Walter J. Schloss: The Superinvestor of Graham-and-Doddsville

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Abstract

Value investing is an investment philosophy first introduced by Benjamin Graham in 1934 and championed by Warren Buffett, one of Graham's many successful disciples. The core principles behind value investing are simple: buy stocks of good quality companies only when trading below a reasonably estimated intrinsic value. Despite value investors' stellar performance record, not only is value investing not practiced by most investors, it has never gained the significant interest of academic inquiry either. Only a few studies analyzed the performance of legendary investor Warren Buffett. The findings of these studies are limited as to why he outperformed the market over a long period. Academia has long considered his performance a statistical aberration and concluded that it doesn't need any attention. But a statistical anomaly that has persisted for over eighty years (since Benjamin Graham and David Dodd first published their classic *Security Analysis* in 1934) is more than just a persistent anomaly. It deserves our attention. We cannot continue to ignore the evidence. Since Warren Buffett's investment approach and performance are well documented, I studied Ben Graham's other students, their association with Graham, investment philosophy, and performance. This article discussed Walter Schloss, his investment approach, and his performance.

Keywords: Value investing, Cigar butt, Book value, Benjamin Graham, Warren Buffett, Walter Schloss

1.0 Introduction

Lesser known, yet no less impressive, Walter Schloss was an investment legend. This study on Walter Schloss is a part of another project where we studied the disciples (direct students or mentees in this case) of Benjamin Graham. Walter J. Schloss was one of them. He was Ben Graham's student at the New York Institute of Finance, and worked for him at Graham-Newman Corp. We looked at Walter's association with his great mentor, investment philosophy, and investment performance at WJS Partners and Walter & Edwin Schloss Associates. The article's sole purpose is to document Walter's investment philosophy so future generations of investors can learn from him.

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Over the course of his career, Ben Graham taught at three institutions – Columbia University in New York, New York Institute of Finance (formerly New York Stock Exchange Institute), and the University of California, Los Angeles. Ben Graham taught hundreds of students at these institutions. Despite their different investment approaches, they all have stellar performance records. Warren Buffett mentioned this in his 1984 article, *The Superinvestors of Graham-and-Doddsville*:

> "In this group of successful investors that I want to consider, there has been a common intellectual patriarch, Ben Graham. But the children who left the house of this intellectual patriarch have called their "flips" in very different ways. They have gone to different places and bought and sold different stocks and companies, yet they have had a combined record that simply cannot be explained by the fact that they are all calling flips identically because a leader is signaling the calls for them to make. The patriarch has merely set forth the intellectual theory for making coin-calling decisions, but each student has decided on his own manner of applying the theory." (Buffett, 1984, p. 7).

Investors across all walks of life benefitted from following the footprint of Benjamin Graham and his many disciples. Ben's approach has been tested in various time and market environments. There is no other investment paradigm that has sustained that long. Despite Ben's profound contribution to the scholarship and investment paradigm, Warren Buffett kept his thoughts alive. After Ben died in 1976, Warren Buffett wrote in his short remembrance published in the *Financial Analysts Journal*:

> "… over 40 years after publication of the book that brought structure and logic to a disorderly and confused activity, it is difficult to think of possible candidates for even the runner-up position in the field of security analysis. In an area where much looks foolish within weeks or months after publication, Ben's principles have remained sound - their value often enhanced and better understood in the wake of financial storms that demolished flimsier intellectual structures. His counsel of soundness brought unfailing rewards to his followers - even to those with natural abilities inferior to more gifted practitioners who stumbled while following counsels of brilliance or fashion... Walter Lippman spoke of men who plant trees that other men will sit under. Ben Graham was such a man." (Buffett, 1976, p. 19).

2.0 Rationale, Objectives, Context

Despite value investors' stellar performance record, not only is value investing not practiced by many investors, but it has also never gained the significant interest of academic inquiry. Only a few studies analyzed the performance of legendary investor Warren Buffett. The findings of these studies are limited as to why he outperformed the market over a long period. While much has been written about Buffett, few systematic studies attempt to determine the reasons for his success. The most comprehensive is by Frazzini, Kabiller, and Pedersen (2018), who, in a well-designed and thorough empirical study, conclude that Buffett's performance can be attributed to (a) his unique access to leverage, and investment in (b) safe, (c) high-quality, and (d) cheap stocks. Otuteye and

Siddiquee (2019) provided behavioral explanations, including tenacity, patience, avoidance of overconfidence, organizational culture, and the reputation effect, to explain Buffett's performance.

Academia has long considered his performance a statistical aberration and concluded that it doesn't need any attention. But a statistical anomaly that has persisted for over eighty years (since Benjamin Graham and David Dodd first published their classic *Security Analysis* in 1934) is more than just a persistent anomaly. It deserves our attention.

There may be some criticisms that the only way to confirm if the performance of these disciples is outstanding or unusual would be to examine the performance of the thousands of other students who learned value investing from Ben Graham. These investors may be just the tail of a typical distribution. I am not unfamiliar with this type of criticism. Academia was always skeptical about the performance of value investors. They attributed Buffett's success to chance without any rigorous examination. "Bill Sharpe described him [Warren Buffett] as "a three-sigma" event, a one in four hundred investor. That was a dismissive sort of praise. What could one possibly learn from such a rare bird?" (Sharpe, quoted by Fox, 2009, p. 223). Michael Jensen, back in 1984, dismissed the performance of Warren Buffett, citing a coin flipping example: "If I survey a field of untalented analysts, all of whom are doing nothing but flipping coins, I expect to see some who have tossed two heads in a row and even some who have tossed ten heads in a row." (Jensen, quoted by Lowenstein, 1996, p. 317). Nobel laureate Merton Miller expressed the same sentiment: "If there's 10,000 people looking at the stocks and trying to pick winners, well, one in 10,000 is going to score, by chance alone, a great coup, and that's all that's going on. It's a game, it's a chance operation, and people think they are doing something purposeful but they're really not." (PBS, 2000).

If this is the situation of Ben Graham's famous student, readers can easily anticipate that any serious academic study on his other disciples is virtually non-exist. This study documents the investment approach of Walter Schloss to understand the reasons behind his stellar performance – what gives him an edge over his competitors in money management.

3.0 Methodology

There were some challenges in undertaking this project, for example, finding an exhaustive list of Ben Graham's students. A complete list would be the students taught by Benjamin Graham at the three institutions mentioned above. From a practical point of view, this is nearly impossible, and also, I believe not all of his students practiced what they learned from their professor or built a career in money management. Even if you have a complete list, separating those students who were in money management and who went to pursue other trades would be difficult. Despite these challenges, I came up with a list of 28 Ben Graham's disciples, mostly from published articles and books (see Appendix A). However, my list should not be considered exhaustive, as Ben Graham taught many more students. I have arranged them alphabetically (see Appendix B). Based on the availability of resources, I chose to study the following five investors, in alphabetic order - Charles H. Brandes (Brandes Investment Partners, LP), Ed Anderson and Tom Knapp (Tweedy, Browne Company LLC), Irving Kahn (Kahn Brothers Group, Inc.) and Walter J. Schloss (Walter & Edwin Schloss Associates).

As I have already mentioned, finding information about these investors was another challenge. Everybody knows Warren Buffett. His investment philosophy and performance are well documented as hundreds of books and articles have been written about him. However, not so much about other disciples of Ben Graham, the reason why I have excluded Warren Buffett from this study. Many of his disciples have already died. I had to contact family members and colleagues to understand their investment philosophy or collect any materials that may help me understand their investment philosophy. I also consulted the rare collection of Walter Schloss Family Business Papers from 1957-2003 at Butler Library, Columbia University. Other than these, I relied solely on secondary information available from their writings or writings by others about them or from their company websites.

I organized the discussion around investors' profiles, association with Benjamin Graham, investment philosophies, and long-term investment performance records by structure. I have also included a list of their intellectual contributions, such as books, academic articles, or articles in trade journals. In the next section, we will discuss Walter Schloss, his association with Benjamin Graham, and his investment performance.

4.1 Walter J. Schloss Profile

Walter J. Schloss was born to Jewish parents Jerome H. Schloss and Evelyn Gomprecht Schloss on August 28th, 1916, in New York City when there were trolleys on Broadway and sheep gazing in Central Park. Walter's parents, siblings Marjorie and Isaac, and grandmother, all shared a three-bedroom apartment in Manhattan. His great grandfather immigrated to the US from Germany in the late 1800s. The advice that he had gotten from his father was "work hard and trust in god, but if this does not work then look up your cousin in New York," which he did. Walter's character of frugality, controlling expenses, and disdain for 'losing money' was instilled in him by seeing the calamity and adverse effect that his grandfather's bankruptcy had on his family. He saw his grandfather go bankrupt and his father struggle through life.

> "He was a bantamweight, mild-mannered, dark-haired man from a family of New York Jewish immigrants, but he probably struck the Marshall-Wells crowd as abrupt by the standards of Duluth.
>
> Schloss's grandfather had dallied away his hours in New York City at the Harmonie Club, leaving his apparel company in the charge of a bookkeeper who – as custodian of the money and the records – applied himself to using the latter to embezzle the former. Next, his father had set up a radio factory with a partner. The warehouse burned down under suspicious circumstances before a single radio was sold. Then, when Walter was thirteen, his mother lost her inheritance in the crash of 1929. The Schloss family got by through perspiration and determination. Walter's father got a job as a factory manager, then sold stamps." (Schroeder, 2008, p. 132).

