# *"My Hero, Benjamin Grossbaum"*

**· By James Grant ·**

***On November 15, 2007 the editor of Grant's spoke before the Jewish Historical Society for its Third Annual History of Jewish Involvement in Business and Finance. Following are his remarks, titled "My Hero, Benjamin Grossbaum," along with a few things he wishes he'd thought to say.***

It is a pleasure to be here this evening. I am under strict instructions from the rector of Grace Church, Brooklyn, not to let down the Episcopal side. Uphold the highest standards of the Episcopalian intellectual tradition, he told me. What that tradition might be, he couldn't say, and neither can I. But I'll do my level best.

My subject is Benjamin Graham: his life, his investment philosophy, his writings and his Jewishness. About his love life, I will say little, as my time this evening is limited—just three hours, I believe. Some years ago, *Fortune Magazine,* in a squib it published on the occasion of Graham's induction into the U.S. Business Hall of Fame, said that the thrice-married father of value investing "leaped from blonde to blonde like an Alpine goat springing from peak to peak."

I am a frankly worshipful admirer of Graham's. I love him for his heart as much as for his head. Between 1929 and 1932, his investment partnership lost 70% of its value. Not until 1936 did it recoup all it relinquished post-Crash. Yet Graham persevered and, along with his partner, Jerry Newman, went on to achieve a brilliant long-term investment record—not excluding those three disastrous years. We have all heard the platitude, "The first rule of investing is not to lose money and the second rule is not to forget the first." Very helpful. Well, Graham shows that a debilitating loss is no reason to give up. . . . Never quit.

Benjamin Graham was born Benjamin Grossbaum on May 9, 1894, in London, and sailed to New York with his family before he was two. He attended New York City public schools and excelled at every subject except gym. He read constantly and forgot nothing—the kind of child we wish we had, or, indeed, had been ourselves. With the untimely death of his father, young Benjamin early learned to do without and to work. He entered Columbia College at 17 in the Class of 1914 and majored in mathematics.

For Graham, the life of the mind was inseparable from the life of finance. He was a fluent and adventurous writer. At one time or another, he tried his hand at poetry, playwrighting, translations, textbook writing and—the highest form of literature—financial journalism. In 1915, the *New York Times* published a letter to the editor under his name. The subject was the city's sinking fund, for which Graham had no use. He was 20 years old at the time and was posting quotations by hand on the chalk board of a NYSE member firm, Newberger, Henderson & Loeb. Graham wrote not only for money—which he could certainly use at that stage of his career—but also for glory, such glory, for example, as a signed piece in the *Magazine of Wall Street* might afford. The modern journalistic convention calls for an author to sprinkle his article with validating quotations from brokerage-house authorities. There was none of that in Graham's pieces. He himself was the authority on topics ranging from bankruptcies and arbitrage to orphaned value stocks. In the summer of 1924, on the eve of the great Coolidge bull market, he identified eight stocks that, seemingly for no good reason, were quoted in the market at less than their pro rata share of net current assets. Then there were eight—in less than a decade, there would be hundreds.

Ben's letter to the editor of the *Times* is the only published piece of his writing signed Benjamin Grossbaum—at least, the only one that my tireless and enterprising research assistant, Adam Rowe, has found. How Grossbaum became Graham is an interesting story. But it's one Ben's immediate family applied to the municipal authorities for permission to change the family surname from Grossbaum in April 1917, shortly after the United States declared war on Germany. In German, Grossbaum means "big tree." It was Ben's uncles and cousin, more recently arrived in the Bronx from England and perhaps more eager to adapt to the alarming tide of rabid nationalism and anti-German hysteria in America, who elected to swap Grossbaum for Graham in November 1915. All American Grahams claimed they were following the lead of their British relatives.

It was the teutonic sound of the word that made it insupportable in that time of Germanophobia, the Grossbaums said. So Ben and his brothers and their mother rebranded themselves. In his petition to New York City authorities, Graham's uncle explained that Grossbaum had no genealogical significance. Rather, his grandfather had taken it up in the middle of the 19th century to conform to a Russian law requiring Jews to adopt a surname. Up until that ukase, the family had had no surname at all—and his grandfather's brothers, either not approving of Grossbaum or simply not caring, assumed different last names for themselves. Besides which, the cousin's application form pleads, "the name Grossbaum results in confusion and discomfort in business matters generally." It's forever being confused with "Rosenblum," "Rosenbeim," "Goldblum," "Greenbaum," "Rosenbaum," "Rosetbaum," and "Goldbeck."

Ben's application reads essentially the same as those of his brothers and mother, though it was more succinct than those of his uncles and cousin. "Our family name," he writes, "is a distinctively German name and at the outbreak of hostilities between England and Germany, members of my family residing in England changed their name to `Graham.' . . . I have been subject to considerable embarrassment in having my name differ from that of many of my relatives, and it is my desire to have it changed to conform with theirs." The Grossbaums were hardly alone in seeking safe haven in a blandly Anglo-Saxon identity. In 1918, according to Manhattan municipal courthouse records, six Goldsteins and two Greenbaums joined the fast-expanding Graham clan. In that same year—the last year of the war—at least three people shed the name "Kaiser." One wonders, Didn't they get the memo?

