BENJAMIN GRAHAM

1894–1976
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DEDICATION TO GEORGE M. HANSEN

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BENJAMIN GRAHAM
THE FATHER OF FINANCIAL ANALYSIS

Benjamin Graham died on September 21, 1976 at his home in Aix-en-Provence, France at age 82. When a pioneer in a profession dies at an advanced age, one generally has to go back many decades to find his last contributions. This was not the case with Ben Graham. The cover of the then current issue of the Financial Analysts Journal (the September/October issue had gone to press only shortly before his death) had the portrait that adorns this publication. The lead article ended with Ben's exhortation consistently stressed for half a century: “True investors can exploit the recurrent excessive optimism and excessive apprehension of the speculative public.”

The profession of financial analysis was built on the pioneering book Security Analysis, published in 1934 and in its fourth edition still is used in the Chartered Financial Analysts Candidate Study Program. More than 100,000 copies of “Graham & Dodd” have brought his concepts about the merits of investment over speculation to two generations of our profession. The financial success of Ben and his clients dramatically demonstrated the practical value of his thorough approach to the evaluation of investments.

Students of Security Analysis recognized that the masterpiece did not spring into life in one outburst of genius. Rather it was the result of much hard work and the experience of two decades before the first edition. Over a year ago The Financial Analysts Research Foundation became interested in the preparation of a biographical sketch of the professional development of Benjamin Graham as a contribution to the history of the development of financial analysis. Ben was most enthusiastic about this project and supplied nearly 200 pages of an unpublished draft of his memoirs written in 1956. The transcript of the March 1976 interview by the Foundation’s Research Coordinator, Hartman L. Butler, Jr., C.F.A., helped Ben to review some of the parts in his active life not covered in his memoirs. One of the co-authors of this sketch, Irving Kahn, had the experience of working extensively and teaching under Ben for over four decades.

The reader should understand that the enduring portions of this biography are among Ben’s many contributions that have both enriched our lives and enhanced our understanding of the early development of the profession of financial analysis.
HIS EARLY LIFE

Benjamin Graham was born on May 9, 1894 in London, the youngest of three children, all boys. His father was in the family business of importing china and bric-a-brac from Austria and Germany. When he was just a year old, the family moved to New York to open an American branch of the firm. Ben began the normal life of a boy in New York, attending P.S. 10 at 117th Street and St. Nicholas Avenue. His father died at only 35, leaving his widow to bring up three boys ages 9, 10, and 11.

Various efforts were made to continue the business but, without an active adult, it failed in little more than a year. Nor did his mother's two-year experiment running a boarding house prove any more successful. When Ben was 13, his mother opened a margin account to buy an odd lot of U. S. Steel. The panic of 1907 wiped out the small margin account. This was Ben's first contact with the stock market.

Despite dwindling family resources, Ben graduated near the top of his class at Boys High School in Brooklyn. A clerical error delayed his scholarship to Columbia for one semester. The need to help support the family forced him to drop his daytime classes to take a full-time job with United States Express. Yet, he continued his studies with such great success that he graduated second in the Class of 1914.

During his final month at Columbia, three departments—Philosophy, Mathematics, and English—each invited him to join their faculties as an instructor. Each of the department heads pointed out the satisfactions of an academic career, despite low starting salaries and slow prospects for advancement. Bewildered by this wealth of offers, Ben conferred with Columbia's Dean, Frederick Keppel, who had a strong predilection for sending bright graduates into business instead of an academic life. By coincidence, a member of the New York Stock Exchange came in to see Dean Keppel about his son's woeful grades and, in the course of the interview, asked the Dean to recommend one of his best students.

THE BEGINNING OF A CAREER

Thus, Ben began his career with Newburger, Henderson & Loeb as an assistant in the bond department at $12 per week ($68 in 1977 dollars). Although Ben never studied economics at Columbia, he was eager to participate in the "mysterious rites and momentous events" alluded to in novels about the world of finance. After a month as a runner delivering securities and checks, he became the assistant to a two-man bond department. His main task was to prepare thumbnail
descriptions of each bond in their daily lists of recommendations. After six weeks, Ben was assigned the additional task of writing the daily market-letter for their Philadelphia office.

A few months later, World War I broke out and European investors’ heavy sales of their American securities caused the panic that forced the New York Stock Exchange to close for several months. When trading resumed on a limited basis, investor confidence gradually returned and the big wartime rise began. His firm, caught shorthanded by this increased activity, used Ben to fill many gaps, including helping the “boardboy” put up stock quotations. Other days he operated the telephone switchboard, helped out in the back office, and even made an occasional delivery of securities. These routine jobs gave Ben an understanding of all aspects of the investment world.

When the market settled down, the partners decided to send Ben out to call on customers. This was then a pleasant occupation, because in those days the average businessman was flattered to be called upon by a bond salesman and even his “No” was invariably polite. Although these calls turned out to be fruitless, Ben was learning about the limited understanding most clients had of the securities they bought or owned.

Ben began to study railroad reports, then the major industry with bonds outstanding. He applied himself diligently to the then standard textbook: The Principles of Bond Investment by Lawrence Chamberlain. One of his earliest studies was an analysis of the Missouri Pacific Railroad. Its report for the year ended in June 1914 convinced him that the company was in poor physical and financial condition and that its bonds should not be held by investors. He showed the report to a friend who was a floor broker on the Exchange. The floor broker in turn showed the report to a partner in Bache & Co. As a result, Ben was asked to become a “statistician”—as security analysts were then called—at a salary of $18 per week, a 50 percent raise.

Ben assumed that Newburger, Henderson & Loeb would not object, as he had brought in no bond commissions to offset his salary. Samuel Newburger instead was outraged that his employee could be so disloyal as to consider leaving. To his surprise, this conversation ensued:

“But, I thought I wasn’t earning my salt here.”