During the 1930s, while growing up in Manhattan and attending Franklin School, Walter was introduced to investing through a family friend's husband, a New York Stock Exchange specialist. Walter used to visit them and was attracted to their lifestyle but wasn't very fond of the speculative nature of their work, but rather enticed by the numbers.

After completing high school in 1934, Walter didn't pursue university because his family could not afford to send him to college but decided to work for Loeb Rhoades. He would perform cage duties, clerical work, and record trades for their investors. Walter aspired to work for their statistical department but was never afforded the opportunity.

> "… I got this job as a runner with Loeb Rhoades for about a month. Then they put me in the cage. In those days, we counted the box every day with the partner in charge of the box. Can you imagine each day counting every security at Carl M. Loeb & Co., later Loeb, Rhoades & Co.? It's hard to imagine today. I worked there for seven years." (Schloss, 1989).

Despite this, one of the partners within the organization recommended that he read the book *Security Analysis* if he wanted to learn more about investing. Walter did just that and enrolled in two finance courses from Benjamin Graham in 1936 and 1939 at the New York Stock Exchange Institute (now New York Institute of Finance).

Roughly three years after taking his last finance course, Walter enlisted in the Army on December 9th, 1942, to serve as part of the US Signals Corps. In support of WWII, Walter served in Iran, where he would assemble the Studebaker trucks, which proved to be an essential ingredient in contributing to the success of the Russians in Stalingrad. Walter finished out his military career working at the Pentagon until 1946. In the 1990s, Walter received a letter of thanks from the Russian government for his contributions during the war.

Upon release from the army in 1946, Walter began his career as a securities analyst. He joined Graham-Newman on January 2nd, 1946. Walter shared an office with Warren Buffett at New York City's Chanin Building on East 42nd Street.

> "When I got out of the service, I got a note from Ben telling me that the fellow who was doing security analysis for him was leaving to work with his father and would I be interested in going to work with him. That's how I got the job with Ben Graham. I joined Graham-Newman on January 2nd, 1946, right after the end of World War II. The first thing I did was to prepare the results of the first ten years of Graham-Newman. Interestingly, Graham-Newman only operated for twenty years." (Schloss, 1989).

He worked for Graham-Newman until opening up his own firm in the middle of 1955.

> "He [Walter Schloss] had been pigeonholed as a journeyman employee who would never rise to partnership. Jerry Newman, who rarely bothered to be kind to anyone, treated Schloss with more than his usual contempt, so Schloss, married with two young children, decided to strike out on his own. It took him a while to get up the nerve to tell Graham, but by the end of 1955 he had started his own investment partnership, funded with $100,000 raised from a group of partners whose names, as Buffett later put it, "were straight from a roll call at Ellis Island." (Schroeder, 2008, p. 197-198).

Ben Graham's decision to retire may have influenced his thought of starting his own partnership. In 1955, Benjamin Graham had advised Walter that he had planned to retire and move to

California. Walter began to consider his options for attaining further employment elsewhere. However, one of the Graham Newman stockholders informed him that if Walter opened up his investment fund, he would invest in it, which provided Walter with the opportunity to start his firm. In 1955, with $100,000 in capital, he did just that (see Appendix E for the Schloss Partnership Agreement).

> "In 1955, Graham said he was going to retire. He was going out to California. I think he was kind of bored. I said "If he's going to retire, I might as well go into business myself." So I got myself 19 partners, and they each put $5,000. One guy put up $10,000. We put up $100,000. It's kind of pathetic, when you think about it. Now you see fellows saying, "I won't start a partnership without $10 million." The people had confidence in me, so we started. And really, it kind of build up from there." (Walter Schloss, quoted by Welling, 1985, p. 6).

Walter's mother, Evelyn warned him not to start his business. Despite his mother's warning, Walter Schloss opened his investment partnership when the stock market was at an all-time high. But he saw an opportunity:

> "In 1955, Graham testified before the Fulbright Committee. The market had gone up to an all-time high - up to the 400 area vs. 381 in 1929. And Graham and John Kenneth Galbraith both testified before the Fulbright Committee that the market was too high. Everybody else - about 18 others testified - thought the market was reasonably priced.
>
> Graham was looking at it historically. Galbraith was just against the capitalist system generally, I think. But, anyway, they both testified against it. And here I was - I admired Graham tremendously, and I was going into the business at just the time when he was saying the market was too high. It was just one of those things. You do what opportunity allows you to do. It turned out to be a fabulous decision. I didn't know it at the time. You really have to stick to your guns no matter what other people think. It's also important to know what you know and what you don't know." (Schloss, 1989).

Over the years, Walter Schloss and his son, Edwin Schloss ran one partnership despite their stellar long-term performance record. He started with 19 investors, eventually rising to 92. One unique thing about the partnership is that there are partners in the fund whose parents were partners; some are even third-generation partners. You can find the list of founding partners in Appendix E. Walter never marketed his fund and kept the fund size to a manageable sum by handing his investors all realized gains at the year-end unless they told him to reinvest.

> "I didn't want to start another. I didn't want to complicate my life too much. If you have two partnership – sort of like Pioneer Fund, Pioneer II, Pioneer III – you always have to decide what to put in each one. I just didn't want it. Life's too short." (Walter Schloss, quoted by Boland, 1989).

The investment partnership that Walter and Edwin Schloss ran for years is unique in many respects. Greenwald, Kahn, Sonkin, and Biema (2004) identified two such policies:

> "There are two policies that the Schlosses follow in their partnership that set them apart from most money managers running similarly structured investment funds. First, they assume that they will distribute all the realized gains to their partners each year… Second, the Schlosses get paid for their work by taking a portion of the investment returns. This is the typical practice for limited investment partnerships. Where they depart from the standard is that they also assume the same portion of the losses… Also, they do not take a management fee from the fund; most of their peers do. They only get paid for performance." (pp. 273-274).

Walter was conscientious about his operating expenses, one of the reasons he could outperform the market for so long. He rented a space in the office of a fellow value-oriented investment firm on Park Avenue in Manhattan, Tweedy, Browne. During the early stages, he sat between the water cooler and the front door, which meant that when people wanted a drink of water, he had to get up to let them pass.

> "When Buffett arrived at Tweedy, Browne, which maintained a tiny office at 52 Wall Street, in the same art deco building where Ben Graham had once worked, it felt like entering an old-fashioned barbershop, with its black-and-white ceramic tile floor. In a little office to the left sat the firm's secretary and office manager. To the right lay the trading room. Past that, in a small rented alcove half filled with a water cooler and a coatrack – in effect a sort of closet – sat Walter Schloss, running his partnership from a battered desk. Using Graham's method without the slightest variation, he had been averaging returns of better than twenty percent a year since leaving Graham-Newman. To pay his rent to Tweedy, Browne, in lieu of cash he gave the firm commissions by trading stocks. His trades were few, and he was getting a great bargain on the rent. He limited his other expenses to the cost of a subscription to Value Line Investment Survey, some paper and pencils, subway tokens, and nothing else." (Schroeder, 2008, p. 269-270).

Walter also lived a very frugal life. He lived in a tiny apartment in New York and invested the same way he always had. Walter made $2,600 a year as an investor, less than the average secretary in 1951, who took home $3,600, according to a survey of the National Secretaries Association. His wife jokes that he trails her around their home, turning off lights to save money, and loves to remove uncancelled stamps from envelopes for later use. He borrowed Value Line sheets from his son, Edwin, who had a subscription.

> "I type on an old upright Underwood typewriter. I like to buy suits on sale. I take public transportation. I shine my own shoes. I like iceberg lettuce. I buy stocks that go down before going up. I don't lie awake at night trying to predict what the market will do. I get a haircut when the market drops precipitously. I bring my own Scotch tape to the post office. I think First Call means that lunch has arrived." (Schloss, 2003).

In 1963 he attained the Chartered Financial Analysts (CFA) designation. As time passed, he upgraded into a modestly sized office but still worked without a secretary, clerk, or bookkeeper. He worked alone until 1973, when his son Edwin Schloss joined the partnership. Edwin received a Bachelor of Fine Arts from the University of North Carolina, where he majored in playwriting.

Like Walter, he also studied security analysis at the New York Institute of Finance. At this point, the firm became known as Walter & Edwin Schloss Associates.

> "Walter did not go to business school, or for that matter, college. His office contained one file cabinet in 1956; the number mushroomed to four by 2002. Walter worked without a secretary, clerk or bookkeeper, his only associate being his son, Edwin, a graduate of the North Carolina School of the Arts." (Buffett, 2006, p. 22).

According to the letter written by Warren Buffett, dated April 15th, 1994, Walter's total office expense was around $11,000, which is minuscule compared to his net income of $19 million. Walter was frugal bar none, which illustrated his commitment to his investors.

