less.
- 2) He can practice selective trading, choosing issues that promise to do better than the market over a period of a year or less.
- 3) He can buy cheap and sell dear, buying when sentiment and prices are depressed and selling when both are exalted.
- 4) He can buy growth stocks, owning securities that will prosper over the years far more than the average enterprise.
- 5) He can purchase bargains, issues that are selling considerably below their true value, as measured by reasonable, dependable valuation techniques.

The losers:

Graham had no time for method 1, which depended on market timing, or method 2, which depended on

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price forecasting. He argued that both methods left no room for error, and thus could not promise safety of principal. Furthermore, they involved foretelling the future of stock movements more skillfully than a host of competitors, and he believed that to be too risky.

The Runners-Up:

As to method 3, Graham accepted that this was indeed investing, in that it promised safety of principal and a satisfactory return. But he worried that this method, ascribed to the original Rothschild, might be difficult to follow in the long run, particularly for people who were not closely involved in the world of business.

Nevertheless, he did recognize that from time to time, the general market would get so high, that the enterprising investor would find it wise to sell many of his holdings and wait for more sober times before re-investing. Contrarily, he appreciated that the market would occasionally become so depressed, and public sentiment fall to such depths, that the enterprising investor would perceive the wisdom of buying quality issues at a discount.

Method 4 was one Graham approved of, with reservation. “It is appropriate”, he wrote, “for investors to select their securities – especially common stocks – with an eye to their long-term prospects.” But he warned that if the growth prospects were obvious to all, then the price of the securities would surely reflect that. He wrote, “Buying such an issue is like betting on a top-heavy favorite in a horse race. The chances may be on your side, but the real odds are against you.”

In particular, he recognized that the best time to buy an individual growth stock was when circumstances drove it to unreasonably low levels, so that the operation then met the characteristics described in our second paragraph.

The Winner:

Which brings us to method 5. It’s a method that can be practiced at all times. It rewards the practitioner who has the requisite skill and devotes the necessary time. It’s the method that worked best for Benjamin Graham and still works for Warren Buffet. And it’s the method that’s the foundation of the Benjamin Graham Value Report.

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