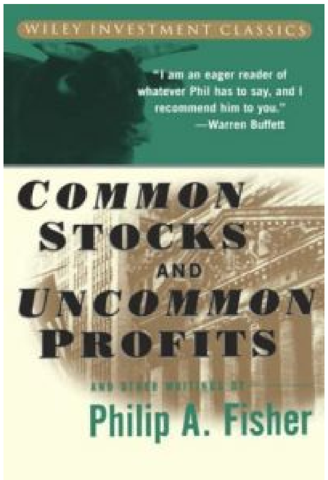

Book Common Stocks and Uncommon Profits and Other Writings

Philip A. Fisher
Wiley, 2003
First Edition:1957

Recommendation

In 1958, for the first time, an investment guide made *The New York Times*' bestseller list. Since then, that book, Philip A. Fisher's *Common Stocks and Uncommon Profits* has become a classic of the personal finance genre, educating students and influencing top investors such as Warren Buffett. More than half a century after its publication, Fisher's advice on doing your homework so you can select long-term growth stocks still resonates. While some of the companies he refers to are long gone, many are still thriving, and though some of his examples evoke nostalgia (in 1958, for instance, color TV was new), he presciently calls for the coming of flat screen television. The book, which also includes Fisher's later writings, shows how he teased out great insights by asking companies "What are you doing that your competitors aren't doing yet?" *BooksInShort* recommends this seminal classic on investing to business students, rookie securities analysts and private investors.

Take-Aways

- Investors in common stocks should focus on long-term returns and not try to buy low and sell high.
- Use "scuttlebutt" – information from discussions with competitors, suppliers and customers – to learn about a company.
- Buy stock in firms with "disciplined plans for achieving dramatic long-range growth in profits." Then hold them until you're sure that the firm's future is no longer rosy.
- To narrow your search, use 15 criteria that evaluate a firm's management and finances.
- For example, seek firms with strong marketing, profit margins and employee relations.
- Choose an investment adviser with five years' experience during good and bad markets.
- Devote most of your investable funds to big "institutional stocks" and a minor portion to smaller, up-and-coming firms.
- Leverage market downturns to buy shares in "a relatively small number of truly outstanding companies."
- Avoid typical mistakes, such as over diversifying and following the crowd. However, if you make a mistake, learn from it.
- To sleep well at night, make conservative investments for the long run.

Summary

Know When to Hold 'Em

Investors buy common stock in the hope of making money, but they should not fall prey to the typical practice of buying low and selling high. The best way to ensure solid returns is to find winning companies, or those poised to become successful, and to hold their shares for the long term – at least 10 years or even more. Identifying those firms isn't easy, but it's certainly possible if you're willing to work hard, ask good questions and use all the resources available to you.

"Scuttlebutt"

To invest wisely for the long term, identify companies that will grow faster than their competitors or faster than the market in general. Seek firms with visionary, capable managers who will drive and guide that growth. You won't find them by analyzing statistics or ratios. Instead, use "scuttlebutt," the information you garner by talking to a firm's competitors, suppliers and customers. Most of the time, a consistent view will emerge from these discussions.

> "Finding the really outstanding companies and staying with them through all the fluctuations of a gyrating market proved far more profitable to far more

people than did the more colorful practice of trying to buy them cheap and sell them dear."

Further exploit this business "grapevine" by interviewing researchers in the company's area of expertise and talking to its trade association leaders. You can even interview former staffers, but take their feedback with a grain of salt, since ex-employees may not have objective opinions. Prepare probing questions, and guarantee absolute confidentiality to whomever you're quizzing. Only after you've completed your due diligence with people outside the firm should you approach its management for information.