> "Accompanying these performance figures is a financial statement that should inspire Ben Graham Production to film Citizen Schloss. Please note that Walter's total office expense is about $11,000 as compared to net income of $19 million. Fixed assets are carried at $2,605 (000's <u>not</u> omitted), but Walter would like me to mention that the cost was $6,569 new.
>
> I think Walter's operational style should be a lesson for us all (one Charlie has already mastered). In effect, Walter is running his office for a year on what it costs Berkshire to start the engine on The Indefensible.†
>
> Meanwhile, Walter continues to outperform managers who work in temples filled with paintings, staff and computers. And he accomplishes this feat by rummaging among the cigar butts on the floor of capitalism. It's quite a 38-year record, a tribute to Ben as a teacher, Walter as a student, and to the advantage of a free puff." (Buffett, 1994).

Walter Schloss, in his rare memoir, *The Memoirs of Walter J. Schloss: A Personal and Family Story*, produced the letter his friend, Warren Buffett, wrote to the disciples of Ben Graham on August 22, 2001:

> "For your amusement, I'm also attaching two pages from the partnership's yearend financial statement, showing that Charlie and I are big spenders compared to Walter. He truly knows the value of a dollar. Note particularly the "other assets" account, which includes his furniture and fixtures totaling $4,598 (no zero omitted) and the operating expenses of $66,000 for an enterprise that delivered a gain of $39.5 million. The message here at Berkshire Hathaway World Headquarters is that we are in for some serious downsizing." (Warren Buffett in Schloss, 2003, p. 69).

† A Bombardier Challenger 600, Warren Buffett's private jet that he bought for $850,000 over 20 years ago despite Charlie Munger's objection and named it "The Indefensible" due to his past criticisms of such purchases that were made by other CEOs. Private jets appealed so much to him that he later renamed it "The Indispensable." He sold the jet once he bought the private jet operator, Executive Jet Aviation (EJA) and its program of fractional ownership of private jets, known as NetJets from Richard Santulli in 1998 for $725 million, half of which was paid in Berkshire stocks.

It was essential to Walter that he added value to his investors, which is why he only charged his investors 25% on the upside but took nothing on the downside. He talked about putting his partners' interests before his own in an interview with Eli Rabinowich in 1989:

> "I wanted to put myself on the same side of the table as my investors. Most funds are set up for managers to get 1% of the assets and 20% of the profits. I wanted to be in the same position as my partners. If they didn't make money I didn't make money. If they made money I wanted to be part of it. So I got 25% of the realized profits, but that's it. If the market went down we would have to make up the loss until my partners were whole." (Walter Schloss, quoted by Rabinowich, 1989, p. 6).

Throughout Walter's career, he showcased his abilities to remain disciplined and patient while investing. He didn't want to purchase an exorbitant amount of stock in any company that would threaten a merger or privatization. He didn't want to be responsible for people losing their jobs and livelihood.

He didn't wish to disclose his holding to his investors as he felt it would increase competition and distract them from their portfolios' overall performance. Before liquidating, Walter's investment firm had around $130 million in capital.

> "… while I was at Graham-Newman, a man called up and said he'd like to speak to Mr. Graham. Because he was out of town that day, I asked if there was anything I could do in his stead. He said, "I just wanted to thank him. Every 6 months Graham-Newman publishes their portfolio holdings. And I've made so much money on the stocks that he had in his portfolio, I just wanted to come by and thank him."
>
> That was one of the reasons I decided never to publish our holdings. We work hard to find our stocks. We don't want to just give them away. It's not fair to our partners." (Schloss, 1989).

Walter told the following story of one of his limited partners who were worried about him investing in ailing railroads:

> "… a little story might help explain why we don't tell them what we own. One of our partners said, "Walter, I have a lot of money with you. I'm very nervous about what you own." So I made an exception and said, "I'll tell you a few things that we own."
>
> I mentioned the bankrupt rail bonds and a couple of other things we owned. He said, "I can't stand knowing that you own those kinds of stocks. I have to withdraw from the partnership."
>
> He died about a year later. That's one of the reasons we don't like to give people specifics." (Schloss, 1989).

There are also behavioral reasons why investors should not be publicly discussing their portfolio holdings. I saw Warren Buffett and Charlie Munger not entertaining any questions on stock recommendations in the Berkshire annual shareholders meetings. Berkshire Hathaway is required to report its holdings quarterly on Form 13F with the Securities and Exchange Commission (SEC).[‡] Noted value investor Guy Spier commented on this in his book, *The Education of a Value Investor*:

> "Over the years, I began to realize that it was a bad idea to speak publicly about stocks that I own. The issue isn't that other investors might steal my best ideas. The real problem is that it messes with my head. Once we've made a public statement, it's psychologically difficult to back away from what we've said—even if we've come to regret that opinion. So the last thing I want to do is walk into the trap of making a public statement about a stock, given that the situation might later change or that I might subsequently discover that I was wrong." (Spier, 2014, p. 148).

Throughout his career, Walter was profiled by multiple financial journals, such as Forbes, Barron's, and Fortune. Walter loved the city of New York and their baseball team, the NY Yankees. He also enjoyed bird watching in Central Park and, like Warren Buffett, excelled at the game of bridge. Warren warmly called him 'Big Walt.'

> "I always liked Babe Ruth and I saw him hit home runs back in 1927. And Edwin's brother-in-law knew that I liked him. So when he met somebody on a plane who had taken the original pictures of the Babe, he made a copy and gave it to me." (Schloss, 1989).

> "Schloss owns a prized 1934 edition of Graham's Security Analysis he still thumbs through. Its binding is held together by three stripes of Scotch tape. In the small room he invests from now, across the hall from his apartment, one wall contains a half-dozen gag pictures of Buffett (the Omaha sage with buxom cheerleaders or with a towering stack of Berkshire Hathaway tax returns). Each has a joke scribbled at the bottom and a salutation using Schloss's nickname from the old days, Big Walt." (Condon, 2008, p. 2).

In 2001, Walter and Edwin decided to liquidate their fund as they could no longer find any cheap stocks to buy on the market. The same year, Walter married Ann Person, whom he met in France in 2000. The two would spend their time traveling, watching the theatre, and having family get-togethers. Walter spent his spare time as trustee and treasurer of Freedom House, an organization that monitors the state of liberty worldwide. He donated $200,000 to Accuracy in Media and helped build an endowment fund worth more than $5 million.

Walter wrote a 96-pages autobiography titled *The Memoirs of Walter J. Schloss: A Personal and Family Story*. The book was self-published by Walter for his family and is thus incredibly rare. Only a few copies were published. A couple of years ago, one of those copies was sold for USD 2,249.00 (approximately CAD 3,084.39) on eBay. The book is currently out of print.

[‡] You can find the latest copy of Berkshire's Form 13F here: https://www.sec.gov/Archives/edgar/data/1067983/000095012322009450/xslForm13F_X01/15796.xml

Sadly, Walter J. Schloss died of leukemia on February 19, 2012, at the age of 95 in New York. He inherited his biological genes from his father, who passed away at 104. Upon Schloss' death, Buffett, who was a close friend for more than 60 years, released the following statement:

> "He had an extraordinary investment record, but even more important, he set an example for integrity in investment management. Walter never made a dime off of his investors unless they made significant money. He charged no fixed fee at all and merely shared in their profits. His fiduciary sense was every bit the equal of his investment skills." (Buffett, quoted by Arnold, 2012).

4.2 Association with Ben Graham

Walter Schloss was first introduced to value investing while working for M. Loeb & Co, where he read Benjamin Graham's Security Analysis. At the time, Benjamin Graham was a customer of Loeb and was teaching night courses at the New York Stock Exchange Institute. After reading the book, Walter enrolled in two of Benjamin Graham's courses in 36' and 39'. From Graham, Walter Schloss learned the arts of value investing.

> "Back in 1935 while working at Loeb Rhodes (then called Carl M. Loeb & Co.), one of the partners, Armand Erpf, gave a good piece of advice when I asked him how I could get into the "statistical department." In those days and perhaps today to some extent, the best way to advance was by bringing in business. If you had a wealthy family or friends, you brought in commissions. Security analysis was in its infancy and who you knew was much more important than what you knew. If you didn't have connections, it was difficult to get ahead. In any case Mr. Erpf told me that there was a new book called Security Analysis that had just been written by a man called Ben Graham.
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> "Read the book and when you know everything in it, you won't have to read anything else."
>
> I took Ben's course in Advanced Security Analysis at the New York Stock Exchange Institute (New York Institute of Finance)." (Schloss, 1976, pp. 1-2).

In her book, *The Snowball: Warren Buffett and the Business of Life*, Alice Schroeder talked about Walter Schloss and his connection to Ben Graham and value investing.

> "Schloss read Graham's book cover to cover and wanted more. Two nights a week from five to seven, he started going to the New York Institute of Finance, where Graham taught investing. Graham had begun these seminars in 1927 as trial runs for a college course he was thinking of teaching at Columbia… Schloss was so captivated that he wound up as one of a couple of employees working for his idol, Ben Graham, and his partner, Jerry Newman." (Schroeder, 2008, p. 133).

