www.FocusedCompounding.com

@FocusedCompound

info@focusedcompounding.com

469-207-5844

"Five Years Hence"

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To Focused Compounding members:

Often, members email me saying *"Sure, this stock is cheap. But, what if it stays cheap indefinitely?"* A U.S. Senator once asked Ben Graham that same question: *"When you find a special situation and you decide, just for illustration, that you can buy for 10 and it is worth 30, and you take a position, and then you cannot realize it until a lot of other people decide it is worth 30, how is that process brought about – advertising, or what happens?"*

Graham's response was: *"That is one of the mysteries of our business, and it is a mystery to me as well as to everybody else. We know from experience that eventually the market catches up with value. It realizes it in one way or another."*

That's true. And it's this bedrock value investing belief that is often the most difficult for new stock pickers to accept and learn to act on. The market for even the most illiquid, obscure, and unloved stock out there is still efficient enough that – though the stock's price may not hover for long at its *"intrinsic value"* – the stock's price will randomly walk in such a way that it will not forever undershoot its intrinsic value. Sometime in any stock's future: there will be days, weeks, and years where it overshoots intrinsic value. No stock is hated or ignored forever. Remember the quote from the Roman poet Horace with which Ben Graham starts Security Analysis: *"Many shall be restored that now are fallen; and many shall fall that now are in honor."*

This is the toughest thing for a stock picker to believe. I read a comment recently where someone said a non-cyclical stock trading at a P/E of 6 seemed to be trading about the right price for that kind of stock. Should a stock ever trade at 6 times earnings? Sure. A stock may sometimes be worth just 6 times ***this*** year's earnings. But, it doesn't make sense to value a stock at 6 times whatever earnings you are projecting five years hence. I can't think of any investment I've made where I was right about what a stock would look like 5 years hence and yet wrong to buy the stock in the first place. So, don't worry about what event will make a cheap stock less cheap. If you know you'll get a good annual return if this stock reaches a fair multiple within 5 years – just buy it. We can't predict what will cause a stock to reach its intrinsic value. But, we can guess that something will happen to make a stock that *"now is fallen"* to be restored to honor if we give it a full five years. The crowd is just that fickle.