WHAT WE CAN LEARN FROM PHIL FISHER.
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What we can learn from Phil Fisher

On turning 80 last month the eminent San Francisco investment counselor Philip Fisher was in a valedictory mood. Rarely interviewed, he sat for a long chat with FORBES. He is one of the seminal figures of modern investment thinking--one of the first, if not the first, to develop the thesis that growth stocks have identifiable characteristics that make them different from ordinary stocks.

Warren Buffett, perhaps the most successful investor of the present era, calls Fisher a "giant.'

HORSE HANDICAPPERS fall into two major categories: speed and class. The speed dopester wants lots of figures: He pores over the form sheet to determine which horse posted the fastest time in recent races, adjusted for track conditions, weight carried, etc. The class handicapper scorns numbers. "Tell me about bloodlines and the quality of past opposition,' he says.

These differing doctrines have their parallel in the investment world--between analysts emphasizing quantitative factors and those who favor a qualitative approach.

The quantitative analyst says, "Let's buy the cheapest stock as measured by some combination of price/earnings ratio, book value, yield, etc.'

The qualitative analyst says, "Buy the best company, the best management and don't worry too much about the numbers.'

Happily, there's more than one way to get to financial heaven. Skilled and insightful practitioners of either persuasion will be rewarded. I was lucky to find good men of both persuasions early in my life, and the resulting synthesis of their ideas has been of enormous benefit to me.

I sought out Phil Fisher after reading his Common Stocks and Uncommon Profits and Paths to Wealth Through Common Stocks in the early 1960s.

When I met him, I was as impressed by the man as by his ideas. Much like Ben Graham, Fisher was unassuming, generous in spirit and an extraordinary teacher. From him I learned the value of the "scuttlebutt' approach: Go out and talk to competitors, suppliers, customers to find out how an industry or a company really operates.

A thorough understanding of the business, obtained by using Phil's techniques, combined with the quantitative discipline taught by Ben, will enable one to make intelligent investment commitments. I am an eager reader of whatever Phil has to say, and I recommend him to you.

A talk with Philip Fisher

Philip Fisher doesn't try to impress you with lavish offices. He works out of a nondescript nine-story office building in San Mateo, Calif., a 30-minute drive-when the traffic's light--south of San Francisco. There's a small outer office with a desk where his secretary sits, a couple of filing cabinets, a phone, an answering machine and not much else. No computers, no Quotron machines, no elaborate library; just a refined and practiced mind. Fisher apologizes for the messy state his desk is in; he's been away paying calls on companies in New England for the

previous week and has just gotten home. Having just turned 80 this September, Fisher is as vibrant as they come, his intellect keen and his wit as sharp as a tack. He's still managing money, still learning how to do it better with every new day. If it is possible for Wall Street, even out here in California, to have produced the equivalent of what the Japanese call a national treasure, then Phil Fisher fits the bill admirably.

FORBES: What signals are your antennas receiving these days?

Fisher: I see new issues of companies that don't look all that outstanding coming at maybe five and six times sales, and things that look totally prosaic coming at three and four times sales. I think this is always the sign of potential danger. I am not calling doom within the next month. I just don't know. But it's a time to be cautious.

I see a huge overextension of credit in all directions. If the banks of the country were held to the same accounting principles that other companies are held to, and had to write down their inventory, their bank loans, to market, they would be in a simply incredible position.

The consumer has a degree of loans outstanding that to me looks abnormally high in relation to his income. People are saying it isn't high in relation to his assets. What are these? Residential real estate is fundamentally higher than the stock market is.

You have an impasse in the government where nothing is being done. You have this trade-deficit situation, which I think is rampant with potential trouble.

The policy of the Federal Reserve and of our government is to encourage foreign lending to support the government bond market. I mean, to encourage foreigners to buy into our ownership of American assets is damnable, to put it mildly. It is so shortsighted. Sooner or later a situation is going to come when these foreigners will want their money back. When they do, what can happen to the dollar, to our markets, is frightening.