"The 15 Points to Look for in a Common Stock"

In identifying firms for investment, you should try and find out how they stack up against the following 15 questions:

1. **Does the company show "sufficient market potential" for long-term sales growth?** – Look for firms with an upward "long-range sales curve." For example, almost 90% of US households had television sets [by the 1960s], so it seemed that future prospects for TV manufacturers had reached a plateau. But agile firms began redirecting their sights to color television and even to flat screens, enabled by "transistor development and printed circuitry."
2. **Can the company's management guide innovation for tomorrow's products? –** The organization's senior executives must have a forward-looking "affirmative attitude" in order to enable the business to accomplish its promise, particularly when expanding research and development efforts increasingly point the way toward new technologies and growing profitability.
3. **Does the company use research and development to advance its agenda?** – Hiring people with top research talent and coordinating their efforts to bring new products to market will ensure a company's future success.
4. **"Does the company have an above-average sales organization?"** – Investors don't really study firms' marketing capabilities, but "without sales, survival is impossible."
5. **"Does the company have a worthwhile profit margin?"** – Good research and marketing are for naught without bottom-line profitability. Firms with "relatively broad profit margins" tend to return more to investors.
6. **"What is the company doing to maintain or improve profit margins?"** – Adopt a future-oriented mind-set; seek out firms that are improving their efficiency and scale. Pay "attention to the…ingenuity of the work being done on new ideas for cutting costs," as well as for building profits.
7. **"Does the company have outstanding labor and personnel relations?"** – Solid enterprises illustrate that they value their workers by paying them well and addressing labor issues quickly.
8. **"Does the company have outstanding executive relations?"** – Look for a firm that promotes from within and has competent leadership.
9. **"Does the company have depth to its management?"** – Watch out for "key man" situations – instances where your firm grows overly dependent on one person. Growing companies should develop their executive benches for the future.
10. **"How good are the company's cost analysis and accounting controls?"** – The lack of a good grasp on a firm's expenses can slow its progress. Scuttlebutt often can reveal perceived lapses in an organization's controls.
11. **Does the company show strengths specific to its industry?** – For example, an engineering firm with top technical talent can rise above its competition.
12. **"Does the company have a short-range or long-range outlook [on] profits?"** – Organizations that sacrifice their current gains in favor of future growth will survive longer than their competitors. Publicly owned firms ought to deliver "outstanding results" to their outside shareholders.
13. **Will the firm need to raise equity in the near future?** – If so, prospective investors should worry about their shares' dilution. Buy shares in a firm that is able to finance its growth over the next several years through cash and loans.
14. **Do executives share bad news as well as good with shareholders? –** Inevitably, a growing firm will experience problems, but avoid companies that aren't accessible to investors during bad times.
15. **"Does the company have a management of unquestionable integrity?"** – Executives should demonstrate a "strong…sense of trusteeship to shareholders." Use your scuttlebutt resources for information about insider deals, nepotism or other shady behavior; drop offenders from your investment radar.

> "Scuttlebutt is simply about finding out from real, 'Main Street' sources if a firm is strong or weak."

Investment analysis is specialized: Just as you wouldn't necessarily act as your own physician or attorney, you probably don't have the time or inclination to perform in-depth investigations to sniff out the best stocks. Select a reputable adviser who follows these 15 guidelines and has a minimum of five years of profitable investing experience, preferably not all in a rising market.

Buying and Selling

Use only your surplus cash to invest in common stock; don't risk your emergency funds or the money you need to educate your children. Organize your investment criteria around long-term appreciation of a growth stock. Put most of your money in institutional stocks – household names like Dow Chemical Company, DuPont and IBM – that are still on the rise. Invest a lesser proportion in small, up-and-coming businesses that usually offer the best potential for greater upside gains over the long haul.

> "More money has probably been lost by investors holding a stock they really did not want until they could 'at least come out even' than from any other single reason."

Forgo current dividends for capital appreciation, because dividends are the least valid reasons to buy a stock. A corporation that reinvests its gains into its future growth will deliver more in the long run than a firm that generously rewards current shareholders with high dividends. If you rely on dividends for a significant share of your income, seek the "regularity or dependability" of a stable payout schedule.

> "The successful investor is usually an individual who is inherently interested in business problems."

Deciding when to buy a stock is just as difficult as determining which stock to buy. Trying to forecast the market is like the "science of chemistry during the days of alchemy in the Middle Ages." Stay alert for buying signals. For example, purchase shares in a company just prior to the launch date for a new product or process. Study possible industry events for purchase opportunities. "Stagger" your buying over time to take advantage of interim price drops. Be aware of the "five powerful forces" affecting the stock market: 1) the business cycle, 2) interest rate movements, 3) the government's current stance toward business and investment, 4) inflation expectations, and 5) potentially seismic changes in existing industries and products.