The courses Walter took with Graham were supported by M. Loeb & Co and cost them around $10 to $20 per semester. Even today, one can purchase Ben Graham's two classics, *The Intelligent*

Investor, for $14.29, and *Security Analysis*, for $47, on Amazon.com, probably the cheapest investment books available.

> "The N.Y. Stock Exchange ran a series of courses for the work on the stock exchange including accounting and finance and after taking them I was allowed to take a course in "Security Analysis" with Ben Graham. It was a great experience and I remember taking 2 different classes with him. The firm paid for the class which I think was $10 a semester but perhaps it was $20… Ben was a very simple straightforward man with a brilliant quick mind. He would use current examples of undervalued stocks which made it profitable for some of the professionals on the street to take his class." (Schloss, 1993, p. 2).

> "At the time Schloss was working at Carl M. Loeb and Company, Graham's brother Leon was a customer's man at the firm, and Graham kept his account there, allowing Schloss to confirm that Graham did indeed practice what he preached in class." (Greenwald, Kahn, Sonkin and Biema, 2004, p. 265).

Within Graham's lectures, Walter recalls that Graham would compare companies alphabetically. Walter vividly remembered Coca-Cola and Colgate-Palmolive Company as one of the statistical comparisons used, with Coke being the cheaper of the two.

Walter was an ardent believer in value investing. Recommending Ben's classic, The Intelligent Investor, to the average investor, Walter mentioned in an interview with Barron's in 1985:

> "Ben's book is called The Intelligent Investor. And I really want, in this interview, to urge the people to get hold of that book. For the average investor, there are so many books out there, and they all tell you to do different things, but this book is really helpful, particularly for investing in commons stocks. Because if you don't have the right investment philosophy, you can get very badly hooked. And I think anybody who has any money to invest should understand this approach." (Walter Schloss, quoted by Welling, 1985, p. 6).

In 1946, shortly after WWII, while working in the Army at the Pentagon, Benjamin Graham wrote Walter Schloss inviting him to work with him as a securities analyst at Graham Newman. "… Walter Schloss, a thirty-four-year-old man who was working for the pittance of fifty dollars a week as one of four employees of Ben Graham's company, the Graham-Newman Corporation." (Schroeder, 2008, p. 132). Walter met Warren Buffett at a Marshall Wells shareholder meeting, and ended up sharing an office at Graham-Newman Corp. in the 1950s. Walter would work alongside Benjamin Graham for nine and a half years and Warren Buffett for a year throughout this experience. It was here that he was able to learn and grow his circle of competence as a value investor.

> "Ben was very generous with his thoughts and his time, particularly with young people. By offering me a job as his security analyst as I was about to leave the Army at the end of 1945, he changed my life. I know he helped others in our field too." (Schloss, 1976, p. 2).

Walter Schloss commented at the luncheon honoring Benjamin Graham and Janet Lowe on the publishing of her biography of Ben Graham[§] on the year of his 100th birthday:

> "Fifty odd years ago, partners in brokerage and other financial firms tended, on the whole, to be removed from the nitty gritty of life. If you don't have money, you didn't count!
>
> Ben, on the other hand, was accessible. Supportive of the younger generation and straight forward in his dealings. By employing me as a security analyst at Graham-Newman for $9^1/_2$ years, he changed my life, for which I am forever grateful." (Schloss, 1994, p. 1).

Walter helped Ben Graham with the third edition of *Security Analysis*, published in 1951. Throughout his career, Walter remained in touch with his mentor, Ben Graham. I got copies of the letters he exchanged with Ben Graham from Butler Library at Columbia University. The subjects of these letters vary from personal and family information to business and investment opportunities.

4.3 Investment Approach

Walter Schloss aspired to attain cheap stocks on the market that carried with it a slight premium over book value. He summarized his investment philosophies in the lecture, Why We Invest the Way We Do, delivered on May 16th, 1996, at the Behavioral Economics Forum at the Harvard Faculty Club in Cambridge, Massachusetts.

> "We are bargain hunters in the stock market instead of the retail trade or similar areas. As Ben Graham said, we buy stocks like groceries not like perfume, or as they say, "a stock well bought is half sold". One reason why we don't disclose our holdings is that we don't want competition. If the stock goes lower, which is quite possible, we'll want to buy more." (Schloss, 1996, p. 2).
>
> "We want to buy cheap stocks based on a small premium over book value, usually a depressed market price, a record that goes back at least 20 years, even though, the company may be somewhat different than now, and one that doesn't have much debt. We don't like a lot of debt and we don't think most value investors care for it either. Price is the key factor in the purchase of a stock compared to what we think the company is worth." (Schloss, 1996, p. 4).

Typically he wanted to purchase stocks that fell in the small to the mid-cap range with a depressed market price, one that carried a performance record that went back at least ten years, and one with little debt. He avoided the tech stocks as well.

> "The big companies have been sort of pawed over by all the analysts. The analysts look at the 150 or 200 largest companies. If you're managing $50 billion, you can't

[§] Lowe, J. (1994). *Benjamin Graham on Value Investing: Lessons from the Dean of Wall Street*. New York, N.Y.: Penguin Books

> fool around with buying a small company, where you might be able to buy only $100 million worth of stock. As for the high-tech companies, they're mostly small, but the speculation was that they had a great future. Well, maybe they do and maybe they don't, I'm not smart enough to know." (Walter Schloss, quoted by Boroson, 2001, p. 182).

When selecting a stock, Walter perused the new lows list to identify stocks trading near their 52-week low. In his eyes, these stocks were an indication of a possible bargain. After identifying these stocks, he would verify that the companies had no long-term debts, as he believed this significantly increased the risk profile of the investment. He also looked at their price and their relation to book value. If it was trading below, Walter saw it as a potential bargain. See Appendix D for the stocks Walter was interested in, described at a Columbia Business School Seminar in 1993.

In the early days in business, Walter had an appetite for "cigar-butt" companies that would be trading as low as one-third of their net working capital (after deducting all debt and preferred stocks).

> "Schloss was the last champion of cigar butts. At the Graham Group meetings, the others razzed him about his "buggy-whip" portfolio of bankrupt steel companies and destitute auto-parts makers. "So what," said Schloss. "I don't like stress and I sleep well at night." He filled out the simple checklists, applying Graham's philosophy in its purest form. He went home from his desk in the closet at Tweedy, Browne at five o'clock every evening, and his results were phenomenal." (Schroeder, 2008, p. 419).

Preserving capital or protection on the downside was the centerpiece of Walter Schloss's investment philosophy. He learned it mostly from his master, Ben Graham, and from growing up in a financially distressed family in New York. Graham developed the net net investment strategy in the debacle of 1930s to help protect investors from downside while providing significant upside potential.

> "In thinking about how one should invest, it is important to look at your strengths and weaknesses. If you don't like to lose money and it affects your judgment, don't buy things that can go down a great deal. I must say, I NEVER have put in a stop loss order because if you like a stock and buy it and it goes down, then you should buy more if you can afford it. I find it very difficult to buy a stock that has gone up after we start buying it.
>
> Basically, we try to buy value as expressed in the differential between its stock price and what we think its worth. What we think a company is worth may not be correct one and this means we have to look at the risk on the downside." (Schloss, 1993, p. 3).

Like Ben Graham, Walter Schloss didn't put much emphasis on management. However, he preferred that management should own a substantial amount of stock within the company, illustrating that they have a stake in the company's success.

> "Ben didn't look for franchise value or managements. He felt that management showed up in the price of the stock. If management was good the stock sold at a higher P-E because its management was better. Basically Ben didn't want to lose money. He had had a rough time during the Depression and in 1938 to 1940 when I took his courses, he was looking for protection on the downside… Ben didn't visit management because he thought the figures told the story." (Schloss, 1993, p. 3).

He was worried about the work needed to monitor the management constantly; he instead preferred a stress-free life:

> "Peter Lynch visited literally thousands of companies and did a superb job in his picking. I never felt that we could do this kind of work... therefore, went with a more passive approach to investing which may not be as profitable but if practised long enough would allow the compounding to offset the fellow who was running around visiting managements... I also liked the idea of owning a number of stocks. Warren Buffett is happy with owning a few stocks and he is right if he's Warren but when you aren't, you have to do it the way that's comfortable for you and I like to sleep nights..." (Schloss, 1993, p. 4).
>
> "When we buy depressed stocks, we seem to reduce stress. Some people seem to thrive on stress, but we feel in the long run it is bad for them. I note that Peter Lynch of Fidelity Magellan Fund did brilliantly, but after 10 years or so, he retired because it became too difficult to keep up the pace. I've been managing our fund for 40 years and Edwin has been with me for 23 years, and we aren't stressed out yet and we hope we never will be.
>
> We do it our way for several reasons: it fits our personality; it avoids stress, and for me, I remember the Depression of the 1930s very clearly and how it affected our family." (Schloss, 1996, p. 2).

Diversification was important to Schloss as he would hold up to 100 stocks at once, with a maximum holding in one stock of not more than 20 percent of his portfolio. However, he would never put the same amount of capital in each stock. If he liked a particular stock, he would put money into it. He would put a little money in stock if he had slight reservations about it. He believed that sometimes you don't pay enough attention if you don't own stock. Generally speaking, he aspired to attain a 50 percent profit from his stocks before selling. If the stock's price dropped, but its fundamentals remained intact, he would purchase more.

