3 Timeless Lessons From the Best Investor You've Never Heard of

Description

Walter Schloss was truly one of Wall Street's great money managers.

The man absolutely trounced the S&P 500 during his 47-year career. His partnership produced returns of 20% annually (or a little over 15% to investors after Schloss took his fee)–a performance that can only be rivaled by a few others, namely Warren Buffett.

Schloss managed to achieve these results despite having no fancy research department, no impressive office, and while maintaining a healthy work/life balance. In fact, he worked only with his son (and that was after years of working alone), renting a closet-sized office close to Wall Street. He regularly would show up at work right as the stock market was opening and leave by 5:00 p.m.

So how did he do it? How did Schloss become so successful that Warren Buffett once called him a "superinvestor?" It can be narrowed down to a few important keys.

Buy cheap stocks

When asked what his secret was, Schloss would respond with just four words. "We buy cheap stocks."

Schloss was a disciple of Benjamin Graham–the man many consider to be the father of value investing. Graham's formula was simple. He would go searching for net-net stocks–companies worth more dead than alive–and then buy shares. He would then sell when these companies approached fair value.

When Schloss left Graham in 1955 to form his own partnership, he simply kept doing what his mentor taught him. Net-net stocks became less and less common as more people entered the market, so Schloss switched his strategy to buying companies with a low price-to-book ratio and little debt.

One Canadian stock I think Schloss would be interested in today is **Hudson's Bay Co** (TSX:HBC). Although the stock doesn't appear to trade under book value, the company is sitting on some very valuable real estate that investors aren't giving it credit for. According to the recent management presentation, the real estate alone is worth $36 per share. What's the current share price? It's under

$14 per share.

Diversify

Many value investors like to have ultra-concentrated portfolios, putting the vast majority of their capital in just a few names. Why invest in your sixth best idea when you could just put more money in an existing opportunity?

Schloss thought very differently. He was always quite diversified, sometimes owning more than 100 stocks.

His thought process was simple. Schloss knew that the more stocks he owned, the less risk he was taking on. Putting 20% of your assets in one company is great if the investment works out. It's a good way to lose a bunch of money if it doesn't. **Valeant** investors learned this lesson the hard way.

Ironically, Schloss would probably be looking at Valeant if he was investing today.

Be a true contrarian

It takes a certain amount of intestinal fortitude to become a Walter Schloss investor. He was constantly zigging when the market was zagging.

This is tougher than most investors imagine. Most investors want nothing to do with contrarian stocks. All they can see are the negatives. Whenever I talk to other investors about the contrarian names I research, I'm always inundated with negative opinions. "There's a reason why that company trades at a fraction of its book value."

Take **Torstar Corporation** (TSX:TS.B), the owner of *The Toronto Star*. There's a lot to hate about the newspaper business. And Torstar consistently loses money.

But it's not all bad. The company has a pristine balance sheet with $70 million in cash and no debt. It trades at approximately half of book value. Free cash flow has been close to breaking even over the last couple of quarters. And the company even pays a 6.1% dividend.

If management can turn the company around, it could be a huge winner.

The bottom line

Walter Schloss's simple investing philosophy isn't for everyone. It's hard to buy stocks the market hates. But it does work. Schloss proved that, turning a simple strategy into one of the best-performing investment records of all time. It's obvious we all have much to learn from this master.

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1. Dividend Stocks
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1. Editor's Choice

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1. TSX:TS.B (Torstar)

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