It happened that Graham once taught Sunday school. It was a small class in Beverly Hills. He was retired and living in California at the time. It was in the 1960s. His half dozen young charges were Jewish. He asked them about anti-Semitism. To his amazement, they said they weren't familiar with the term—didn't know what it meant. In his memoir Graham relates, "When I was their age, anti-Semitism was an important part of the air we breathed; it affected our plans for dealing with the outside world; it played the leading part in our literature and in our humor." But he goes on to say that, as an adult, his relations with Christians were cordial and respectful. Never did he suffer "rebuffs or embarrassments because of my religion." To be sure, Graham—through his mother, the grandson of the chief Rabbi of Warsaw, if you please—did not wear that religion on his sleeve. He seems not to have worn it at all. “I have a theory which is anathema to most of my Jewish friends," he wrote posthumously. "It is that the real mission of Jews is to intermarry and thus to contribute their hard-won stock of talents and abilities to a much wider group. What a wonderful adventure in genetics that would be.” Let me say, on behalf of the worldwide Anglican Communion, that we welcome all the genetic support we can get.

Anyway, the bright-eyed Columbia graduate was, as he himself acknowledged, one smart cookie. He quickly developed proficiency in the kinds of investment activities that many find too complex to penetrate—arbitrage, workouts and market-neutral strategies (as we would call them today), among others. “My standard procedure,” Graham relates, “was to buy convertible bonds around par and to sell calls against them on the related common stock; or else—in a more elaborate variant—sell the common stock short and sell puts against our short position.” The

amounts received on the put and call transactions were big enough effectively to guarantee a profit on the overall operation, wherever the price of the common traded.

So smart was Graham that he presently came to outsmart himself. This careful analyst and keen appraiser of risk had had a jolly and lucrative time of it in the Coolidge bull market. He was certainly no uncritical booster of the supposed new era. In his magazine pieces and to his class in securities analysis at Columbia University, he flagged the divergence of public market values from private ones. Before World War I, the typical analyst was a businessman who thought about stocks as he did about his own company. That is, he focused on property, plant and equipment, on cash and on liabilities. That is, he started with the balance sheet. The market of the late 1920s, in stark contrast, was single-mindedly concerned with the income statement. What would a certain company earn this year? What would it earn next year? Never mind “book value.” It was an anachronism.

So there was a CNBC market 50 years before CNBC. At the manic peak, investors were paying 8% to borrow in the call-loan market in order to buy stocks yielding 2%. Palavering with Bernard M Baruch, the great inventor and venture capitalist, Graham prophesied that before the cycle was completed, the public would be running from the chance to pay 2% in the call-loan market in order to buy stocks yielding 8%. And, by the way, that forecast was almost literally validated. The two out-of-sorts value investors agreed that a crash was in the offering.

Not that there was nothing for a value investor to do, even in that momentum- and earnings-crazed market. Graham continued to uncover cheap stocks, including some trading for less than their pro rata share of cash, or near-cash, in the company’s treasury. By now he was managing money and living what we might now describe as the Greenwich hedge-fund lifestyle. He kept a man-servant—one flunky among a troupe his wife retained—in his extra-commodious and extravagantly priced apartment at the newly opened Beresford on Central Park West. It was the first and only time in his life that he had a butler, Graham relates. Nor is it surprising that this experiment in self-indulgence was cut short. Value investors hate ostentation.

Then, again, value investors are supposed to have a deep-rooted aversion to financial leverage, but Graham and his partners went into the Crash in a highly leveraged position. He relates that he was operating with $2 ½ million in capital and that $2 ½ million of longs were hedged with $2 ½ million of shorts. So far, so good. But Graham had, in addition, as much as $4 ½ million in unhedged long positions, against which he had borrowed $2 million. "We were convinced," Graham explains, "that all of our long securities were intrinsically worth their market price. Although many of our issues were little known to active Wall Street hands, similar ones had previously shown a praiseworthy tendency to come to life at a decent interval after we bought them and give us the chance to sell them out at a nice profit, replacing them with other bargain issues which we were constantly digging up."

It might have been for penance that Graham, with the editorial assistance of David L. Dodd, began to write his magnum opus, "Security Analysis"—for penance and for money. Certainly, there was no money coming in from the money-management business. Graham's fund was down by 20% in 1929, by 50% in 1930 and by 16% in 1931. In 1932, the year the Dow bottomed at 41.22, he managed to achieve a kind of moral victory by losing a mere 2%. Still, there was but 30 cents remaining of each dollar entrusted to his stewardship at the peak only three years before.

Graham was in the throes of composition in the spring of 1932, though he was writing not for his book publisher, McGraw-Hill, but for *Forbes Magazine*. Under his byline, starting in the issue dated June 1, appeared a three-part series headed, "Is American Business Worth More Dead Than Alive?" To judge by the valuations then prevailing on the New York Stock Exchange, the answer was "yes." More than a third of all listed industrial companies changed hands at less than the companies' own net current assets. In other words, the business values of these companies—as distinct from their net cash and other liquid assets—was worth less than zero.