> "Doing what everybody else is doing at the moment, and therefore what you have an almost irresistible urge to do, is often the wrong thing to do at all."

However, you would be wise to sell your shares on three specific occasions: 1) when you've made a mistake – admit it, swallow your pride, and sell; 2) when a firm no longer fits most of the 15 points to look for in a common stock, particularly if it has "exhausted the growth prospects of its market"; and 3) if something better comes along – for example, a new company that better fits your 15 investing criteria – though if you've done your research, this shouldn't happen often.

> "In the stock market a good nervous system is even more important than a good head."

Do not sell into a bear market, because you'll never guess the right moment to buy again. Also, don't sell after a run-up in the price of your shares; if you've determined it's a good stock with long-term prospects, a momentary share price increase doesn't mean it has run its course.

Ten Don'ts

Now that you know what to do to make a good investment, here's what not to do:

1. **"Don't buy into promotional companies"** – Avoid the temptation to "get in on the ground floor" of a new, unproven venture.
2. **"Don't ignore a good stock just because it is traded 'over the counter'"** – Good liquidity now exists for nonexchange-listed shares as well.
3. **Don't buy based on the annual report** – Public relations personnel usually write them as promotional pieces.
4. **Don't think a stock's high P/E means there's no upside left** – A stock selling at a high price/earnings ratio (share price divided by earnings per share), provided the firm keeps investing in its own future, can continue to offer opportunities for appreciation.
5. **"Don't quibble over eighths and quarters"** – When you've done your research and know a specific stock is the right one for you, "buy at the market"; don't wait for the stock to reach some magic price that may never arrive.
6. **"Don't overstress diversification"** – Having an overly diversified investment portfolio can be as troubling as not being diversified enough: You can't possible remain close enough to 25 different businesses to make adequate assessments about their management and prospects.
7. **"Don't be afraid of buying on a war scare"** – In modern times, stocks fell at the threat of war but rebounded strongly once hostilities ceased. Because government spending for defense is inflationary, equities become a better investment than cash.
8. **"Don't be influenced by what doesn't matter"** – Pay little attention to information on past share price performance; it has nothing to do with future possibilities.
9. **"Don't fail to consider time as well as price in buying a true growth stock"** – Stay aware of company actions that could temporarily drop the share price. Buy once those effects are well discounted.
10. **"Don't follow the crowd"** – Because markets are made of human beings, mass psychology, "fads and styles" abound. Avoid the herd and make up your own mind.

"Conservative Investors Sleep Well"

Smart investors seek to "conserve purchasing power at a minimum of risk." To do so, a conservative investor should consider "four dimensions" in analyzing a company: 1) its "low-cost production," including a powerful sales process, topnotch financial acumen, and excellent technology and research capabilities; 2) its recognition of and investment in its employees; 3) "certain inherent characteristics" that keep a firm at the top, such as scale economies or technical proficiency; and 4) an earnest "appraisal" of its price/earning ratio relative to the market.

> "If the job has been correctly done when a common stock is purchased, the time to sell it is – almost never."

If you want to sleep well, heed these eight principles honed during a successful 50-year career in stock selection:

1. Buy the stock of firms with "disciplined plans for achieving dramatic long-range growth in profits."
2. Purchase the shares when "they are out of favor."
3. Hold onto your investment until you're sure that the company's future is no longer rosy.
4. Don't rely on dividends.
5. Learn from your investing mistakes.
6. Use market dips to buy into "a relatively small number of truly outstanding companies."
7. Rely on your judgment, not the crowd's.
8. In investing, as in most other endeavors, "success greatly depends on a combination of "hard work, intelligence and honesty" to achieve investing success.

About the Author

The late **Philip A. Fisher** started his investment firm, Fisher & Co., in 1931 and managed investments for no more than a dozen select clients at any time for five decades. He also wrote *Paths to Wealth Through Common Stocks* and *Conservative Investors Sleep Well.*