> "Walter has diversified enormously, owning well over 100 stocks currently. He knows how to identify securities that sell at considerably less than their value to a private owner. And that's all he does. He doesn't worry about whether it it's January, he doesn't worry about whether it's Monday, he doesn't worry about whether it's an election year. He simply says, if a business is worth a dollar and I can buy it for 40 cents, something good may happen to me. And he does it over and over and over again. He owns many more stocks than I do — and is far less interested in the underlying

> nature of the business; I don't seem to have very much influence on Walter. That's one of his strengths; no one has much influence on him." (Buffett, 1984, p. 9).

When performing equity analysis, Schloss didn't care about market timing, nor did he speak with the management of companies, as he felt it clouded his judgment. When people asked him about the market, he would say their guess is as good as his. Walter never used a computer or the internet. Instead, he would solely rely on the numbers utilizing Value Line and annual reports.

> "Walter and Edwin never came within a mile of inside information. Indeed, they used "outside" information only sparingly, generally selecting securities by certain simple statistical methods Walter learned while working for Ben Graham. When Walter and Edwin were asked in 1989 by *Outstanding Investors Digest*, "How would you summarize your approach?" Edwin replied, "We try to buy stocks cheap."" (Buffett, 2006, p. 22).

> "He has no connections or access to useful information. Practically no one in Wall Street knows him and he is not fed any ideas. He looks up the numbers in the manuals and sends for the annual reports, and that's about it. He is a very family-oriented fellow: he probably spends more time thinking about children than about stocks." (Buffett, quoted by Smith, 2006, pp. 193-194).

> "I try to be removed from the day-to-day; I don't have a ticker-tape machine in my office… I can read the papers, and there's an office nearby where I can go and watch it, but basically, I try to stay away from the emotions of the market. The market is a very emotional place that appeals to fear and greed … all these unpleasant characteristics that people have. Making judgment is very difficult." (Walter Schloss, quoted by Welling, 1985, p. 6).

He wasn't fond of sitting on cash, but he would if he couldn't find anything worth buying. Schloss did not purchase any foreign companies as he saw it cumbersome to compare the financial statements and ratios with firms in the U.S., as they used differing reporting and accounting techniques. In terms of industries, he cautioned about anything that fell outside his circle of competence and felt much more comfortable dealing with older industries like manufacturing.

Like fellow Graham's disciples, Walter Schloss was also a contrarian investor. His name is synonymous with contrarian, intelligent, and successful investing. "We have found that if we are somewhat contrarian, we seem to do better than if we purchased companies that are doing well today." (Schloss, 1996, p. 2). Talking about value investing, which he was a lifetime follower and supporter of, Walter mentioned:

> "Basically, it's a contrarian philosophy, and people really like buying things that are doing well. But to make money, you have to spend a little time at it. It isn't just, "Oh, I think I'll buy this stock because it's got a nice name," or "my friend told me to buy it." This is business, like any other business." (Welling, 1985, p. 6).

When asked to summarize his investment approach, Walter mentioned that they try to buy stocks cheaply.

> "In the old days, Graham had a very good theory - you just buy below working capital and you don't worry too much about the business they're in – don't worry about management, earnings or anything else.
>
> Warren wants franchises and good businesses. We do too, but we're not willing to pay for them so we don't buy them. I guess we buy difficult businesses. As Warren would say, he likes to row downstream and we like to row upstream.
>
> Basically, we like to buy assets. Assets seem to change less than earnings. You could argue that assets are not always worth what they're carried for.
>
> And that's only one of the reasons why Edwin and I aren't wild about earnings. They can be manipulated – legally. If people are just looking at earnings, they may get a distorted view." (Schloss, 1989).

As market conditions changed, the Schlosses needed to adjust their criteria accordingly. As expected, when markets are very expensive, their definition of cheapness has to be somewhat more flexible. For example, with working capital stocks gone in the 1960s and 1970s, the Schlosses looked next at book value. They used to look for companies selling at half of the book. They looked for companies trading at two-thirds of the book if they weren't available. They even looked at companies selling at book value if this is unavailable. But they hardly ever paid over asset value unless it's a special situation or franchise. When asked whether their approach has changed significantly, Walter replied:

> "Yes, it's changed because the market's changed. I can't buy any working capital stocks anymore so instead of saying well I can't buy 'em, I'm not going to play the game, you have to decide what you want to do. And so we've decided that we want to buy stocks if we can that are depressed and have some book value and are not too, selling near to their lows instead of their highs and nobody likes them." (Walter Schloss, quoted by Grant 1999, p. 9).
>
> "Well, we look at book value, which is a little lowering of our standards, because book values have some good and bad features. You look at the history of the company and see where it stands, what's happened to it over the years." (Walter Schloss, quoted by Welling 1985, p. 20).

Although the supply of net net stocks was low, Walter Schloss was able to put Graham's principles to work by buying firms for less than the value of their realizable asset values: "You don't have to just look at book value. You can look at what you think companies are worth, if sold. Even if it isn't going to be sold. Are you getting a fair shake for your money?" (Walter Schloss, quoted by Welling 1985, p. 20).

4.4 Investment Performance

Table 1 provides Walter Schloss's performance as Warren Buffett presented in his 1984 article, *The Superinvestors of Graham-and-Doddsville*. Walter Schloss has run circles around the indexes. For 281/4 years, WJS Limited Partners generated an annual compounded rate of 16.1% when WJS Partnerships produced a yearly compound rate of 21.3% compared to S&P's 8.4% for the same period.

Table 1: Walter J. Schloss's Performance

Year	S&P Overall Gain, Including Dividends (%)	WJS Partners Overall Gain per year (%)	WJS Partnership Overall Gain per year (%)
1956	7.5	5.1	6.8
1957	-10.5	-4.7	-4.7
1958	42.1	42.1	54.6
1959	12.7	17.5	23.3
1960	-1.6	7.0	9.3
1961	26.4	21.6	28.8
1962	-10.2	8.3	11.1
1963	23.3	15.1	20.1
1964	16.5	17.1	22.8
1965	13.1	26.8	35.7
1966	-10.4	0.5	0.7
1967	26.8	25.8	34.4
1968	10.6	26.6	35.5
1969	-7.5	-9.0	-9.0
1970	2.4	-8.2	-8.2
1971	14.9	25.5	28.3
1972	19.8	11.6	15.5
1973	-14.8	-8.0	-8.0
1974	-26.6	-6.2	-6.2
1975	36.9	42.7	52.2
1976	22.4	29.4	39.2
1977	-8.6	25.8	34.4
1978	7.0	36.6	48.8
1979	17.6	29.8	39.7
1980	32.1	23.3	31.1
1981	-6.7	18.4	24.5
1982	20.2	24.1	32.1
1983	22.8	38.4	51.2
1984 1st Qtr.	-2.3	0.8	1.1
Standard & Poor's 28¼ year compounded gain			887.2%
WJS Limited Partners 28¼ year compounded gain			6,678.8%
WJS Partnership 28¼ year compounded gain			23,104.7%
Standard & Poor's 28¼ year annual compounded rate			8.4%
WJS Limited Partners 28¼ year annual compounded rate			16.1%
WJS Partnership 28¼ year annual compounded rate			21.3%
During the history of the Partnership it has owned over 800 issues and, at most times, has had at least 100 positions. Present assets under management approximate $45 million. The difference between returns of the partnership and returns of the limited partners is due to allocations to the general partner for management.			

Source: Buffett (1984, p. 6)

Again in his letter to the Graham gang in 2001, Warren Buffett discussed Walter Schloss's performance to the group:

> "Of Walter's partnership, however, there is much to be said. Over its lifetime, it had a gross return of 21% compounded annually (before the general partner's share) and achieved this return using only minor leverage and without ever running any risk of permanent loss of capital. The S&P delivered 11.2%. It is an astounding record." (Schloss, 2003, p. 69).

It seems Warren Buffett was obsessed with Walter's performance as he talked about the performance of Walter Schloss again in his 2006 letter to Berkshire shareholders:

> "From 1956 to 2002, Walter managed a remarkably successful investment partnership, from which he took not a dime unless his investors made money… Following a strategy that involved no real risk – defined as permanent loss of capital – Walter produced results over his 47 partnership years that dramatically surpassed those of the S&P 500. It's particularly noteworthy that he built this record by investing in about 1,000 securities, mostly of a lackluster type. A few big winners did not account for his success." (Buffett, 2006, p. 22).

"For 45 years, from 1955 through 2000, Walter Schloss has managed the same investment partnership. The compound rate of return for his Limited Partners was 721.5x or 15.7% per year compared to a gain for the S&P 500 Industrial Average of 117.5x or 11.2% per year." (Rabinowich, 2003, p. 5). Walter and his son, Edwin, beat the market by about 5% over 45 years, a feat that not many money managers have accomplished before. Quite impressive for a guy who didn't attend college.