And yet you hear these monkeys in Washington saying we've got to make government bonds attractive so that foreigners will buy more of them.

Put all this together with the desperate financial condition of much of the Third World, and currently you have a situation that is not too different from what happened in the late 1920s.

In 1929-33 we went through four years of such economic hell that people who went through it have been psychologically scarred ever since. You saw people who were well-fixed lose jobs, people who had been wealthy going through their homes taking out every light bulb except one in each room. I knew a manufacturing executive who went to work as a watchman, and his wife took a job cleaning and cooking.

When will the crash come?

I haven't the faintest idea whether we are in 1927 or 1929. Some awfully bright, able, sound people were scared as hell in 1927. But the thing rolled on for two more years, and that may happen here. I don't know.

We have learned how to take dope and stop the pain. That dope is very simple. You run the printing presses or run the credit machine, to have huge, huge expenditures of government money and expansion of credit.

Instead of a crash, what will happen is exactly the kind of hyperinflation that you have seen in Argentina and Brazil. I think in two years, one or two years, it will start and then run on for maybe four or five years.

If that's what's coming, how does one protect oneself against this hyperinflation?

I made as deep a study as I could of what happened after World War I in France, where there was lots of inflation, and in Germany, where there was inflation into infinity. And in both countries the same thing happened. If you bought the very best stocks, according to my definition--not just any stocks--you were still darned uncomfortable during that period of the spiraling inflation. But when the inflation was over, you came out of it with about 80% of the real purchasing power intact.

If I can come out of it with 80% of my present assets in real money, and my people can do that, that is fine. Until then I'm keeping a fair amount in Treasury bills.

Timing these things is so damnably difficult. I don't want to be the smart guy with too much cash because I think a big break is coming. Nor do I want, once it comes, to spend too long getting myself ready. When you're not sure, you hedge. Very roughly, I have between 65% and 68% in the four stocks I really like, between 20% and 25% in cash and equivalents, and the balance in the five stocks that are in the grooming stage.

You don't own or buy a large number of issues.

I have four core stocks that are exactly the thing I want. They represent the bulk of my holdings. I have five others in much smaller dollar amounts that are potential candidates to enter this group. But I'm not sure yet. If I were betting today, I'd bet on two and not on the other three.

Each decade up to this one--there hasn't been time to work it out for the Eighties--I have found a very small number of stocks, 14 in all, starting with 2 in the Thirties, that over a period of years made a profit for me of a minimum seven times the funds I put in and a maximum of many thousands of times my investment.

Now I have gone into about three to four times as many additional securities in which I've made more money than I've lost. I've had losses, in two cases as high as 50%. There also have been a number where I have made or lost 10%. That's almost the cost of being in business. But there are lots of cases where a stock has gone down moderately, and I've bought more, and it's paid off for me enormously.

These efforts were necessary to weed out the 14 where I have made the real gains. I've held those 14 from a minimum of 8 or 9 years to a maximum of 30 years. I don't want to spend my time trying to earn a lot of little profits. I want very, very big profits that I'm ready to wait for.

What do you look for in a core stock?

They are all low-cost producers; they are all either world leaders in their fields or can fully measure up to another of my yardsticks, the Japanese competition. They all now have promising new products, and they all have managements of above-average capabilities by a wide margin.

You place a lot of emphasis on management, don't you?

Getting to know the management of a company is like getting married. You never really know the girl until you live with her. Until you've lived with a management, you don't really know them to that same degree.

Getting back to the kinds of companies you like, the ones that will help get you and your clients through the bustup. . . .

My own interests essentially are in manufacturing companies that in one way or another--I hate the buzzword "technology'--can expand their markets by taking advantage of the discoveries of natural science.

In other fields, such as retailing and finance, there are excellent opportunities, but I feel this is one where I am more qualified. I think a weakness of many people's approach to investment is that they try to be jacks of all trades and masters of none.

Are you looking at other stocks?