“That’s for us to decide, not you.”

“But I’m not cut out for a bond salesman; I’d do better at statistical work.”

“That’s fine. It’s time we had a statistical department. You can be it.”
**EARLY YEARS ON WALL STREET**

Investment activity in that era was almost entirely limited to bonds. Common stocks, with a relatively few exceptions for the major railroads and utilities, were viewed as speculations. Nonetheless, a growing supply of corporate information had begun to appear. Operating and financial information was supplied by corporations, either voluntarily to attract investors, or else to conform with stock exchange regulations. The financial services took advantage of this information, reprinting it in convenient form in their manuals and current publications. In addition, the ICC and various regulatory bodies were gathering enormous quantities of data, all of which were open for inspection and study.

Most of this financial information, however, was neglected in common stock analysis. The figures were considered to have limited current interest. What really counted was “insider information”—some of it related to a company’s operations, but much relating to the plans of stock market pools. Market manipulators were held responsible for most of the moves, up or down, in major stocks. The improved financial position of industrial companies—resulting from World War I expansion—developed those factors of intrinsic value and investment merit that were to become the dominant concepts in future market moves. Thus, the Wall Street of the early 1920’s became virgin territory for exploitation by genuine, penetrating analysis of security values, especially among industrial issues.

Ben’s career as a distinctive professional Wall Street analyst dates back to the 1915 plan for the dissolution of the Guggenheim Exploration Company. This holding company had large interests in several copper mining companies actively trading on the New York Stock Exchange. When Guggenheim Exploration proposed to dissolve and to distribute its various holdings to its shareholders on a pro rata basis, Ben calculated the arbitrage values as follows:

<table>
<thead>
<tr>
<th>Equivalent Securities Held</th>
<th>Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1 share Guggenheim Exploration</strong></td>
<td>$68.88</td>
</tr>
<tr>
<td>.7277 share Kencott Copper @ 52.50</td>
<td>= $38.20</td>
</tr>
<tr>
<td>.1172 share Chino Copper @ 46.00</td>
<td>= 5.39</td>
</tr>
<tr>
<td>.0833 share Amer. Smelting @ 81.75</td>
<td>= 6.81</td>
</tr>
<tr>
<td>.185 share Ray Cons. Copper @ 22.88</td>
<td>= 4.23</td>
</tr>
<tr>
<td>Other assets</td>
<td>= 21.60</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$76.23</strong></td>
</tr>
</tbody>
</table>
These calculations meant an assured arbitrage profit of $7.35 for each share of Guggenheim Exploration purchased, provided that simultaneous sales were made of the underlying copper companies. The risks lay in the possibility that the shareholders might not approve the dissolution, or that litigation might delay it. Another potential problem might arise in maintaining a “short” position in the copper stocks until the distribution was made to Guggenheim shareholders. Because none of these risks appeared substantial, the firm arbitraged a large number of shares. One of Ben’s associates proposed that he manage his venture in Guggenheim in return for a 20 percent share in the profits. When the dissolution went through on January 17, 1916, Ben’s reputation and his net worth both grew.

The years 1915-1916 saw the big bull market of World War I. The typical U.S. corporation, still lightly taxed, benefited hugely from war orders for munitions and supplies for England and France. Common stocks rose to unprecedented heights; the brokerage community prospered mightily; and Ben’s salary did, too.

In April 1917, when the United States entered the war, Ben applied for the Officer Candidate Training Camp, but he received a curt rejection because he was still a British subject. Ben joined Company M of the New York State Guard, whose most active participation was marching to the Guard’s band led by Victor Herbert!

Ben’s success with the Guggenheim Exploration Co. dissolution encouraged him to buy common stocks that appeared to be underpriced while simultaneously selling overpriced stocks. His good friend, Algernon Tassin, Professor of English at Columbia, agreed to supply $10,000 of capital, with the profits or losses of the trading account to be divided equally between the professor and Ben. The account prospered famously during the first year with several thousand dollars of profit for each. Ben used his share to invest $7,000 in “The Broadway Phonograph Shop” at Broadway and 98th Street, with his brother Leon operating the store. The store was kept going for several years before selling out.

Beginning with a so-called “peace scare” in the Fall of 1916 and continuing for a year after America entered the war in early 1917, security prices suffered a persistent decline. The Tassin account was generally in obscure issues that actually were worth more than their market quotations. But, these stocks also dropped in the general weakness and, even worse, bids for such obscure issues tended to disappear. The account was called for more margin, and it was necessary to make sales at a considerable loss. Ben was unable to repay his share of the loss since his funds were tied up in the phonograph shop. The unsuspecting Algernon was shocked to hear the results, but
sympathetically allowed Ben to make up the deficiency at $60 per month. After two years the market strengthened sufficiently to make up the deficiency, and in later years Ben was able to build up Professor Tassin's fortune to a "quite respectable figure."

During the war years Ben submitted to the Magazine of Wall Street an article entitled "Bargains in Bonds." This was a thorough study showing the disparities among the prices of a number of quite comparable issues. From then on, he became a frequent contributor to the magazine. At one point he was asked to join the staff and later he was asked to become editor with an attractive salary. Mr. Newburger again talked Ben out of leaving the firm, this time promising him a junior partnership. Instead, Ben's brother, Victor, became an advertising salesman for the Magazine of Wall Street, where he had a great success, becoming the vice president in charge of the department.

THE NEW ERA BEGINS

Between 1919 and 1929, Ben's upward progress in Wall Street was so rapid as to verge on the spectacular. At the beginning of 1920 he was made a partner in Newburger, Henderson & Loeb, retaining his salary and gaining a 2½ percent interest in the profits, without any liability for losses.