Table 2 presents Walter & Edwin Schloss Associates' annual return figures and those of the S&P 500 for each of the 45 years that ended December 31st, 2002. All performance figures were provided by Walter & Edwin Schloss Associates, LP.

Table 2: Results of Walter & Edwin Schloss Associates Compared to Standard & Poor's Industrial Average

Year Ended Dec 31st	Associates Net Asset Value After Yearly Payments on 1 Unit	Years 1956-2002			S&P Industrial Gain Per Year Including Dividends	Industrial Average at Year End
		Total Distributed Annually Per Year in Percent	Ltd Partners Overall Gain Per Year in Percent	Associates Overall Gain in %		
1955	$ 5,082.50					48.44
1956	5,034.85	$ 306.28	+5.1%	+6.8%	+7.5%	50.08
1957	4,423.30	377.10	-4.7%	-4.75%	-10.5%	42.66
1958	5,667.90	617.85	+42.1%	+54%	+42.1%	58.97
1959	5,954.50	704.04	17.5%	23.35	12.7%	64.50
1960	5,909.33	463.50	7.0%	9.3%	-1.65%	61.49
1961	6,012.30	1,170.90	21.65%	28.8%	+26.4%	75.72
1962	6,185.93	323.50	8.3%	11.1%	-10.2%	66.00

1963	6,272.18	846.66	15.1%	20.1%	23.3%	79.25
1964	6,440.56	902.06	17.1%	22.8%	16.5%	89.62
1965	6,905.14	1,263.38	26.8%	35.7%	13.1%	98.47
1966	6,192.35	749.78	0.5%	0.7%	-10.4%	85.24
1967	6,695.30	1,094.66	25.8%	34.4%	+26.8%	105.11
1968	7,372.94	1,103.60	26.6%	35.55%	10.6%	113.03
1969	6,103.80	606.20	-9.0%	-9.0%	-7.5%	101.45
1970	5,483.85	119.90	-8.2%	-8.2%	+2.4%	100.90
1971	6,426.60	453.00	+25.5%	+28.3%	14.9%	112.75
1972	6,761.94	407.52	11.6%	15.5%	19.8%	131.87
1973	5,728.52	492.12	-8.0%	-8.0%	-14.8%	109.14
1974	4,978.37	391.96	-6.2%	-6.2%	-26.6%	76.47
1975	6,640.00	461.80	+42.7%	+52.2%	+36.9%	100.88
1976	7,799.00	793.03	29.4%	39.2%	22.4%	119.46
1977	9,074.00	734.34	25.8%	34.4%	-8.6%	104.73
1978	11,166.00	1,233.40	36.6%	48.8%	+7.0%	107.23
1979	11,462.00	3,036.36	29.8%	39.7%	17.6%	121.02
1980	10.200.00	3,932.00 *	23.3%	31.1%	32.1%	154.45
1981	10,026.00	2,046.00	18.35%	24.5%	-6.7%	137.12
1982	10,718.00	1,728.00	24.1%	32.1%	+20.2%	157.62
1983	12,512.00	2,322.00	38.4%	51.2%	22.8%	186.24
1984	11,480.00	1,820.00	6.3%	8.4%	4.1%	186.36
1985	11,336.00	2,380.00	19.5%	25.0%	30.0%	234.56
1986	10,382.00	2,306.60	11.9%	15.9%	18.5%	269.93
1987	10,848.00	1,632.00	20.2%	26.9%	9.1	285.86
1988	11,916.00	2,161.00	29.8%	39.7%	15.8%	321.26
1989	10,848.00	1,334.00	2.2%	2.9%	29.1%	403.49
1990	9,332.00	206.00	-12.8%	-12.8%	-3.4%	387.42
1991	10,518.00	1,714	+31.1%	+37.3%	+29.1%	497.72
1992	10,650.00	840.00	9.2%	12.3%	4.6%	507.46
1993	11,828.00	974.00	20.2%	26.9%	9.0%	540.19
1994	12,434.00	746.00	11.4%	15.2%	3.8%	547.51
1995	13,438.00	1,626.00	21.2%	28.3%	34.3%	721.19
1996	13,317.00	2,352.00	16.6%	22.1%	22.9%	869.97
1997	13,303.00	3,022.12	22.6%	30.1%	30.8%	1,121.38
1998	10,388.00	2,328.00	-4.4%	-5.9%	33.4%	1,479.16
1999	10,938.00	1,889.50	23.5%	29.8%	25.7%	1,841.92
2000	11,660.00	2,337.00	28.0%	37.3%	-16.2%	1527.86
2001	7,037.17	6,000.00 **	11.8%	14.75%	-11.7%	1,333.94
2002	1,935.58	5,500.00 ***	5.7%	7.6%	-23.4%	1,005.99

* In 1980, $1500 of our distribution was a return of capital.
** In 2001, 44,017.94 was a return of capital out of the $6,000 distribution.
*** In 2002, $4,789.73 was a return of capital out of $5,500.

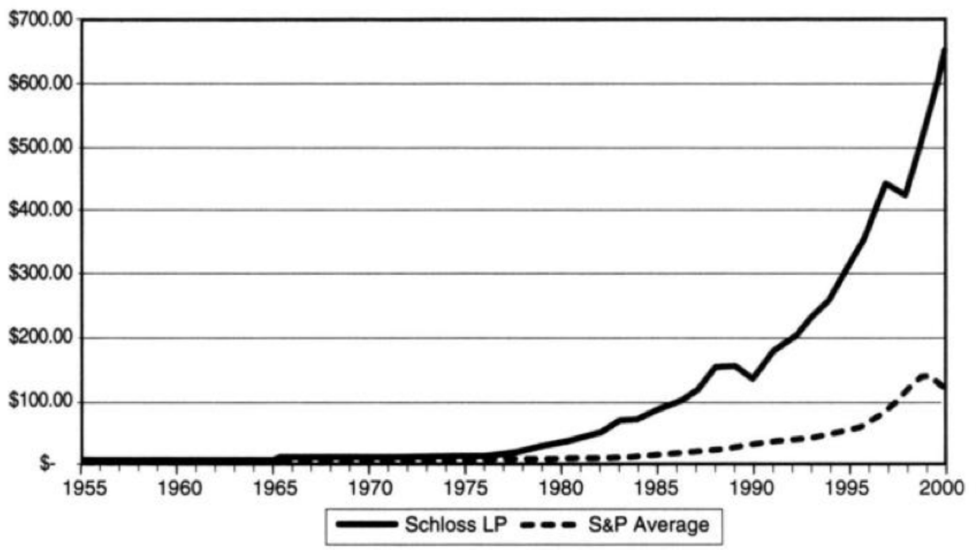
Source: 47 Year Results of Walter & Edwin Schloss Associates, Retrieved from https://static1.squarespace.com/static/5886cbc4a5790a5c18741c5a/t/5d8a8e012e8cee749cb66e38/1569361410853/47+Year+Results+of+Walter+%26+Edwin+Schloss+Associates.pdf

Walter Schloss was very proud of his results, particularly those in the last few years; even when the stock market tanked, he did very well for their partners. In a letter to fellow Ben Graham disciples, Warren Buffett talked about Walter's performance: "Walter has had five down years compared to seven for the S&P. His superiority in such down years would indicate that not only is he a man for all seasons, but that he has special strength when facing a headwind. Maybe all of you had better watch Ben Graham on Wall Street Week this Friday." (Buffett, 1976).

Among Schloss' extremely successful track record during this period (see Table 2), I paid close attention to the down years such as 1957, 1962, 1966, 1969, 1973, and 1974, when the market indices were down by more than Walter's partnerships with an exception to 1969. For example, in 1974, when the market was down by more than 26 percent, Walter Schloss was down only by 6 percent. However, in 1977 when the market was down by more than 8 percent, Walter Schloss was up by 24 percent (Limited partners overall) and 34 percent (Associates overall). During the dot-com bubble, in 2000, for example, Walter Schloss returned 28 percent (Limited partners overall) and 34 percent (Associates overall) when the market tanked by more than 16 percent.

To illustrate how well he performed against the market, the figure below shows how a dollar invested in Walter's firm in 1956 compares to a dollar invested in the S&P 500.

Figure 1: Value of $1.00 Invested in the Schloss partnership versus the S&P Industrial Index, 1956-2000



Source: Greenwald, Kahn, Sonkin and Biema (2004, p. 264)

> "Every dollar a fortunate investor entrusted with Schloss at the start of 1956 had grown to $662 by the end of 2000, including all charges for management (see Figure 15.1, figure 5 above). A dollar invested in the S&P Index would have been worth $118. The Schlosses' accomplishment is even better than this initial comparison suggests. Over that entire 45-year period, their portfolio had seven years in which it lost money; the S&P Index had 11. The average loss in the Schloss partnership was 7.6 per cent; in the S&P, 10.6 per cent." (Greenwald, Kahn, Sonkin and Biema, 2004, pp. 263-264).

Walter understood well that he was not the world's best investor, nor did he strive to be. He also knew that to beat the market consistently was nearly impossible. Thus, Walter always stuck to what he knew, understood, and purchased stocks aligned with his value-oriented style. Walter believed that the power of compounding would take care of the rest by doing this.