Graham treated this astonishing fact not only with wonder—who could have dreamt it?—but also with a well-reasoned measure of indignation. In the long-vanished boom, companies had raised billions of dollars from the public. Now they were liquid, while the public was struggling to pay the rent and put food on the table. The only rational way to explain the existence of so many cheap stocks, Graham proposed, was that the market, in its wisdom, was discounting operating losses for years to come. But if that were the case, he asked, "should not the stockholder demand liquidation before his money is thus dissipated?"

Well, the market wasn't wise, he judged. It was an ass. How could it be otherwise when the people who bought and sold—especially those who sold—refused even to look at balance sheets? "Much of the past year's selling of stocks has been due to fear rather than necessity," Graham wrote in *Forbes*. "If these timid holders were thoroughly aware that they were selling out for only a fraction of the liquid assets behind their share, many of them might have acted differently. But since valuation has come to be associated exclusively with earning power, the stockholder no longer pays any attention to what his company owns—not even its money in the bank."

If "earning power" was the boomtime cry, "losing power" was the motto of the bust. "Is it true," Graham posed, "that one out of three American businesses is destined to continue losing money until the stockholders have no equity remaining? That is what the stock market says in no uncertain terms."

And Graham answered his own question: "In all probability [the market] is wrong, as it has always been wrong in its major judgments of the future. The logic of Wall Street is proverbially weak. It is hardly consistent, for example, to despair of the railroads because the trucks are going to take most of their business, and at the same time to be so despondent over the truck industry as to give away shares in its largest units for a small fraction of their liquid capital alone."

The *Forbes* series bracketed the July 8 low in the Dow. Graham was never one for market calls, but he was bullish when one ought to have been bullish—in 1933, incidentally, he was up by 50%. Of course, at the bottom of the market, being bearish is what comes naturally, and that sinking feeling was highly contagious in the final summer of the administration of Herbert Hoover. Competing for the attention of the reading public at about the time the Graham series was running in *Forbes* was a new book from Harper Brothers entitled "Is Capitalism Doomed?" Why yes, the author, Lawrence Dennis, replied to his own question. Fascism was the coming thing. It could "supplant the now disintegrating laissez-faire liberal capitalism of the past century."

It happens that the Dennis book got a good notice from the *The New York Times* book critic, Louis Rich. And it happens that, two years later, the same critic held forth on Graham-and-Dodd's "Security Analysis" for review. He liked it, too. "On the assumption," wrote Mr. Rich, "that despite the debacle of recent history there are still people whose money burns a hole in their pockets, it is to be hoped that they will read this book. It is a full-bodied, mature, meticulous and wholly meritorious outgrowth of scholarly probing and practical sagacity."

Seventy-odd years later, the critic's verdict still stands. "Security Analysis" is Graham's legacy and testament. It is a comprehensive guide to investing as investing was defined and practiced in the early decades of the 20th century. "Value investing" is the name posterity attaches to Graham's approach to seeking out securities that afford the buyer a margin of safety. Graham himself called it simply---"investing." It might trouble his shade to know that even after seven decades of financial evolution, only one Wall Street tribe—the one that styles itself value-seeking—consistently strives not to overpay. We are a kind of cult. For the mainstream, it is as true today as it was in 1929 that value is nearly the same as earning power. Certainly, to judge by the 2007 credit crackup, balance-sheet analysis isn't much more faithfully practiced today than it was in the days of Calvin Coolidge.

Graham was an educated man who happened to invest rather than an investor who, in order to get a job, happened to have gone to college. He wrote and read and thought his whole life long. And as an educated man, he had a somewhat detached view of the times in which he lived. He could see, for example, that the Great Depression was an anomalous catastrophe, one not to be repeated in his lifetime and therefore not one for which an investor had to armor himself. It was a fluke.

Yet Graham, a human being quite as fallible as the next very smart human being, sometimes lost his sense of perspective. He, too, could become historically disoriented. One sees it at the end of the second edition of "Security Analysis," which was published in 1940. Fresh in the author's mind, of course, was the Depression. Even fresher was the brutal, trap-door bear market of 1937-38. Graham had been through the mill, and he seemed to let it show in the words of advice he tendered to the managers of trust funds, mutual funds and endowments. How should they invest? Well, Graham proposed, if they could afford to, they should buy bonds—then yielding a mere 2% or 3%. They should do themselves a favor and give wide berth to common stocks. What? Steer clear of the very asset class on which he had elucidated for most of the preceding 725 pages? Astonishingly, yes. "We doubt," Graham writes, "if the better performance of common-stock indexes over past periods will, in itself, warrant the heavy responsibilities and the recurring uncertainties that are inseparable from a common-stock investment program." There you have it. Some of the worst investment advice ever proffered by one of the best investors, and thinkers about investing, who ever lived.

Raise a glass, then, to Ben Graham, my very human hero.

Jim