Preface to the Fourth Edition, by Warren E. Buffett

I read the first edition of this book early in 1950, when I was nineteen. I thought then that it was by far the best book about investing ever written. I still think it is.

To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insights, or inside information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework. This book precisely and clearly prescribes the proper framework. You must supply the emotional discipline.

If you follow the behavioral and business principles that Graham advocates—and if you pay special attention to the invaluable advice in Chapters 8 and 20—you will not get a poor result from your investments. (That represents more of an accomplishment than you might think.) Whether you achieve outstanding results will depend on the effort and intellect you apply to your investments, as well as on the amplitudes of stock-market folly that prevail during your investing career. The sillier the market's behavior, the greater the opportunity for the business-like investor. Follow Graham and you will profit from folly rather than participate in it.

To me, Ben Graham was far more than an author or a teacher. More than any other man except my father, he influenced my life. Shortly after Ben's death in 1976, I wrote the following short remembrance about him in the *Financial Analysts Journal.* As you read the book, I believe you'll perceive some of the qualities I mentioned in this tribute.

BENJAMIN GRAHAM
1894–1976

Several years ago Ben Graham, then almost eighty, expressed to a friend the thought that he hoped every day to do "something foolish, something creative and something generous."

The inclusion of that first whimsical goal reflected his knack for packaging ideas in a form that avoided any overtones of sermonizing or self-importance. Although his ideas were powerful, their delivery was unfailingly gentle.

Readers of this magazine need no elaboration of his achievements as measured by the standard of creativity. It is rare that the founder of a discipline does not find his work eclipsed in rather short order by successors. But over forty 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.

A remarkable aspect of Ben's dominance of his professional field was that he achieved it without that narrowness of mental activity that concentrates all effort on a single end. It was, rather, the incidental by-product of an intellect whose breadth almost exceeded definition. Certainly I have never met anyone with a mind of similar scope. Virtually total recall, unending fascination with new knowledge, and an ability to recast it in a form applicable to seemingly unrelated problems made exposure to his thinking in any field a delight.

But his third imperative—generosity—was where he succeeded beyond all others. I knew Ben as my teacher, my employer, and my friend. In each relationship—just as with all his students, employees, and friends—there was an absolutely open-ended, no-scores-kept generosity of ideas, time, and spirit. If clarity of thinking was required, there was no better place to go. And if encouragement or counsel was needed, Ben was there.

Walter Lippmann spoke of men who plant trees that other men will sit under. Ben Graham was such a man.

Reprinted from the *Financial Analysts Journal,* November/December 1976.

A Note About Benjamin Graham by Jason Zweig

Who was Benjamin Graham, and why should you listen to him?

Graham was not only one of the best investors who ever lived; he was also the greatest practical investment thinker of all time. Before Graham, money managers behaved much like a medieval guild, guided largely by superstition, guesswork, and arcane rituals. Graham's *Security Analysis* was the textbook that transformed this musty circle into a modern profession.[1]

And *The Intelligent Investor* is the first book ever to describe, for individual investors, the emotional framework and analytical tools that are essential to financial success. It remains the single best book on investing ever written for the general public. *The Intelligent Investor* was the first book I read when I joined *Forbes* Magazine as a cub reporter in 1987, and I was struck by Graham's certainty that, sooner or later, all bull markets must end badly. That October, U.S. stocks suffered their worst one-day crash in history, and I was hooked. (Today, after the wild bull market of the late 1990s and the brutal bear market that began in early 2000, *The Intelligent Investor* reads more prophetically than ever.)

Graham came by his insights the hard way: by feeling firsthand the anguish of financial loss and by studying for decades the history and psychology of the markets. He was born Benjamin Grossbaum on May 9, 1894, in London; his father was a dealer in china dishes and figurines.[2] The family moved to New York when Ben was a year old. At first they lived the good life—with a maid, a cook, and a French gov-

[1] Coauthored with David Dodd and first published in 1934.

