Investment Strategy, 1966-1970

by LANCASTER M. GREENE

INVESTING for future security should be concerned not with making short term stock market profits, but with a search for strong storehouses of value that will produce expanding income and capital. Our investment strategy is based on our hard-won experience, that no one can consistently forecast the short term fluctuations of the economy, but that it is possible to recognize the underlying values which may be counted on to emerge over an extended period.

We try to screen out many popular commodity stocks in favor of intrinsic human values. We have 41 years of clear evidence that the percipient investor places his money and confidence with managements whose top officials enjoy reputations among their peers of unquestioned integrity and exceptional ability. Therefore we think in terms of what a management might achieve over a period of three to five years.

Since our concern is not predicting the inevitable declines and up-flurries, we try to choose the best people to associate with. We are firm in our convictions that investors must be helped to share ownership in company managements who possess superior potentials and who also excel in research and development, production and marketing. Contrary to popular opinion, this cannot always be determined from published figures — there are well publicized cases on record which prove that such figures can be very misleading. These records should be studied, however, to determine when stocks may be bought at better than average price-times-earnings.

The business of sifting through hundreds of companies in the market to find these requirements calls for experienced investigation based on a willingness to make independent judgments which run counter to those generally accepted by the institutional community, regarding quality and future growth.

We are often asked how we would advise a widow to invest with maximum security. In general we exercise care and caution equally for all investors. But taking as a specific example a widow with $200,000, we say her best defense is intelligently guided offense. This may mean acceptance of not more than a 3 percent yield from dividends.

But if this $6,000 annual income will not be adequate for her needs I recommend that rather than seek out securities for greater current dividend or interest income, she put aside enough for a 5-year supplement. If she can manage on $9,000 a year I would have her place $15,000 in a commercial bank savings account (interest payable to any date of withdrawal) and have her draw on it at the rate of $3,000 a year. At the end of 5 years I am confident she can liquidate enough at higher prices to provide another 5-year cash fund. In the meantime her income from dividends will have grown.

For a college or similar institution I suggest that 10 percent short term U.S. treasury bills and 5 to 15 percent medium term government bills will assure maintenance of staff salaries. The balance of 75 to 85 percent I will invest in the same type of stocks as are selected for a widow — those with investment quality promising growth in earnings and dividends. I look also for another powerful influence for creating growth of capital. That is the increase in the price-earnings-multiple which will come from belated recognition of investment quality and continued growth. The discovery of an impetus to capital growth also presupposes independence of judgment courageous enough to ignore cliches and arrive at conclusions which may evoke protests from conventional investors.

Two examples of industries which I have consistently judged as quality investments are aerospace and capital goods companies. Five top quality aerospace companies sell at 10 to 11 times earnings, but they are not yet accepted by many institutional investors who are late in recognizing increased quality. The aerospace industry has changed since World War II when it was regarded largely as a hardware producer. Now, as the cutting edge of our nation's technological revolution, it has established the U.S. as the technology leader of the world. Government and industry depend on a huge dollar investment in research and development to maintain our leadership.

To mention again the stock I have commended to HGN readers for many years, we started buying Boeing at $18 paying $1 in 1947. It has been split more than 6 times, so that equals $2.79 a share, and the dividends equalled 15c vs. $140 a share now and $2.50 in dividends. If dividends should increase 15 times over the next 19 years most of us would feel we had been rewarded for enduring the swings of business and market cycles, and would feel justified in having held firmly to our faith through the alarms of two decades.

Top capital goods industry stocks sell at only about 12 times earnings because of the devotion of institutions to the theory of inexorable severe cyclical changes in sales and earnings. It is true that history bears them out, but slavish devotion to history cannot take the place of thorough analysis of the changing factors which will be creating the future earnings for certain companies. When more investors discover that the cycles of the past are not necessarily repeated, I believe the best of the capital goods industry stocks will be selling at 15 times their earnings or more.

Those who have read my annual discussions in HGN remember that I have been buying Cincinnati Milling Machine Company stock for 18 years from $10 on shares paying 70c, to the present when it is seven times higher and paying $2. We shall see what the next five years do for us.

The successful investor is not blind to the trend toward socialism, but he believes our greatest natural resource is in the business brains of the country. Therefore he elects to seek his investment security with managements that will use his money profitably. The impressive gains are made by the optimist who depends, despite all ominous warnings, on the ingenuity of experienced industrialists to increase his earnings and dividends. He will be uneasy at times and will have to exercise patience in resisting the profit-takers and, conversely, in not being carried away with enthusiasm.

Some of the short term traders who have written the currently popular books about their manipulations have found they are making more from their books than from their short lived success. In hopping around from company to company they were sometimes paying more in brokers' fees than they could hope to gain from trading. If the market fraternity would apply their time and energy to analyzing companies instead of attempting to forecast fluctuations they would do a much better service for investors.

The foregoing reflects the philosophy that has made (brothers) Lancaster & Norvin Greene, Inc., one of the unique counseling firms in the Wall Street community. Lancaster M., long an advocate of Georgist principles is an officer of the Henry George School and of the Robert Schalkenbach Foundation.