Over two decades, Walter had returns that were 1.4 percent per year lower than his friend Warren Buffett. Walter knew he wasn't Warren and never tried to duplicate or mimic his overall strategy. He just continually focused on himself and stayed within his circle of competence.

Despite this, Walter still performed exceptionally well when compared to his peers. Looking at the years between 1962 to 1975, one can see in table 3 that Walter produced an annualized return of 16.1 percent, which is just 3.7 percent lower than Charlie Munger and 7.4 percent lower than Warren Buffett. Although his returns were much more erratic than the others, the power of compounding can be seen in his overall performance.

Table 3: Performance Comparison among Walter Schloss, Warren Buffett and Charlie Munger

	Buffett	**Munger**	**Schloss**	**Dow**
1962	13.9%	30.1%	11.1%	-7.6%
1963	38.7%	71.7%	20.1%	20.6%
1964	27.8%	49.7%	22.8%	18.7%
1965	47.2%	8.4%	35.7%	14.2%
1966	20.4%	12.4%	0.7%	-15.6%
1967	35.9%	56.2%	34.4%	19.0%
1968	58.8%	40.4%	35.5%	7.7%
1969	16.2%	28.3%	-9.0%	-11.6%
1970	12.0%	-0.1%	-8.2%	8.7%
1971	16.4%	25.4%	28.3%	9.8%
1972	21.7%	8.3%	15.5%	18.2%
1973	4.7%	-31.9%	-8.0%	-13.1%
1974	5.5%	-31.5%	-6.2%	-23.1%
1975	21.9%	73.2%	52.2%	44.4%
Annualized	**23.5%**	**19.8%**	**16.1%**	**4.9%**
Best Year	58.8%	73.2%	52.2%	44.4%
Worst Year	4.7%	-31.9%	-9.0%	-23.1%
Positive Years	14	11	10	9
Negative Years	0	3	4	5
Beat Market Years	13	9	3	-
Lose Market Years	1	5	11	-

Source: Huber (2013)

Despite his stellar performance, Walter Schloss was a remarkable man. Out of Ben Graham's many disciples, Warren Buffett liked Walter the most:

> "… Warren did manage to find reasons, however, to drop in on his new acquaintance, Walter Schloss, down at the Graham-Newman Corporation. He got to know Schloss better and learned he was caring for a wife who had been suffering from depression throughout most of their marriage. Schloss, like David Dodd, appeared to be remarkably loyal and steadfast, qualities that Buffett sought out in people. He also envied Schloss his job …" (Schroeder, 2008, p. 149).

In response, Walter Schloss also trusted his very good friend, Warren Buffett:

> "One day not long after, Buffett called Walter Schloss, saying, "You know, Walter, I have these small positions in five different companies, and I'll sell them to you." These were Jeddo-Highland Coal, Merchants National Property, Vermont Marble, Genesee & Wyoming Railroad, and another whose name is lost in time. "Well, what price would you want, Warren?" Schloss asked. "I'll sell them to you at the price that I'm carrying them at," Buffett said. "Okay, I'll buy them from you," said Schloss immediately. "I didn't say, 'Well, you know, you have to look up each one and check what it's worth,'" Schloss says. "I trusted Warren." (Schroeder, 2008, p. 246).

Investors today can learn a great deal from the legacy left behind by Walter Schloss. Fortunately, he left all his business papers, Schloss Family Business papers 1957-2003, at Columbia University Libraries Rare Book & Manuscript Library (Butler Library). This collection documents the business and legal activities of Walter J. Schloss and his company, Walter & Edwin Schloss Associates, from the late 1950s through the early 2000s. It also contains lectures and writings by and about his mentor, Benjamin Graham, and personal correspondence with Ben Graham and his friend Warren Buffett.

5.0 Conclusion

The unconditional and unchanging support for Graham's views on investment came from the success of many of his disciples, notably Warren Buffett, not from academia. As Buffett (1984) mentioned, although they followed diverse paths in managing money, they beat the market consistently. In the original study, we covered five Ben Graham disciples. This article discussed Walter J. Schloss of Walter & Edwin Schloss Associates, his investment approach, and performance.

Here are a few notable observations from the original study. Apart from a stellar performance record, almost all of Ben Graham's disciples studied believed that investment is not science. Both Irving Kahn and Walter Schloss talked about it. Also, in the business, Irving Kahn and Walter Schloss partnered with their sons, Thomas Kahn and Edwin Schloss. Some of them also made changes to their investment philosophies. For example, when he noticed that there were practically no working capital stocks during the 1960s and 1970s, Walter Schloss moved from working capital to book value. Very recently, Warren Buffett dropped book value altogether in reporting Berkshire Hathaway's long-term performance. However, they still adhered to the central value principles.

One can argue that when book value has lost all its mojos in today's market, Walter Schloss will be out of business. We should note that over four and a half decades of managing money, Walter Schloss has delivered an annual return of 15.3% versus 10% for the S&P 500, a feat matched by a handful of investors. He achieved this remarkable record with a deceptively simple strategy (see Appendix C and D). Individual investors can learn a great deal by studying the investment philosophies of Walter J. Schloss (see Appendix F for his scholarly contributions).

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Appendix A: Ben Graham's Disciples

From The Superinvestors of Graham-and-Doddsville by Warren Buffett (1984)

Walter J. Schloss (WJS Limited Partners)
Tom Knapp (TBK Limited Partners)
Warren Buffett (Buffett Partnerships, Ltd.)
William J. Ruane (Sequoia Fund, Inc.)
Charles Munger (Charles Munger, Ltd.)
Rick Guerin (Pacific Partners, Ltd.)
Stan Perlmeter (Perlmeter Investments, Ltd.)
Washington Post Master Trust (managed by three different managers)
FMC Corp. Pension Fund (managed by eight different managers)

From The Legacy of Benjamin Graham: The Original Adjunct Professor, Heilbrunn Center for Graham and Dodd Investing, Columbia Business School (February 1, 2013)

Warren Buffett (Former student)
Marshall Weinberg (Former student)
Henry Schneider (Former student)
Irving Kahn (Former student/Teaching Assistant)
Charles Brandes (Former Mentee)

From Damn Right!: Behind the Scenes with Berkshire Hathaway Billionaire Charlie Munger by Janet Lowe (p. 77)

Bill Ruane (Sequoia Fund)
Tom Knapp (Tweedy, Browne)
Walter Schloss
Henry Brandt
David "Sandy" Gottesman
Marshall Weinberg
Ed Anderson
William (Buddy) Fox
Jack Alexander

From Lessons from the Legends of Wall Street: How Warren Buffett, Benjamin Graham, Phil Fisher, T. Rowe Price, and John Templeton Can Help You Grow Rich by Nikki Ross (2000, p. 52)

John Spears
Chris and Will Browne (the managing directors of Tweedy, Browne)

From Supermoney by Adam Smith (1972, p. 2000)

Herbert (took a Graham course at night at the Institute of Finance)

From Value Investing: From Graham to Buffett and Beyond by Bruce C. N. Greenwald, Judd Kahn, Paul D. Sonkin and Michael van Biema (2004)

Warren Buffett
Robert Heilbrunn (enrolled in Graham's course as a nondegree student)
Walter Schloss

From The Einstein of Money: The Life and Timeless Financial Wisdom of Benjamin Graham by Joe Carlen (2012)

Warren Buffett
Tom Knapp (Graham-Newman employee)
Walter Schloss
Irving Kahn
Thomas Kahn (son of Irving Kahn, who assisted Graham with the 1973 edition of *The Intelligent Investor*)
Bill Ruane (took classes at Columbia or the New York Institute of Finance)
Charles Brandes (Ben personally tutored him)
Ed Anderson (Graham-Newman employee)
Fred Stanback (Warren's classmate)

From The Financial Times Guide to Value Investing: How to Become a Disciplined Investor (2nd edition) by Glen Arnold (2012)

Sidney Robbins (University of Toledo, updated *Security Analysis*)

From Benjamin Graham and Security Analysis: A Reminiscence by Walter J. Schloss (1976)

Gus Levy

Appendix B: Compiled List in Alphabetic Order

1. Charles Brandes (Former Mentee)
2. Charles Munger (Charles Munger, Ltd.)
3. Chris Browne (Tweedy, Browne Co.)
4. Conrad Taff (private investor, Warren Buffett's classmate at Columbia who convinced Paul Samuelson to buy Berkshire's stock)
5. David "Sandy" Gottesman (Berkshire director, founder First Manhattan Co.)
6. Ed Anderson (Tweedy, Browne Co.)
7. FMC Corp. Pension Fund (managed by eight different managers)
8. Fred Stanback (Warren's classmate)
9. Gus Levy (Senior partner of Goldman Sachs)
10. Henry Brandt (Ruane, Cunniff)
11. Henry Schneider (Former student)
12. Herbert
13. Irving Kahn (Former student/Teaching Assistant, Kahn Brothers)
14. Jack Alexander (Warren Buffett's classmate at Columbia)
15. John Spears (Tweedy, Browne Co.)
16. Marshall Weinberg (Brokerage firm, Gruntal & Co.)
17. Rick Guerin (Pacific Partners, Ltd.)
18. Robert Heilbrunn (enrolled in Graham's course as a nondegree student)
19. Dr. Sidney Robbins (Professor of Finance, Columbia University and University of Toledo)
20. Stan Perlmeter (Perlmeter Investments, Ltd.)
21. Tom Knapp (TBK Limited Partners)
22. Thomas Kahn (Irving Kahn's son, Kahn Brothers)
23. Walter J. Schloss (WJS Limited Partners)
24. Warren Buffett (Buffett Partnerships, Ltd.)
25. Washington Post Master Trust (managed by three different managers)
26. Will Browne (Tweedy, Browne, Co.)
27. William (Buddy) Fox
28. William J. Ruane (Sequoia Fund, Inc.)