[2] The Grossbaums changed their name to Graham during World War I, when German-sounding names were regarded with suspicion.

erness—on upper Fifth Avenue. But Ben's father died in 1903, the porcelain business faltered, and the family slid haltingly into poverty. Ben's mother turned their home into a boardinghouse; then, borrowing money to trade stocks "on margin," she was wiped out in the crash of 1907. For the rest of his life, Ben would recall the humiliation of cashing a check for his mother and hearing the bank teller ask, "Is Dorothy Grossbaum good for five dollars?"

Fortunately, Graham won a scholarship at Columbia, where his brilliance burst into full flower. He graduated in 1914, second in his class. Before the end of Graham's final semester, three departments—English, philosophy, and mathematics—asked him to join the faculty. He was all of 20 years old.

Instead of academia, Graham decided to give Wall Street a shot. He started as a clerk at a bond-trading firm, soon became an analyst, then a partner, and before long was running his own investment partnership.

The Internet boom and bust would not have surprised Graham. In April 1919, he earned a 250% return on the first day of trading for Savold Tire, a new offering in the booming automotive business; by October, the company had been exposed as a fraud and the stock was worthless.

Graham became a master at researching stocks in microscopic, almost molecular, detail. In 1925, plowing through the obscure reports filed by oil pipelines with the U.S. Interstate Commerce Commission, he learned that Northern Pipe Line Co.—then trading at $65 per share—held at least $80 per share in high-quality bonds. (He bought the stock, pestered its managers into raising the dividend, and came away with $110 per share three years later.)

Despite a harrowing loss of nearly 70% during the Great Crash of 1929–1932, Graham survived and thrived in its aftermath, harvesting bargains from the wreckage of the bull market. There is no exact record of Graham's earliest returns, but from 1936 until he retired in 1956, his Graham-Newman Corp. gained at least 14.7% annually, versus 12.2% for the stock market as a whole—one of the best long-term track records on Wall Street history.[3]

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[3] Graham-Newman Corp. was an open-end mutual fund (see Chapter 9) that Graham ran in partnership with Jerome Newman, a skilled investor in his own right. For much of its history, the fund was closed to new investors. I am

How did Graham do it? Combining his extraordinary intellectual powers with profound common sense and vast experience, Graham developed his core principles, which are at least as valid today as they were during his lifetime:

- A stock is not just a ticker symbol or an electronic blip; it is an ownership interest in an actual business, with an underlying value that does not depend on its share price.
- The market is a pendulum that forever swings between unsustainable optimism (which makes stocks too expensive) and unjustified pessimism (which makes them too cheap). The intelligent investor is a realist who sells to optimists and buys from pessimists.
- The future value of every investment is a function of its present price. The higher the price you pay, the lower your return will be.
- No matter how careful you are, the one risk no investor can ever eliminate is the risk of being wrong. Only by insisting on what Graham called the "margin of safety"—never overpaying, no matter how exciting an investment seems to be—can you minimize your odds of error.
- The secret to your financial success is inside yourself. If you become a critical thinker who takes no Wall Street "fact" on faith, and you invest with patient confidence, you can take steady advantage of even the worst bear markets. By developing your discipline and courage, you can refuse to let other people's mood swings govern your financial destiny. In the end, how your investments behave is much less important than how you behave.

The goal of this revised edition of *The Intelligent Investor* is to apply Graham's ideas to today's financial markets while leaving his text entirely intact (with the exception of footnotes for clarification).[4] After each of Graham's chapters you'll find a new commentary. In these reader's guides, I've added recent examples that should show you just how relevant—and how liberating—Graham's principles remain today.

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grateful to Walter Schloss for providing data essential to estimating Graham-Newman's returns. The 20% annual average return that Graham cites in his Postscript (p. 532) appears not to take management fees into account.

[4] The text reproduced here is the Fourth Revised Edition, updated by Graham in 1971–1972 and initially published in 1973.