One of Ben's friends was with the important public utility bond house, Bonbright & Co. He introduced Ben to a young man, Junkichi Miki, who had tried to interest Bonbright & Co. in acting as agent for his employer, the Fujimoto Bill Broker Bank of Osaka, active in acquiring Japanese Government bonds. Bonbright & Co. was too busy with its own underwritings, but Ben was able to offer Miki his firm's comprehensive and energetic service. Various issues of Japanese Government bonds had been placed in Europe and America in 1906 during the Russo-Japanese War. These bonds were payable, at the option of the holder, either in a European currency or in yen. The prosperity of Japan combined with the currency problems of Europe following World War I meant that these bonds became very attractive for Japanese investors.

Ben arranged for the purchase of these bonds on a large scale through his firm's correspondents in London, Paris, and Amsterdam. The bonds were then shipped to Japan, draft attached. The two percent commission provided over $100,000 during the two years that Newburger, Henderson & Loeb was the exclusive agent. The back office was less enthusiastic, however, because a large portion of the Japanese bonds had been sold in $100 denominations or equivalent pieces in Paris and London. These "small pieces" were considered a nuisance in
Western markets, selling at a substantial discount. As the Japanese had no prejudice against these bonds, his back office was inundated with reams of documents. The typical purchase of $100,000 face amount would usually result in the appearance of one thousand separate bonds. The special safe deposit box for these bonds was known, not too favorably, as the “Ben Graham” box.

After two years, the Fujimoto Bank set up its own New York office, with Miki in charge, to buy these bonds. Two other Japanese banking firms then became customers and made up for some of the lost business.

Ben’s main work was in handling all inquiries about security lists or individual issues. He was given an assistant, Leo Stern, later a senior partner in the firm and the father of Walter P. Stern—whose own distinguished career has included terms as President of The Financial Analysts Federation and of The Institute of Chartered Financial Analysts. Periodically, they issued “circulars” analyzing one or more securities in detail.

For example, in May of 1921 they recommended the sale of the U. S. Victory 4 3/4’s due in 1923 and selling at 97 3/4 and reinvestment in the U. S. 4 3/4’s of 1938 then selling at 87 1/2. They believed that the then high level of interest rates would subside and thus the longer term bonds had better appreciation possibilities. This circular was advertised in the newspapers under the title “Memorandum to Holders of Victory Bonds.” The New York Stock Exchange promptly asked for a copy, as an unwritten rule prohibited Stock Exchange Members from recommending switches out of Government Bonds into corporate securities. Fortunately, the circular did not recommend any unpatriotic act—and it proved to be a profitable recommendation.

Another circular was more notable for teaching Ben a lesson. That circular was a detailed statistical comparison of all the listed tire and rubber stocks. The study duly noted that Ajax Tire common appeared to be the most attractive. A few days later the president of Ajax Tire appeared at Ben’s office. Ben subsequently wished he had met him before the circular was issued. Ajax Tire flourished only a little while and then declined into bankruptcy. Thus, a lesson in the importance of meeting top management was learned.

In 1919, Ben prepared a detailed comparison of the Chicago, Milwaukee & St. Paul Railroad with the St. Louis & Southwestern Railroad. Because his analysis portrayed the Milwaukee Railroad in a highly unfavorable light, he felt it best to submit it to the company before publication. An appointment was made with the Financial Vice-President, Robert J. Marony. Marony looked over the material rather rapidly and said: “I don’t quarrel with your facts or your
conclusions. I wish our showing was a better one, but it isn’t and that’s that.” This episode led to a long-lasting business and personal association in which Mr. Marony became a substantial investor and director in Graham-Newman Corporation and in Government Employees Insurance Company.

The same year Ben wrote three pamphlets “Lessons for Investors,” giving the wisdom of this precocious 25-year old. A strong argument was made for the purchase of sound common stocks at reasonable prices. It also contained the novel statement that “if a common stock is a good investment, it is also an attractive speculation.”

Beginning in 1913 and throughout World War I, tax laws and tax regulations became increasingly complicated as well as onerous. Ben realized that it was necessary to study tax laws thoroughly to see their effect on corporations’ results. This led to an unexpected use of the tax figures. At that time the typical corporate balance sheet contained a large amount of “goodwill,” almost always lumped together with actual tangible investments in the “property account” as published. The extent of “goodwill” or “water” was a jealously-guarded secret.

The Excess Profits Tax of 1917, however, allowed a credit of a certain percentage on tangible invested capital, but only a minor allowance for intangibles such as goodwill, patents and so forth. Ben devised a series of formulas to work back from three items—taxes, pretax income, and the property account—to determine how much of the property account was in the goodwill category. These findings were the basis for an article in The Magazine of Wall Street. Editor Powers said: “Ben, nobody around here can make head or tail of your formulas. It looks as if you’ve done the whole thing with mirrors. But, we’ll publish it anyway.”

Although the published figures available could have been misleading, Ben’s computations proved remarkably correct. The accuracy of his calculations was not publicly available for many years—until most corporations finally started to write off the more imaginary intangibles embedded in their balance sheets. By then, earning power had begun to become the most significant factor affecting a stock’s price and asset values were much less important. Ben’s computations, for example, revealed that all the $508 million par value of the U. S. Steel common stock and even a good part of its $360 million of preferred had originally been “water.” Subsequently U. S. Steel wrote down $769 million of “goodwill” and similar intangibles by using many years of retained earnings.

Word of Ben’s success with arbitrage and hedging operations spread, and several clients opened accounts that allowed him, as sole manager, a 25 percent share in the cumulative net profits. A standard
operation was the purchase of convertible bonds near par value and the simultaneous sale of calls on an equivalent amount of common. At times the market would be stronger for puts and then the bonds would be bought, the stock sold short and a put also sold. As the premium prices then received for puts and calls were substantial, this procedure guaranteed a satisfactory profit no matter whether the stock rose, fell, or remained constant.

