3 Tips for Defensive Investors From Warren Buffett's Teacher

Description

Investors don't lose money because their stocks go down. They lose money because they sell their declined stocks.

Benjamin Graham, the father of value investing, was Warren Buffett's teacher and a key influencer to Buffett's winning investing style. Graham offers three defensive investing tips in *The Intelligent Investor*.

These tips will powerfully boost your overall investment success.

Adequate diversification

Graham suggests holding 10-30 stocks for adequate diversification. Jason Zweig added commentary in the book, stating, "Diversification doesn't just minimize your odds of being wrong."

It also maximizes your chances of being right… *Money Magazine* identified the 30 best-performing stocks over the 30 years ending in 2002… the list is startlingly unpredictable. Rather than lots of technology or health-care stocks, it included **Southwest Airlines**, Worthington Steel, **Dollar General** discount stores, and snuff-tobacco maker UST Inc."

This reminded me of when **Air Canada** traded at $6 per share back in 2014 — a dirt-cheap price-to-earnings ratio of less than five. Of course, at the time, it seemed like the company was in hot water.

In hindsight, however, it could make sense to allocate a small portion of a diversified portfolio in the industry leader as a contrarian investment. The stock went on to be an eight-bagger, delivering annualized returns of close to 45% per year!

Large, prominent, and conservatively financed

Defensive investors should choose industry leaders, which have large scale and competitive advantages. **Pason Systems** (TSX:PSI) is an industry leader, though arguably, the industry of oil and gas services equipment has diminished in prominence.

Still, as a market leader, Pason Systems enjoys, well, a market-leading margin. Year to date, its adjusted EBITDA margin was 45.3%. Its profitability has remained remarkably stable despite the lower drilling activity in North America. Although it increased capital spending by 21%, its free cash flow only fell 4% to $66 million.

Notably, Pason Systems' balance sheet is very solid with no long-term debt to weigh it down, which means it doesn't have to worry about servicing debt.

A long record of continual dividend payments

Defensive investors should consider stocks that have at least 10 years of dividend payments with no dividend cuts. Pason Systems stock has this characteristic, but it has been abandoned by the market lately. It could therefore be a strong contrarian pick.

Pason Systems has maintained or increased its dividend since 2003. That's 16 years of continuous dividend payments. Year to date, the company paid out about 71% of its free cash flow as dividends. Management also instilled confidence in shareholders by hiking the dividend by 5.6% earlier this year.

Currently, Pason Systems stock offers a big yield of 5.9%.

Want more tips?

There are many more goodies than these three tips in *The Intelligent Investor*. Serious investors should pick up a copy of the book and get a pen and highlighter ready.

Stay hungry. Stay Foolish.

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