I envy you the excitement and enlightenment of reading Graham's masterpiece for the first time—or even the third or fourth time. Like all classics, it alters how we view the world and renews itself by educating us. And the more you read it, the better it gets. With Graham as your guide, you are guaranteed to become a vastly more intelligent investor.

INTRODUCTION:

What This Book Expects to Accomplish

The purpose of this book is to supply, in a form suitable for laymen, guidance in the adoption and execution of an investment policy. Comparatively little will be said here about the technique of analyzing securities; attention will be paid chiefly to investment principles and investors' attitudes. We shall, however, provide a number of condensed comparisons of specific securities—chiefly in pairs appearing side by side in the New York Stock Exchange list—in order to bring home in concrete fashion the important elements involved in specific choices of common stocks.

But much of our space will be devoted to the historical patterns of financial markets, in some cases running back over many decades. To invest intelligently in securities one should be forearmed with an adequate knowledge of how the various types of bonds and stocks have actually behaved under varying conditions—some of which, at least, one is likely to meet again in one's own experience. No statement is more true and better applicable to Wall Street than the famous warning of Santayana: "Those who do not remember the past are condemned to repeat it."

Our text is directed to investors as distinguished from speculators, and our first task will be to clarify and emphasize this now all but forgotten distinction. We may say at the outset that this is not a "how to make a million" book. There are no sure and easy paths to riches on Wall Street or anywhere else. It may be well to point up what we have just said by a bit of financial history—especially since there is more than one moral to be drawn from it. In the climactic year 1929 John J. Raskob, a most important figure nationally as well as on Wall Street, extolled the blessings of capitalism in an article in the *Ladies' Home Journal,* entitled "Everybody Ought to Be

Rich."* His thesis was that savings of only $15 per month invested in good common stocks—with dividends reinvested—would produce an estate of $80,000 in twenty years against total contributions of only $3,600. If the General Motors tycoon was right, this was indeed a simple road to riches. How nearly right was he? Our rough calculation—based on assumed investment in the 30 stocks making up the Dow Jones Industrial Average (DJIA)—indicates that if Raskob's prescription had been followed during 1929–1948, the investor's holdings at the beginning of 1949 would have been worth about $8,500. This is a far cry from the great man's promise of $80,000, and it shows how little reliance can be placed on such optimistic forecasts and assurances. But, as an aside, we should remark that the return actually realized by the 20-year operation would have been better than 8% compounded annually—and this despite the fact that the investor would have begun his purchases with the DJIA at 300 and ended with a valuation based on the 1948 closing level of 177. This record may be regarded as a persuasive argument for the principle of regular monthly purchases of strong common stocks through thick and thin—a program known as "dollar-cost averaging."

Since our book is not addressed to speculators, it is not meant for those who trade in the market. Most of these people are guided by charts or other largely mechanical means of determining the right moments to buy and sell. The one principle that applies to nearly all these so-called "technical approaches" is that one should buy *because* a stock or the market has gone up and one should sell *because* it has declined. This is the exact opposite of sound business sense everywhere else, and it is most unlikely that it can lead to

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* Raskob (1879–1950) was a director of Du Pont, the giant chemical company, and chairman of the finance committee at General Motors. He also served as national chairman of the Democratic Party and was the driving force behind the construction of the Empire State Building. Calculations by finance professor Jeremy Siegel confirm that Raskob's plan would have grown to just under $9,000 after 20 years, although inflation would have eaten away much of that gain. For the best recent look at Raskob's views on long-term stock investing, see the essay by financial adviser William Bernstein at www.efficientfrontier.com/ef/197/raskob.htm.

lasting success on Wall Street. In our own stock-market experience and observation, extending over 50 years, we have not known a single person who has consistently or lastingly made money by thus "following the market." We do not hesitate to declare that this approach is as fallacious as it is popular. We shall illustrate what we have just said—though, of course this should not be taken as proof—by a later brief discussion of the famous Dow theory for trading in the stock market.*