The postwar bull market of 1919 was a typical bull market of the times—marked by manipulations by insiders, plus the usual greed, ignorance, and enthusiasm on the part of the public. Ben came through the dangerous period of 1919-1921 quite well, remembering his experience with the Tassin account. His accounts concentrated on arbitrage and hedging operations. One of the speculative favorites of the time was Consolidated Textile, a recent conglomeration of cotton mills whose convertible seven percent bonds appeared sufficiently safe to buy. Later, as the common rose in price, corresponding amounts of stock were sold short, assuring a good profit. One of the firm's senior partners, an enthusiastic bull on the stock, had purchased large quantities of the common for his customers. Ben pointed out that the convertible bonds had the same potential for profit as the stock, plus less risk of loss. The partner said his customers liked an active stock rather than a bond. Within a year, Consolidated Textile common fell from 70 to 20, while the seven percent convertible bonds were refinanced and redeemed at a premium above par value. This valuable lesson has yet to be learned by amateur investors.

Ben was not completely immune to the then current nonsense. A friend had been in a syndicate that bought privately Ertel Oil common at $3 per share and after a few weeks began trading the stock publicly in the over-the-counter market at $8 per share. The friend good naturedly offered to let him in on the next deal. In April of 1919, the next deal came along. Savold Tire was formed to exploit a patented process for retreading automobile tires. Ben put in $2,500, and the syndicate subscribed at 10. A few days later trading began at 24 and then rose to 37 amid considerable excitement. The syndicate sold out and Ben's share was nearly $7,500.

In spite of his usual common sense, greed prevailed. The parent decided to license its process to affiliates in the various states and these companies would sell stock to the public. Four weeks after the original Savold Tire deal, New York Savold Tire was organized. This time some of Ben's friends joined in a $20,000 participation in the syndicate that subscribed to shares at 20 and saw the stock open on the Curb Exchange at 50 and then rise to 60. This happened during the week of Ben's 25th birthday. Promptly a check was received for the initial
contribution plus 150 percent in profits. No accounting came with the check, and Ben said he wouldn’t have dreamt of asking for one. A third company, Ohio Savold, came the next month, but this was a small one with no room for Ben’s group.

Then a very large deal was concocted, Pennsylvania Savold. This was to be the last in the series with rights to the process in the remaining 46 states, as it had been decided that more than four Savold companies would be cumbersome. Ben “neither understood nor approved of this artistic restraint, but prepared to profit to the hilt from this last gorgeous opportunity.” Ben’s circle of friends combined to send in $60,000 for this venture. It is now August 1919, and the bull market continues strong with great emphasis on stocks of the rankest speculative flavor. The original Savold was strong, reaching a peak of 77%. In a week, however, it fell by 30 percent. The group waited for Pennsylvania Savold to begin trading. There was a slight delay. This continued for a few weeks until all the Savold issues collapsed completely, disappearing forever. The friend brought Ben along to a meeting with the Savold promoter, who was pressured into turning over cash and shares in some other promotions that at least gave back to the victims of the Savold Tire promotion one-third of their “investment”.

Apparently nobody complained to the district attorney’s office about this swindle—nor about similar swindles. Wall Street firms behaved ethically in the execution of their customer’s orders and in their dealings with other firms. Most of the brokerage firms, however, condoned manipulation and did virtually nothing to protect the public or often themselves against gross abuses similar to the Savold Tire swindle.

Ironically, the subsequent success of retreading companies, such as Bandag, justified the product’s legitimacy.

BEN BECOMES A PORTFOLIO MANAGER

Some of Ben’s friends were so impressed with his approach to investments that in early 1923 they proposed a $250,000 account and, if the results warranted it, this would be increased greatly. Ben could bring in other accounts as part of the original capital. He would receive a salary of $10,000 per year ($34,200 in 1977 dollars). Then the investors would be entitled to a six percent return. Ben would be entitled to a 20 percent share in profits beyond that.

Newburger, Henderson & Loeb agreed, this time, to let Ben leave. The New York Stock Exchange had tightened its rules on the amount of capital required by member firms. Their volume of business had been greatly expanding and Ben’s arbitrage operations required more capital
than they could now supply. They agreed to let Ben continue to use an office at the firm, in return for doing his business through Newburger, Henderson & Loeb.

Thus the new business was incorporated as Grahar Corporation (Louis Harris being the major investor). It began operations on June 1, 1923 when the Dow Jones Industrial Average was 95.

Grahar Corporation operated for two and one-half years until the end of 1925, and then dissolved with a good percentage appreciation—the Dow Jones Industrials having risen 79 percent during the period. Investments were limited to arbitrage operations and to the purchase of securities that appeared to be greatly undervalued.

The first trades were the purchase of Du Pont common, and the simultaneous short sale of seven times as many shares of General Motors common. At that time Du Pont was selling for no more than the value of its General Motors holdings. The market in effect placed no value on DD's large chemical business and other assets. In time, this anomaly ended with the market price of Du Pont rising to reflect the value of the chemical business as well as its GM holding. Grahar then took its profits by selling DD and closing out the GM short position.

Ben prided himself on his ability to recognize overvalued stocks as well as undervalued issues. He would sell short an overvalued stock and buy an undervalued one. Accordingly, it was decided to sell short a few hundred shares of Shattuck Corp., the owner of the Schrafft's restaurant chain. Ben had his regular weekly luncheon with the major investors at a Schrafft's restaurant. After the short sale, they all felt that it was not right to support Schrafft's with their business. Time went by, but Shattuck common continued to go up. The group grew tired of fighting the trend, closing out the short at a $10,000 loss.