I am spending time looking at situations that I'm not eager to buy today. But under the strain of a rapidly falling market, I don't want to have to act with too much speed on stocks that I'm not more familiar with.

Can I get you to name your nine stocks?

In the case of the five smaller ones, I don't want to. I will identify two of my four core stocks--Motorola and Raychem. The third is a small-cap where there's been steady accumulation of shares by other long-range investors besides myself, so the floating supply of shares is abnormally small. A mention in FORBES would make the thing whoosh up. But until the earnings have started to materialize, it would whoosh down again. I don't want to cause that.

Number four has an excellent record of making products allied to what it already has, but it's now doing one so big in relation to the present company that, if this shouldn't work as well, there could be risk in the shares. And the stock is already up. So again I'll pass.

As for Motorola, Wall Street is just beginning to see how good management really is. In the recent semiconductor depression, it was the only major company to earn subnormal but not insignificant profits. Of the others, one just about broke even and three went heavily into the red. That kind of stuff attracts Wall Street, but not the reasons behind it. Wall Street should pay greater attention, for instance, to whether a company has its production under statistical quality control--shortening the production cycle, thereby reducing inventories and cutting costs.

Motorola is also way above the average company in planning. One reason its semiconductor business has done so

well in time of stress is that it picked the right areas to be in and didn't have the bulk of its effort in areas that ran into more trouble. Another reason it's so outstanding is due to the farsightedness and high moral standards of Bob Galvin, its chairman.

Now Motorola is not on the bargain counter today, but it will have very pleasing growth.

With Raychem you've got another situation. {With annual sales of $944 million, Raychem manufactures high-performance plastic products.} Several years back management recognized that its older product lines wouldn't keep growing the 20% to 25% a year that they had since the company was started. Raychem developed a whole series of new technologies. But it underestimated how long it would take to get prosperity out of them.

The last couple of years it's been bringing these into the market. Now people who are interested in growth but who aren't very sophisticated tend to measure it by how much you spend on R&D. Actually, when bringing on new products, R&D, while important, is less costly than the combination of marketing money, when you're first introducing those new products, and the high-cost production when you first start to get those new products out but where you haven't yet come down the learning curve.

The fact these new products have been bunched together has resulted in several years of flat earnings. For a company that had steadily growing earnings before that, this threw Wall Street, with its short-term outlook, for a loop. Now there is great suspicion. Is it really a growth company? To me, it epitomizes a growth company but sells at a price/earnings ratio that doesn't fully reflect this.

What else do you look at besides good management?

When I have to argue strongly with {clients} to like something, and they say, "Well, all right, if you say so, we'll do it.' I'm much more apt to be right than when, as sometimes happens, I say, "Let's buy 10,000 shares,' and they say, "Why don't we buy 50,000?' That's usually a warning signal that it's too late to buy.

Nor will I buy market-favored stocks. I particularly notice it when I attend meetings for technology stocks and see all the people crowding into the room and so on. If there's standing room only, that's usually a pretty fair sign it's not a good time to buy the stock.

You sound like a contrarian.

Part of real success is not being a 100% contrarian. When people saw that the automobile was going to obsolete the old streetcar system in the cities, some decided that since nobody would want streetcar stocks, they'd buy them. That is ridiculous. But being able to tell the fallacy in an accepted way of doing things, that's one of the elements in the investment business of big success.

What's the single most important lesson to be learned from your career as an investor?

It is just appalling the nerve strain people put themselves under trying to buy something today and sell it tomorrow. It's a small-win proposition. If you are a truly long-range investor, of which I am practically a vanishing breed, the profits are so tremendously greater. One of my early clients made a remark that, while it is factually correct, is completely unrealistic when he said, "Nobody ever went broke taking a profit.'

Well, it is true that you don't go broke taking a profit, but that assumes you will make a profit on everything you do. It doesn't allow for the mistakes you're bound to make in the investment business.

Funny thing is, I know plenty of guys who consider themselves to be long-term investors but who are still perfectly happy to trade in and out and back into their favorite stocks.