Since its first publication in 1949, revisions of *The Intelligent Investor* have appeared at intervals of approximately five years. In updating the current version we shall have to deal with quite a number of new developments since the 1965 edition was written. These include:

1. An unprecedented advance in the interest rate on high-grade bonds.
2. A fall of about 35% in the price level of leading common stocks, ending in May 1970. This was the highest percentage decline in some 30 years. (Countless issues of lower quality had a much larger shrinkage.)
3. A persistent inflation of wholesale and consumer's prices, which gained momentum even in the face of a decline of general business in 1970.
4. The rapid development of "conglomerate" companies, franchise operations, and other relative novelties in business and finance. (These include a number of tricky devices such as "letter stock,"[1] proliferation of stock-option warrants, misleading names, use of foreign banks, and others.)†

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* Graham's "brief discussion" is in two parts, on p. 33 and pp. 191–192. For more detail on the Dow Theory, see http://viking.som.yale.edu/will/dow/dowpage.html.

† Mutual funds bought "letter stock" in private transactions, then immediately revalued these shares at a higher public price (see Graham's definition on p. 579). That enabled these "go-go" funds to report unsustainably high returns in the mid-1960s. The U.S. Securities and Exchange Commission cracked down on this abuse in 1969, and it is no longer a concern for fund investors. Stock-option warrants are explained in Chapter 16.

5. Bankruptcy of our largest railroad, excessive short- and long-term debt of many formerly strongly entrenched companies, and even a disturbing problem of solvency among Wall Street houses.*
6. The advent of the "performance" vogue in the management of investment funds, including some bank-operated trust funds, with disquieting results.

These phenomena will have our careful consideration, and some will require changes in conclusions and emphasis from our previous edition. The underlying principles of sound investment should not alter from decade to decade, but the application of these principles must be adapted to significant changes in the financial mechanisms and climate.

The last statement was put to the test during the writing of the present edition, the first draft of which was finished in January 1971. At that time the DJIA was in a strong recovery from its 1970 low of 632 and was advancing toward a 1971 high of 951, with attendant general optimism. As the last draft was finished, in November 1971, the market was in the throes of a new decline, carrying it down to 797 with a renewed general uneasiness about its future. We have not allowed these fluctuations to affect our general attitude toward sound investment policy, which remains substantially unchanged since the first edition of this book in 1949.

The extent of the market's shrinkage in 1969–70 should have served to dispel an illusion that had been gaining ground during the past two decades. This was that leading common stocks could be bought at any time and at any price, with the assurance not only of ultimate profit but also that any intervening loss would soon be recouped by a renewed advance of the market to new high lev-

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* The Penn Central Transportation Co., then the biggest railroad in the United States, sought bankruptcy protection on June 21, 1970—shocking investors, who had never expected such a giant company to go under (see p. 423). Among the companies with "excessive" debt Graham had in mind were Ling-Temco-Vought and National General Corp. (see pp. 425 and 463). The "problem of solvency" on Wall Street emerged between 1968 and 1971, when several prestigious brokerages suddenly went bust.

els. That was too good to be true. At long last the stock market has "returned to normal," in the sense that both speculators and stock investors must again be prepared to experience significant and perhaps protracted falls as well as rises in the value of their holdings.

In the area of many secondary and third-line common stocks, especially recently floated enterprises, the havoc wrought by the last market break was catastrophic. This was nothing new in itself—it had happened to a similar degree in 1961–62—but there was now a novel element in the fact that some of the investment funds had large commitments in highly speculative and obviously overvalued issues of this type. Evidently it is not only the tyro who needs to be warned that while enthusiasm may be necessary for great accomplishments elsewhere, on Wall Street it almost invariably leads to disaster.

