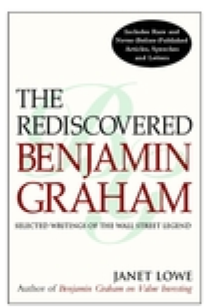
THE REDISCOVERED BENJAMIN GRAHAM *Lectures*

Lecture Number Six

This is a transcript of a lecture from the series ***Current Problems in Security Analysis*** presented by **Benjamin Graham** at the **New York Institute of Finance** from **September 1946 to February 1947**. This content is found in abridged form in *The Rediscovered Benjamin Graham: Selected Writings of the Wall Street Legend* (Wiley, April 1999) by Janet Lowe. Alternatively, full html versions for all ten lectures are available on the publisher's website.



The first thing that I want to make clear in any attempt to obtain a view as to future earnings, either in general or in particular, is that the analyst is not really trying to look into the crystal ball and come out with the correct answer for the period of time that he is forecasting. What he is really trying to do is to determine how the analyst should act and think -- that is, how far he can go in logical thinking with respect to the always enigmatic future.

I don't believe any of us have the pretension of believing that by being very good analysts, or by going through very elaborate computations, we can be pretty sure of the correctness of our results. The only thing that we can be pretty sure of, perhaps, is that we are acting reasonably and intelligently. And if we are wrong, as we are likely to be, at least we have been intelligently wrong and not unintelligently wrong. (Laughter.)

*** In a study of fourteen companies which I made -- mainly those that appeared in the Dow-Jones Average, either before or after 1914 -- I found that seven of them showed larger earnings in the post-war period than before the war, six of them showed lower average earnings, and one of them was even. That one, incidentally was United States Steel, which had widely fluctuating earnings in the period after the war, but which averaged in those five years the same figure as it did in the preceding three.

Those results were not as satisfactory as they should have been, because in that period we had the very serious depression of 1920 to 1922; and the effect of depressed conditions was to reduce the average earnings well below what they would have been if we had had a level period of national income. You recall that the figure of $62-billion, which I gave you, was an average national income for the five years. But there were rather wide fluctuations from year to year, and the effect on earnings as a whole was bad. You do not gain as much from periods of unusual prosperity as you lose in periods of depression when you are in business. That is almost an axiom.

*** I am more and more impressed with the possibilities of history's repeating itself on many different counts. You don't get very far in Wall Street with the simple, convenient conclusion that a given level of prices is not too high. It may be that a great deal of water will have to go over the dam before a conclusion of that kind works itself out in terms of satisfactory experience. That is why in this course we have tried to emphasize as much as possible the obtaining of specific insurance against adverse developments by trying to buy securities that are not only not too high but that, on the basis of analysis, appear to be very much too low. If you do that, you always have the right to say to yourself that you are out of the security market, and you are an owner of part of a company on attractive terms. It is a great advantage to be able to put yourself in that psychological frame of mind when the market is not going the way you would like.

*** There are great advantages in dealing with a group valuation, because you are more likely to be nearly accurate, I am sure, when you are considering a number of components together -- in which your errors are likely to cancel out -- than when you are concentrating on an individual component and may go very wide of the mark in that one.

Furthermore, there is nothing to prevent the investor from dealing with his own investment problems on a group basis. There is nothing to prevent the investor from actually buying the Dow-Jones Industrial Average, though I never heard of anybody doing it. It seems to me it would make a great deal of sense if he did.

When we talk about buying bargain issues, for example, the emphasis on group operation becomes even greater, because you then get into what could practically be know as an insurance type of operation. Here you have an edge, apparently, on each individual company. That advantage may conceivably disappear or not be realized in the individual case; but if you are any good at all as an analyst you ought to realize that advantage in the group. And so I have had a great partiality for group operations and group analysis. I must say, however, that you gentlemen, as functioning security analysts, advisers to the multitude, and so on, are unable to obtain that advantage in all the work you do. For I am sure you are compelled to reach rather definite conclusions about individual companies, and can't hide them in a group result.