Some years ago I was the adviser to a profit-sharing trust for a large commodities dealer. I bought for them--I think the stock has been split 15 times since then--a block of Texas Instruments at $14 a share. When the stock got up to $28, the pressure got so strong ("Well, why don't we sell half of it, so as to get our bait back?') I had all I could do to hold them until it got to $35. Then the same argument: "Phil, sell some of it; we can buy it back when it gets down again.'

That is a totally ridiculous argument. Either this is a better investment than another one or a worse one. Getting your bait back is just a question of psychological comfort. It doesn't have anything to do with whether it is the right move or not.

But, at any rate, we did that. The stock subsequently went above $250 within two or three years. Then it had a

wide open break and fell to the mid-50s. But it didn't go down to $35.

What turned you off the short term?

Let me go back to the 1930s. The company I really started my business on was FMC Corp., then called Food Machinery. Two-thirds of its business was in selling to fruit and vegetable canners. So I started learning a fair amount about the canning business. Three different times in the Thirties I bought California Packing--that's the Del Monte line--at a low price, when the outlook for canning looked poor, and sold it at a high price. I also bought, for any client who I could get to buy it, as much Food Machinery stock as they would let me.

Then in 1940 or 1941 I reviewed the bidding and found that the effort I had put into the timing of buying and selling California Packing shares considerably exceeded the time I had spent learning about and watching Food Machinery stock. Yet already by 1940 my profits in Food Machinery dwarfed the ins and outs of California Packing.

That episode finally made me decide not to follow the almost accepted policy at the time that you should buy low and sell high and make a profit and bring it in. This just isn't valid.

Warren Buffett once said his investment philosophy was 85% Ben Graham, 15% Phil Fisher. What's the difference between Giahamism and Fisherism?

There are two fundamental approaches to investment. There's the approach Ben Graham pioneered, which is to find something intrinsically so cheap that there is little chance of it having a big decline. He's got financial safeguards to that. It isn't going to go down much, and sooner or later value will come into it.

Then there is my approach, which is to find something so good--if you don't pay too much for it--that it will have very, very large growth. The advantage is that a bigger percentage of my stocks is apt to perform in a smaller period of time--although it has taken several years for some of these to even start, and you're bound to make some mistakes at it. {But} when a stock is really unusual, it makes the bulk of its moves in a relatively short period of time.

The disadvantage of Ben Graham's approach, as he preached it, is it is such a good method that practically everybody knows it and has picked up the things that meet his formula.

I don't want to say that mine is the only formula for success. But I think, and I may be conceited about this, that I started my business before the term growth stock was thought of.

How many clients do you have?

The Grim Reaper has cut into my client list. I've actually got only nine at the present time.

I wondered as I turned 80 if some of my clients would begin to worry, well, should we leave our investments with a man whose life expectancy is obviously shorter than it was some years back? I was amazed to find the majority are not at all concerned. The reason is rather basic. The stocks I have put their funds in have certain common characteristics that I referred to earlier. If they're going to start going downhill, which many companies do sooner or later, that might be a minimum five years off.

If I were to pass out of this world tomorrow, my people would have plenty of time before they'd have to worry about these stocks and would still benefit from them as the present momentum carries on.

Doesn't sound like you're about to retire.

I could wax for a half-hour on the utter folly of people being forced to retire at the age of 65. I think I have produced better results in the last five years than in any other five-year period. The refinement that comes from contemplating your own mistakes and improving yourself has continued.

I have seen enough people start to go senile as they get older that if it should happen to me, with my responsibilities, I would cut myself off. But unless that happens, I think it's ridiculous to stop the work I enjoy.

For our readers who won't have the benefit of having you run their money, how about some advice on choosing a portfolio manager?

The only way that I've suggested is get them to give you a transcript of what they actually have done. And if they take losses, and small losses, quickly and let their profits run, give them a gold star. If they take their profits quickly and let their losses run, don't go near them.