One of the characteristics of popular issues is that such a stock may continue to remain popular and, therefore, overvalued instead of returning to a more normal price. The only consolation was that Ben and his group were able to go back to eating lunch at Schrafft's.
By 1925 the bull market was well under way. Ben had reached the ripe age of 31. Many of the customers' men (today called registered representatives) ran discretionary accounts—some with profits being evenly split, but any net loss being absorbed by the customer. They told Ben he was foolish to settle for 20 percent of the profits and that they could bring him accounts on a fifty-fifty basis. He proposed a new arrangement to Lou Harris. Ben would give up his salary but, after the six percent allowed on capital, Ben would receive 20 percent of the first 20 percent return, 30 percent of the next 30 percent, and 50 percent on the balance. This would have worked out as follows:

<table>
<thead>
<tr>
<th>Return on Capital</th>
<th>Investors' Share</th>
<th>Graham's Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>6%</td>
<td>6%</td>
<td>---</td>
</tr>
<tr>
<td>26</td>
<td>22</td>
<td>4%</td>
</tr>
<tr>
<td>56</td>
<td>43</td>
<td>13</td>
</tr>
<tr>
<td>100</td>
<td>65</td>
<td>35</td>
</tr>
</tbody>
</table>

Mr. Harris rejected this proposal, and they mutually agreed to dissolve Grahar Corporation at the year end.

On January 1, 1926, the “Benjamin Graham Joint Account” began with capital contributed by old friends plus Ben’s own funds. The profit-sharing terms were those Ben had proposed for Grahar. The original capital was $450,000 and grew to $2,500,000 in three years by the start of 1929, with much of the gain reflecting appreciation rather than capital additions. Towards the end of 1926, Jerome Newman joined Ben. Jerry Newman remained as an ever more active and valuable associate for the next 30 years until Ben retired in 1956.

THE NORTHERN PIPE LINE CONTEST

One day in 1926, Ben was looking through an annual report of the Interstate Commerce Commission (ICC) to obtain data on a railroad. At the end of the volume he found some statistics about pipeline companies that had the notation: “taken from their annual reports to the Commission.” Ben wondered if the reports filed with the ICC might have interesting details and wrote for a blank copy of the ICC report form to see what details were asked for. The ICC sent a 50-page blank form showing that complete details were required. Ben took the train to Washington the next day.

Eight pipeline companies were carrying crude oil to various refineries. Originally part of the Standard Oil Trust, they were spun off in 1911 as part of the U. S. Supreme Court antitrust decision to split up the trust. Each of the companies was relatively small and published a
one line "income account" and a very abbreviated balance sheet. Two large Wall Street firms specialized in the markets for all the 31 former Standard Oil subsidiaries, but they gave no data for the eight pipeline companies except their brief annual reports.

At the ICC, Ben found that all of the pipeline companies owned large amounts of investment-grade railroad bonds, often exceeding their own market value. Moreover, no business reason seemed needed for keeping these bonds. The companies had relatively small gross revenues, but wide profit margins. The outstanding value was Northern Pipe Line, selling at 65 and holding $95 per share of cash assets, mostly in good railroad bonds. It earned and paid a $6 dividend to yield nine percent.

The pipeline companies had paid even larger dividends a few years earlier before the advent of large railroad tank cars that began cutting into their business. Investors thought that the downtrend in earnings and dividends would continue and, despite nine percent yields, only trouble was ahead.

By careful and persistent buying, Ben was able to buy 2,000 shares of Northern Pipe Line's 40,000 shares, making him the largest shareholder except for the Rockefeller Foundation's 23 percent interest. He met the president of Northern Pipe Line at the company's office in the Standard Oil Building. Ben pointed out how unnecessary it was for Northern Pipe Line to carry $3,600,000 in bond investments when its gross revenues were only $300,000. These surplus cash resources of $90 per share should be distributed to the shareholders. The president raised a number of specious arguments as to why this was not possible: the railroad bonds were needed to cover the stock's $100 per share par value; they might be needed as a source of funds when the present line would have to be replaced; and finally, they might want to extend the line. His parting comment was one that Ben came to hear many times. "The pipeline business is a complex and specialized business about which you know very little; but in which we have spent a lifetime. We know better than you what is best for the company and the stockholders. If you don't approve of our policies, you should sell your shares."

Old Wall Street hands would have regarded Ben's efforts to change management's policies as either naive or suspect. Many years ago one man, Clarence Venner, had made quite a lot of money (and an unenviable reputation) by bringing suits against managements for alleged financial misdeeds, some being only minor technical errors. Therefore, anyone attempting to challenge management would be characterized as a "hold-up artist."

Having failed to impress the Northern Pipe Line management with the logic of the case for distributing the surplus cash assets to the
shareholders, Ben asked if he could present his argument at the annual meeting. Accordingly, he attended the meeting in January 1927 at Oil City, Pennsylvania. Ben had neglected, however, to bring someone to second his motion to present the memorandum, and the meeting was adjourned after a few perfunctory actions.

Ben began preparing for next year's meeting by buying more shares of Northern Pipe Line with the partnership's increased capital. A lawyer of great ability and prominence was retained. Pennsylvania corporations had mandatory cumulative voting so that it would be necessary to have the votes of one-sixth of the shares in order to elect one director to the five-person board. Ben decided to solicit proxies in favor of a resolution to reduce the capitalization and to pay the surplus cash to shareholders. He also sought to elect two members to the board.

Surprisingly, Northern Pipe Line thought so little of his chances that the shareholders' list was furnished without a lawsuit. Each side sent out letters requesting proxies, with the arguments for both sides being the same as at Ben's first meeting with the president. Because proxy solicitation firms did not exist, management utilized its employees. Ben and his associates visited the larger shareholders. He was even able to arrange an interview with the financial advisor to the Rockefeller Foundation, which owned 23 percent of the stock. He listened courteously, but said the Foundation never interfered in the operations of any of the companies in which it held investments.

At the 1928 annual meeting, Ben came supplied with proxies for 38 percent of the shares, guaranteeing the election of two directors. The president suggested that a single slate of directors be named, including any two from the rebels, except Ben. As this was unacceptable, the single slate included Ben and one of the lawyers. Thus, Ben became the first person not directly affiliated with the Standard Oil system to be elected a director of one of the affiliates.