The major question we shall have to deal with grows out of the huge rise in the rate of interest on first-quality bonds. Since late 1967 the investor has been able to obtain more than twice as much income from such bonds as he could from dividends on representative common stocks. At the beginning of 1972 the return was 7.19% on highest-grade bonds versus only 2.76% on industrial stocks. (This compares with 4.40% and 2.92% respectively at the end of 1964.) It is hard to realize that when we first wrote this book in 1949 the figures were almost the exact opposite: the bonds returned only 2.66% and the stocks yielded 6.82%.[2] In previous editions we have consistently urged that at least 25% of the conservative investor's portfolio be held in common stocks, and we have favored in general a 50–50 division between the two media. We must now consider whether the current great advantage of bond yields over stock yields would justify an all-bond policy until a more sensible relationship returns, as we expect it will. Naturally the question of continued inflation will be of great importance in reaching our decision here. A chapter will be devoted to this discussion.*

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* See Chapter 2. As of the beginning of 2003, U.S. Treasury bonds maturing in 10 years yielded 3.8%, while stocks (as measured by the Dow Jones Industrial Average) yielded 1.9%. (Note that this relationship is not all that different from the 1964 figures that Graham cites.) The income generated by top-quality bonds has been falling steadily since 1981.

In the past we have made a basic distinction between two kinds of investors to whom this book was addressed—the "defensive" and the "enterprising." The defensive (or passive) investor will place his chief emphasis on the avoidance of serious mistakes or losses. His second aim will be freedom from effort, annoyance, and the need for making frequent decisions. The determining trait of the enterprising (or active, or aggressive) investor is his willingness to devote time and care to the selection of securities that are both sound and more attractive than the average. Over many decades an enterprising investor of this sort could expect a worthwhile reward for his extra skill and effort, in the form of a better average return than that realized by the passive investor. We have some doubt whether a really substantial extra recompense is promised to the active investor under today's conditions. But next year or the years after may well be different. We shall accordingly continue to devote attention to the possibilities for enterprising investment, as they existed in former periods and may return.

It has long been the prevalent view that the art of successful investment lies first in the choice of those industries that are most likely to grow in the future and then in identifying the most promising companies in these industries. For example, smart investors—or their smart advisers—would long ago have recognized the great growth possibilities of the computer industry as a whole and of International Business Machines in particular. And similarly for a number of other growth industries and growth companies. But this is not as easy as it always looks in retrospect. To bring this point home at the outset let us add here a paragraph that we included first in the 1949 edition of this book.

> Such an investor may for example be a buyer of air-transport stocks because he believes their future is even more brilliant than the trend the market already reflects. For this class of investor the value of our book will lie more in its warnings against the pitfalls lurking in this favorite investment approach than in any positive technique that will help him along his path.*

* "Air-transport stocks," of course, generated as much excitement in the late 1940s and early 1950s as Internet stocks did a half century later. Among the hottest mutual funds of that era were Aeronautical Securities and the

The pitfalls have proved particularly dangerous in the industry we mentioned. It was, of course, easy to forecast that the volume of air traffic would grow spectacularly over the years. Because of this factor their shares became a favorite choice of the investment funds. But despite the expansion of revenues—at a pace even greater than in the computer industry—a combination of technological problems and overexpansion of capacity made for fluctuating and even disastrous profit figures. In the year 1970, despite a new high in traffic figures, the airlines sustained a loss of some $200 million for their shareholders. (They had shown losses also in 1945 and 1961.) The stocks of these companies once again showed a greater decline in 1969–70 than did the general market. The record shows that even the highly paid full-time experts of the mutual funds were completely wrong about the fairly short-term future of a major and nonesoteric industry.

On the other hand, while the investment funds had substantial investments and substantial gains in IBM, the combination of its apparently high price and the impossibility of being *certain* about its rate of growth prevented them from having more than, say, 3% of their funds in this wonderful performer. Hence the effect of this excellent choice on their overall results was by no means decisive. Furthermore, many—if not most—of their investments in computer-industry companies other than IBM appear to have been unprofitable. From these two broad examples we draw two morals for our readers:

1. Obvious prospects for physical growth in a business do not translate into obvious profits for investors.
2. The experts do not have dependable ways of selecting and concentrating on the most promising companies in the most promising industries.