Appendix C: Factors Needed to Make Money in the Stock Market

Factors needed to make money in the stock market

1. Price is the most important factor to use in relation to value.
2. Try to establish the value of the company. Remember that a share of stock represents a part of a business and is not just a piece of paper.
3. Use book value as a starting point to try and establish the value of the enterprise. Be sure that debt does not equal 100% of the equity. (Capital and surplus for the common stock).
4. Have patience. Stocks don't go up immediately.
5. Don't buy on tips or for a quick move. Let the professionals do that, if they can. Don't sell on bad news.
6. Don't be afraid to be a loner buy be sure that you are correct in your judgment. You can't be 100% certain but try to look for weaknesses in your thinking. Buy on a scale and sell on a scale up.
7. Have the courage of your convictions once you have made a decision.
8. Have a philosophy of investment and try to follow it. The above is a way that I've found successful.
9. Don't be in too much of a hurry to sell. If the stock reaches a price that you think is a fair one, then you can sell but often because a stock goes up say 50%, people say sell it and button up your profit. Before selling try to reevaluate the company again and see where the stock sells in relation to its book value. Be aware of the level of the stock market. Are yields low and P-E ratios high. If the stock market historically high. Are people very optimistic etc.?
10. When buying a stock, I find it helpful to buy near the low of the past few years. A stock may go as high as 125 and then decline to 60 and you think it attractive. 3 years before the stock sold at 20 which shows that there is some vulnerability in it.
11. Try to buy assets at a discount than to buy earnings. Earnings can change dramatically in a short time. Usually assets change slowly. One has to know much more about a company if one buys earnings.
12. Listen to suggestions from people you respect. This doesn't mean you have to accept them. Remember it's your money and generally it is harder to keep money than to make it. Once you lose a lots of money it is hard to make it back.
13. Try not to let your emotions affect your judgment. Fear and greed are probably the worst emotions to have in connection with the purchase and sale of stocks.
14. Remember the work compounding. For example, if you can make 12% a year and reinvest the moneyback, you will double your money in 6 yrs, taxes excluded. Remember the rule of 72. Your rate of return into 72 will tell you the number of years to double your money.
15. Prefer stocks over bonds. Bonds will limit your gains and inflation will reduce your purchasing power.
16. Be careful of leverage. It can go against you.

Source: Schloss, W.J. (1994, March 10). On Common Stocks. Retrieved from https://www8.gsb.columbia.edu/sites/valueinvesting/files/files/Factors%20neede%20to%20make%20money%20in%20the%20stock%20market.pdf

Appendix D: What Kind of Stocks Do We Look at For Investments?

What kind of stocks do we look at for investments?

We look for stocks that are depressed.
Why are they depressed?
Are they selling below book value?
Is good will in book value?
What has been the high low over the past 10 years?
Have they any cash flow?
Have they any net income?
How have they done over the past 10 years?
What is their debt level?
What kind of an industry are they in?
What is their profit margins?
How are their competitors doing?
Is this company doing poorly compared to its competitors?
What appears to be the risk on the downside vs. the upside potential?
How much stock do the insiders own?

Based on the above factors and perhaps a few other items, if the figures look satisfactory, we will take an initial position. We will watch the action of the stock and decide how much more we may want. It will depend a good deal on price.
Generally we are happy with a 5% holding but we can go up to 10-125 if we really like it a lot. Since we own some 60-75 stocks, we have small holdings in a number of securities. One reason for this is that while selling a stock, it goes down so that we end of holdings some of its shares. Sometimes when buying a stock it goes up and we don't want to follow it up so we stop buying it. On the whole we are allergic to bonds.

Source: Schloss, W.J. (1993, November 17). Columbia Business School Upper Level Seminar in Value Investing. Retrieved from http://www.grahamanddoddsville.net/wordpress/Files/Gurus/Walter%20Schloss/Schloss%2520Seminar%2520at%2520CBC.pdf

Appendix E: Schloss Partnership Agreement

STATE OF NEW YORK)
: SS:
COUNTY OF NEW YORK)

WE, the undersigned, being desirous of forming a Limited Partnership, pursuant to the laws of the State of New York, and being severally dully sworn, do certify, as follows:

1. The name of the partnership is WALTER J. SCHLOSS ASSOCIATES.
2. The character of the partnership's business is investments, buying, and selling and investing in stocks, bonds and securities of all kinds on its own account, but shall not act as dealer or broker, not engage in any brokerage business.
3. The principal place of business of the copartnership is 41 East 42nd Street, City, County, and State of New York.
4. The name and place of residence of each General Partner is as follows:

Name	Residence	Cash Contributed
Evelyn E. Altheimer	1 E. 74th Street NYC	$5,000
Meier Bernstein	42 Livingston St., Bklyn, NY	$5,000
Ethel Frankel	30 E. 72nd Street NYC	$5,000
Frankel Enterprises	135 Madison Ave., NYC	$5,000
Rudolph Goldsmith	27 Earlewood Drivee, White Plains, NY	$5,000
Pauline Gomprecht	156 W. 86th Street, NYC	$5,000
George M. Kates	5 Hathaway Lane, White Plains, NY	$10,000
Louis E. Kates	37 Stratton Road, Scarsdale, NY	$5,000
Paul W. Kates	129 Soundview Ave., White Plains, NY	$5,000
William Kruskal	1227 E. 54th Street, Chicago 15, Ill.	$5,000
Henry Lemaire	133 Reldyes Ave., Leonia, N.J.	$5,000
Mortimer Lerner	511 E. 20th Street, NYC	$5,000
Carl T. Middendorf	3521 N. 22nd St., Phila., Pa.	$5,000
James M. Rosen	40 Stimson Rd., New Haven, Conn.	$5,000
Edith M. Scheurer and Henry Scheurer	23 W. 73rd Street, NYC	$5,000
Walter J. Schloss	441 E. 20th Street, NYC	$5,000
Irving Siegel	22 Hampton Road, Scarsdale, NY	$5,000
Dr. David Steinbaum	789 Avenue C, Bayonne, N.J.	$5,000
H. A. Trichon	7603 Woodlawn Ave., Phila., Pa.	$5,000

5. The term for which the partnership is to exist is from July 1, 1955 to December 31, 1960. Upon the death, retirement or insanity of a General Partner, the remaining General Partner shall continue the partnership business solely for liquidation, unless the Limited Partners unanimously agree in writing that the partnership continue. The death or insanity of a Limited Partner shall not terminate the partnership and his

personal representative shall have the same rights hereunder and shall be subject to the previous thereof.

6. No property other than cash is to be contributed by the Limited Partners and the amount of cash contributed by them as above stated.
7. The contribution of each Limited Partner is to be returned upon the happening of any of the following events:
   (a) On termination or dissolution of the partnership; or
   (b) At the end of any year upon written notice to the partnership on or before December 1st of any year.
8. The share of the profits or other compensation by way of income which the Limited Partners shall receive by reason of their contributions, is as follows: 75% of the realized net profits of the business (including dividends and interests received); the General Partners, aside from their capital contributions, shall receive 25% of the realized net profits to be divided between them as they may agree; any net loss shall be debited to each partner in proportion to his respective capital contribution.
9. No Limited Partner shall have the right to substitute an assignee as contributor in his place and stead.
10. The General Partners may admit additional Limited Partners and may receive additional capital contributions from the Limited Partners.
11. In the event of the termination or dissolution of the partnership or the withdrawal of any Limited Partner, his interest in the partnership shall be returned to him in cash, as provided in the partnership agreement, and he shall not be entitled to demand and receive property other than cash in return for his contribution.

Dated: July 1st, 1955

Source: Schloss Partnership Agreements; Schloss Family Business Papers; Box 9; Rare Book and Manuscript Library, Columbia University Library.

Appendix F: Articles, Books and Interviews by Walter Schloss

Articles

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Book

Schloss, W.J. (2003). *The Memoirs of Walter J. Schloss: A Personal and Family Story*. New York, NY: September Press

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Schloss, W.J. (1971). Letter to the Limited Partners, January 6
Schloss, W.J. (1971). Letter to the Limited Partners, January 7
Schloss, W.J. (1971). Letter to the Limited Partners, January 8
Schloss, W.J. (1971). Letter to the Limited Partners, January 12

Schloss, W.J. (1972). Letter to the Limited Partners, January 7
Schloss, W.J. (1972). Letter to the Limited Partners, January 11
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