A few weeks after the meeting, the president invited Ben to his office and told him: "We really were never opposed to your idea of returning capital to the stockholders; we merely felt the time wasn't appropriate." He agreed to distribute $70 per share. It was later learned that when the Rockefeller Foundation returned their proxy to management, they indicated that they would favor a distribution of as much capital as the business could spare. Subsequently, the other pipeline companies made similar distributions of surplus capital to shareholders, no doubt since the Rockefeller Foundation had a number of uses for the surplus funds. The $70 distribution plus the value of Northern Pipe Line afterwards exceeded $100 per share, compared with the initial market price of 65 when Ben began his campaign.
MEETING THE BARUCHS

As the Benjamin Graham Joint Account continued to prosper in other operations, it was necessary to move from the small office at Newburger, Henderson & Loeb into its own offices. These were in the same building with the main office of H. Hentz & Co., one of whose senior partners was Dr. Herman Baruch. All three of Bernard Baruch's brothers made the not surprising choice of becoming Wall Street brokers. At this time Ben began buying shares in another former Standard Oil subsidiary, National Transit Company. National Transit operated a pipeline and also manufactured pumps. To counter Ben's proposal to distribute their surplus cash, management came up with a plan to use it in a rather unproductive manner. Herman Baruch and his clients joined in the purchase of National Transit shares and, after some prodding from the Rockefeller Foundation, a substantial distribution of cash was made to shareholders. In gratitude Dr. Baruch gave Ben the use of his fully manned yacht for a week— with Ben inviting some of his friends for a luxurious week.

Ben's special interests became well known on Wall Street. One day a trader from a large over-the-counter firm came to Ben with an elaborate proposition to buy a large block of Unexcelled Manufacturing Company, the nation's leading fireworks company. The price of 9 was less than working capital and only 6 times earnings. The purchase of this block would also enable a change in control, with the old president being replaced by a capable vice president and Ben joining the company as a part-time Financial Vice President. The partnership took 10,000 shares and sought to place the balance in "good hands." Bernard Baruch had become increasingly interested in Ben's type of operations and agreed to buy the balance of the block of Unexcelled. At the annual meeting he saw for the first time the president of Unexcelled, who had founded the company and run it for 25 years, and Ben felt uneasy at being part of a conspiracy to end the career of a man who had never done him any harm. The change in control took place as scheduled, yet shifting demand and legal restrictions on the use of fireworks kept this investment from being a success.

Ben recommended a number of other issues to Bernard M. Baruch, which appealed to his keen sense of security values. During the bull market of the late 1920's, emphasis was focused on certain popular issues. Lesser-known stocks in promising industries, such as electric utilities and chemicals, became as popular as the giant companies. Also, many smaller companies with short but exceptional growth records received the attention of speculators and manipulators. Other
substantial companies, however, fell outside these favored categories and sold at bargain-counter prices, even below their minimum values as judged by ordinary standards. Among these were Plymouth Cordage, Pepperell Manufacturing Co., and Heywood & Wakefield, the leader in the baby carriage industry, each selling below working capital. Bernard Baruch bought substantial amounts of these issues, confirming the soundness of Ben’s analyses. Baruch egotistically believed that his concurrence was a sufficient reward for Ben’s efforts.

Both agreed that the market had advanced to inordinate heights and, with such frenzied speculation, it would ultimately end in a major crash. Baruch commented that it was ridiculous for short-term interest rates to be eight percent while the Dow Jones Industrials provided only a two percent yield. Ben replied: “By the law of compensation, someday the reverse should happen.” Some years later after the crash when the law of compensation took effect, Ben realized that it was strange that, despite his accurate projection, he did not realize that all operations involving borrowing, including his own, would be affected by the ultimate collapse.

One day in 1929, Baruch invited Ben to his office. For the first time in his life he wanted a partner. “I’m now 57 and it’s time to slow up a bit and let a younger man like you share my burdens and my profits.” Although this was most gratifying to one’s ego, Ben had just completed a year in which his personal net profit was over $600,000 and thus saw no reason to be a junior partner even to the eminent Bernard M. Baruch.

THE DELUGE

The Benjamin Graham Joint Account began with $450,000 at the start of 1926 when the Dow Jones Industrial Average was 157. In 1926, the Dow had only a nominal gain, but 1927 provided an encouraging 32 percent return. The Benjamin Graham Joint Account ended that year at $1,500,000, with new capital coming into the account, as well as capital gains.

The year 1928 was the last full year of the bull market, with a 51 percent return for the Dow Jones Industrials and a 60 percent return for the Joint Account, after Ben’s share that exceeded $600,000.

This excellent record led to an even more exciting proposal, one to manage a large new investment trust. Many major investment trusts were formed in the 1920’s. The first were fixed trusts with a specified and fixed portfolio of common stocks, with the shareholder holding a pro rata share in this unchanging list. Actually, this was really not greatly different from the index funds of today.
Next, investment trusts were formed that could be managed, patterned after the investment trusts that had long operated successfully in England. The speculative atmosphere of the late 1920's led many investment banking firms to launch their own investment trusts—to obtain management fees, as well as commissions on the sale of shares in the trust plus commissions on the trust’s business.

The H. Hentz partners thought they should have an investment trust and that Ben Graham should run it. They were planning a $25 million fund, which would supply adequate compensation for all concerned. The details of organizing the trust delayed the initial sale for some months and when September came, the 1929 stock market crash ended any possibility for establishing the Hentz-Graham Fund.

Ben had enough to do to keep up with the Joint Account. At mid-1929, the capital was $2.5 million, about where it was at the start of the year. The Account had a large number of arbitrage and hedging operations involving long positions of $2.5 million and an equal amount of short positions. In addition, $4.5 million of other securities were held on which $2 million was borrowed, leaving $2.5 million of equity. These securities were not Wall Street favorites, but rather issues that had intrinsic values above their market prices.