Missiles-Rockets-Jets & Automation Fund. They, like the stocks they owned, turned out to be an investing disaster. It is commonly accepted today that the cumulative earnings of the airline industry over its entire history have been negative. The lesson Graham is driving at is not that you should avoid buying airline stocks, but that you should never succumb to the “certainty” that any industry will outperform all others in the future.

The author did not follow this approach in his financial career as fund manager, and he cannot offer either specific counsel or much encouragement to those who may wish to try it.

What then will we aim to accomplish in this book? Our main objective will be to guide the reader against the areas of possible substantial error and to develop policies with which he will be comfortable. We shall say quite a bit about the psychology of investors. For indeed, the investor's chief problem—and even his worst enemy—is likely to be himself. ("The fault, dear investor, is not in our stars—and not in our stocks—but in ourselves. . . .") This has proved the more true over recent decades as it has become more necessary for conservative investors to acquire common stocks and thus to expose themselves, willy-nilly, to the excitement and the temptations of the stock market. By arguments, examples, and exhortation, we hope to aid our readers to establish the proper mental and emotional attitudes toward their investment decisions. We have seen much more money made and *kept* by "ordinary people" who were temperamentally well suited for the investment process than by those who lacked this quality, even though they had an extensive knowledge of finance, accounting, and stock-market lore.

Additionally, we hope to implant in the reader a tendency to measure or quantify. For 99 issues out of 100 we could say that at some price they are cheap enough to buy and at some other price they would be so dear that they should be sold. The habit of relating what is paid to what is being offered is an invaluable trait in investment. In an article in a women's magazine many years ago we advised the readers to buy their stocks as they bought their groceries, not as they bought their perfume. The really dreadful losses of the past few years (and on many similar occasions before) were realized in those common-stock issues where the buyer forgot to ask "How much?"

In June 1970 the question "How much?" could be answered by the magic figure 9.40%—the yield obtainable on new offerings of high-grade public-utility bonds. This has now dropped to about 7.3%, but even that return tempts us to ask, "Why give any other answer?" But there are other possible answers, and these must be carefully considered. Besides which, we repeat that both we and our readers must be prepared in advance for the possibly quite different conditions of, say, 1973–1977.

We shall therefore present in some detail a positive program for common-stock investment, part of which is within the purview of both classes of investors and part is intended mainly for the enterprising group. Strangely enough, we shall suggest as one of our chief requirements here that our readers limit themselves to issues selling not far above their tangible-asset value.* The reason for this seemingly outmoded counsel is both practical and psychological. Experience has taught us that, while there are many good growth companies worth several times net assets, the buyer of such shares will be too dependent on the vagaries and fluctuations of the stock market. By contrast, the investor in shares, say, of public-utility companies at about their net-asset value can always consider himself the owner of an interest in sound and expanding businesses, acquired at a rational price—regardless of what the stock market might say to the contrary. The ultimate result of such a conservative policy is likely to work out better than exciting adventures into the glamorous and dangerous fields of anticipated growth.

The art of investment has one characteristic that is not generally appreciated. A creditable, if unspectacular, result can be achieved by the lay investor with a minimum of effort and capability; but to improve this easily attainable standard requires much application and more than a trace of wisdom. If you merely try to bring *just a little* extra knowledge and cleverness to bear upon your investment program, instead of realizing a little better than normal results, you may well find that you have done worse.

Since anyone—by just buying and holding a representative list—can equal the performance of the market averages, it would seem a comparatively simple matter to "beat the averages"; but as a matter of fact the proportion of smart people who try this and fail is surprisingly large. Even the majority of the investment funds, with all their experienced personnel, have not performed so well

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* Tangible assets include a company's physical property (like real estate, factories, equipment, and inventories) as well as its financial balances (such as cash, short-term investments, and accounts receivable). Among the elements not included in tangible assets are brands, copyrights, patents, franchises, goodwill, and trademarks. To see how to calculate tangible-asset value, see footnote † on p. 198.