The hedge operations generally involved the purchase of a convertible preferred and a short sale of the equivalent amount of common. In weak markets the common would decline faster than the preferred stock and they would undo the hedge at a good profit. However, they found that oftentimes the market would recover and they would reinstate the position by buying the convertible preferred once again and selling more common. This would usually involve the purchase of the preferred at a higher price than the price at which it was sold earlier. Thus they came to adopt a policy of only partially undoing the hedging operation when the stocks declined, closing out the short positions in the common, but holding on to the preferred. In addition, they began to go in for partial hedges, selling short only half as much common as would be required for a complete hedge. These adaptations of the basic hedging operation increased profits during a bull market, but also created risks that were not present in fully hedged positions.

As the market collapsed in the final months of 1929, Ben covered a large part of the short position, recording large profits. In most cases, however, Ben did not sell the related convertible preferreds since their prices seemed too low. The Joint Account ended the year with a loss of 20 percent, as compared with a 15 percent decline for the Dow Jones Industrials. Many of the participants in the fund had their own margin
accounts that had experienced much greater losses. Near the close of
the year, some recovery developed and most investors believed the
worst was over.

In early 1930, the market continued its recovery, but soon the
economic picture clouded over. Ben went down to Florida in January.
He met a 93 year old man, John Dix, a successful retired businessman.
Mr. Dix asked a great number of penetrating questions, displaying a
keen mind, and then said with great earnestness:

Mr. Graham, I want you to do something of the greatest
importance. Get on the train to New York tomorrow. Sell
out your securities. Pay off your debts and return the capital
to the partners in the Joint Account. I wouldn’t be able to
sleep at night if I were in your position.

Ben thanked the old gentleman and said he would consider his
advice. Actually, he then thought the advice was preposterous, as Mr.
Dix was probably not far from his dotage and could not possibly have
really understood Ben’s methods. It turned out, of course, that Mr. Dix
was absolutely right and Ben should have been content to keep his
position as a “near-millionaire.”

The market recovery continued through April but then the market
headed down again. Thus, 1930 was to prove to be the most disastrous
year in all of Ben’s active career. He had already covered nearly all of
the short positions, leaving a large long position in securities whose
declining market values were accentuated by the substantial margin
debt of the Joint Account. The record of the account during the crash
was as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Benjamin Graham Joint Account</th>
<th>Dow Jones Industrials</th>
<th>S&amp;P 500</th>
</tr>
</thead>
<tbody>
<tr>
<td>1929</td>
<td>-20%</td>
<td>-15%</td>
<td>-7%</td>
</tr>
<tr>
<td>1930</td>
<td>-50</td>
<td>-29</td>
<td>-25</td>
</tr>
<tr>
<td>1931</td>
<td>-16</td>
<td>-48</td>
<td>-44</td>
</tr>
<tr>
<td>1932</td>
<td>-3</td>
<td>-17</td>
<td>-8</td>
</tr>
<tr>
<td>For entire period</td>
<td>-70%</td>
<td>-74%</td>
<td>-64%</td>
</tr>
</tbody>
</table>

From 1930 on, Ben’s main effort was to reduce the margin debt
without sacrificing too much of the values inherent in the portfolio. All
through this period, quarterly distributions of 1¼ percent of capital
were made. A number of the participants withdrew all or part of their
capital at various year-ends. The only one to make a new investment in
the fund during these difficult years was Jerry Newman’s father-in-law.
Since this was near the low point, his show of confidence enabled him to reap a large reward when the recovery began. Considering the fact that the Benjamin Graham Joint Account began this period with approximately 44 percent margin debt, performance equal to the Standard & Poor's would have wiped out the account sometime in 1930. Thus, keeping the fund alive was a great achievement. The small losses of 1931 and 1932 were especially impressive.

A TEACHING CAREER BEGINS

In 1925, after eleven years on Wall Street, Ben decided to write a book to impart his knowledge of the investment world. However, he thought it would first be best to organize his material and to see how it could be used most effectively. He had the inspiration to start teaching if he could. Most Wall Streeters who were interested in teaching became associated with New York University's Graduate School of Finance, because of the convenient location. Ben, however, applied at his alma mater, Columbia, and in 1928 began a 28-year career as a lecturer in the evening division of the School of Business Administration.

Ben taught a two-hour course one evening a week on current investments using rigorous security analysis. Most of his students worked on Wall Street and attended because Ben's teaching worked in actual practice. A number of finance majors attended, as well as faculty members such as David L. Dodd, who enrolled in Ben's first class in order to gain practical insights. As stock market volume and prices rose, news of the practical value of the class spread and enrollment grew rapidly. By 1929, the class reached its peak attendance of over 150 students, a fairly important fraction of the working statisticians or analysts then on Wall Street.

Some of the students returned year after year in order to ask questions about important topics of the day. Ben enjoyed being challenged by a wide range of questions, which he used to present to the class the general principles of finance and security analysis. He presented actual case studies only to develop proven theorems. Typically, both popular and unpopular securities were used as illustrations, fully documented with relevant data.

For example, in one 1929 class a student, bullish on American and Foreign Power Co. warrants, was directed to the blackboard to compute the total market value for the outstanding warrants. When this calculation indicated that the market value for the warrants exceeded the market value for the entire Pennsylvania Railroad, the degree of speculative distortion was brought home to the entire class. At that time the Pennsylvania Railroad common was an investment quality
stock, while American and Foreign Power was a holding company newly formed to pyramid a leveraged public utility empire.

Around 1931, Irving Kahn became Ben's assistant, preparing statistical analyses for use in classroom discussions as well as guiding and marking studies and exams. Often, when a question was asked, Ben chose to withhold his own reply. He knew the superior results that would come from study and participation on the part of the student. Thus, a question on the merits of land trust certificates might result in a team of four or five students being assigned to prepare an evaluation report. Irving would organize the team to prepare a plan for a thorough review of the topic and would coordinate preparation of the written report. Then Ben would bring it before the entire class, adding his penetrating questions and comments with everyone free to attack or defend the methods and conclusions.

Ben understood the merits of the Socratic method, using it to re-examine his own conclusions as harshly as those of the students. He believed that a teacher should stimulate and guide the student with questions, so that the student not only was exposed to the answer but remembered how the answer was reached. Even in as mundane a topic as definitions, Ben never believed in supplying a ready answer. One day Irving asked: "This ad shows a $10 million tranche of a French Government issue being offered. What does tranche mean?" Ben pointed to the dictionary, which defined "tranche" as a slice, such as a slice of cake. Ben said: "If I told you the answer, you might have soon forgotten it." Some 45 years later, the senior author of this sketch still remembers that a tranche is a portion of an underwriting.

The depression years thinned the ranks of bankers, brokers, and analysts. Shrewd Wall Streeters, however, realized that the disoriented markets of those times were creating many buying opportunities. Over the years thousands came to Ben's class and to hear him analyze undervalued securities. Many wanted his keen mind to review issues they believed worthy of consideration. Ben so enjoyed teaching that often he would remain after class for half an hour or longer responding to questions from his fascinated students.

These classes in security analysis were held continuously until Ben's retirement from Wall Street in 1956. So many successful people from the world of finance were attracted to this class that Columbia's Business School grew in stature as the achievements of the faculty became better known in the financial community.

Simultaneously Ben found time to teach for a decade at the New York Stock Exchange's School, now known as the New York Institute of Finance. His lectures on security analysis were adapted into a correspondence course by Walter Morris, Steve Jaquith, and Irving
Kahn. This material remains as the heart of the course still being offered by the New York Institute of Finance. No other single course reached or held so large a student body as this one.

During 1931-1933, Ben also presented a series of lectures at the New School for Social Research. He became a friend of the New School’s President, Alvin Johnson, participating in an informal group meeting weekly to discuss possible solutions to the economic crisis. Among the members of the group were William McChesney Martin, A. A. Berle, and a great many other distinguished and thoughtful leaders. These efforts led to Ben’s development of an important economic theory, described later in this narrative.

SECURITY ANALYSIS

By 1932, Ben had adjusted the Joint Account to a secure position and began searching for lessons from the stock market crash. In June 1932, he wrote a series of three articles for Forbes magazine under the title “Is American Business Worth More Dead Than Alive?” Over 40 percent of the stocks listed on the New York Stock Exchange were selling at less than their net working capital and many were selling below even their cash assets. Ben concluded that the stock market was placing an inordinately low value on American business.

It was time to set to work on the writing of the textbook that he had first projected six years earlier. Professor Dodd agreed to collaborate on the book. Ben would be the senior author and write the entire text in his style. Professor Dodd would make suggestions, check the numerous facts and references, and work up tables. The authors prepared a Table of Contents and a sample chapter. McGraw-Hill retained a Harvard professor of finance to review this proposal and were so impressed with his recommendation that they offered a straight 15 percent royalty, rather than the standard contract that started at 10 percent. The contract was signed near the close of 1932. The authors began work and, with Irving as a research assistant, much of the comparative analysis done by students at Columbia was incorporated into the book.

In 1934, a year and a half later, the first edition of Security Analysis was printed. It would be hard to overestimate the significance of this text that has sold over 100,000 copies to date (the Graham/Dodd/Cottle fourth edition was printed in 1962). It has become the basic text for the teaching and practice of two generations of security analysts. Despite the economic, financial, and political chaos at home and abroad, and the overwhelming disillusionment at that time with American enterprise and the investment community, Security
Analysis presented a well-reasoned and well-organized case for the great investment opportunities then open to those competent to learn its teachings.

Typical of Ben’s wide erudition and sense of the timeless qualities of great philosophy is its opening quotation from Horace: “Many shall be restored that now are fallen and many shall fall that are now in favor.” It is beyond the scope of this biographical sketch to examine all the original and radical concepts outlined in this pioneering book, most of which have become so well accepted that it is difficult to imagine why they once were not obvious to the entire investment community.

EARNING A LIVING

The halcyon days of 1928, when Ben’s share of the Joint Account’s profits exceeded $600,000, were long past. Because their unique profit sharing arrangement was a cumulative one, Ben and Jerry Newman went five years without any payment for their work. Because of the drastic price decline, the fund’s capital would have to triple before they would be eligible to start sharing again. One partner suggested a revision be made and, following discussion with some of the larger investors, the terms were revised, reducing the share of Ben and Jerry to a straight 20 percent of profits earned after January 1, 1934. By the end of 1935, all past losses had been made good.

In that year, because the Internal Revenue Service questioned whether the Joint Account really qualified as a partnership or whether it was a quasi-corporation, Graham-Newman Corporation was formed to succeed the partnership as of January 1, 1936.

During these difficult years, Ben spent a considerable amount of time as an expert witness, preparing studies and testifying on complicated cases requiring professional valuation. The U. S. Treasury Department had asked the School of Business at Columbia to recommend an expert. The case involved the valuation for the Federal estate tax of the controlling block of stock in Whitney Manufacturing Co., a maker of chains. The executors claimed that the stock market quotation at the date of the owner’s death in 1932 was the proper basis for determining the value. Ben testified that the shares should be valued as a private business, because they represented the controlling interest. He estimated that the minimum liquidating value of the business was its net working capital, with no allowance for plant or equipment. This figure was substantially in excess of the stock market quotation. The Tax Court agreed with Ben.

Because of his obvious abilities in valuation cases, Ben served as an expert witness in some 40 cases. Professor James Bonbright of