

Index

Note: Page numbers in italics indicate exhibits.

- Absolute models:
 - core principles of, 142–144
 - discount rate, 148–151
 - margin of safety, 151–154
 - overview of, 136
 - See also* Absolute P/E model
- Absolute P/E model:
 - adjustments to, 162–163
 - advantages of, 146–148
 - earnings visibility and, 141–142
 - growth rate and, 139–140
 - margin of safety model and, 155
 - math of, 142–146
 - risks and, 140–141
 - setting sell based on, 213
- Absolute valuation, 122
- Absolute valuation tools, 132–136, 156–157
- Acquisitions, 100, 130–131, 132
- Acquisition target, 95
- Adventure Capitalist* (Rogers), 206
- Against the Gods* (Bernstein), 234
- Airlines, 91
- Alexander, Michael A., *Stock Cycles*, 7–8
- Amaranth, 233
- Analyst sentiment screen, 195–196
- Analytical process, cornerstones of, 77–78
- Asset, value of, 119
- Asset allocation role, 69, 71–72
- Asset utilization, 111
- AT&T, 100
- Auto manufacturers, 91
- Backtester (Standard & Poor's), 157
- Balance sheet, 91–95
- Bank of America, 157–158
- Bank One, 131
- Banks, 128–131, 218–219
- Bear market:
 - bond-only strategy and, 255–256
 - definition of, 4
 - emotions of, 25–29
 - performance of strategy in, 253–255
 - range-bound market compared to, 6
- Becton Dickenson, 90, 106–107
- Belsky, Gary, *Why Smart People Make Big Money Mistakes*, 246
- Berkshire Hathaway, 96, 247
- Bernstein, Peter:
 - Against the Gods*, 234
 - The Power of Gold*, 11–12
- Beta, 137–138, 139
- Bond-only strategy, 255–256
- Bonds, 9–11, 67–72
- Brand, strong, 81
- Bristol-Myers Squibb, 89
- Buffett, Warren, 80, 103, 130, 185, 237, 239, 241, 247
- Bull market:
 - annual returns, 1982–2000, 71
 - average, description of, 15
 - definition of, 4
 - emotions of, 23–25, 61, 214
 - performance of strategy in, 252–253
 - range-bound market compared to, 7
 - returns on, and range-bound markets, 15, 18, 19
 - stock valuations in, 177
 - volatility of, 31–35, 182
- Bull market, years to:
 - earnings growth 3 percent, 265
 - earnings growth 3.5 percent, 264

- Bull market, years to (*Continued*)
 earnings growth 4 percent, 263
 earnings growth 4.5 percent, 262
 earnings growth 5 percent, 261
 earnings growth 5.5 percent, 64
 earnings growth 6 percent, 260
 earnings growth 6.5 percent, 259
 earnings growth 7 percent, 258
 Business reporters, 198
 Business risk analysis, 140–141
 Buy-and-hold strategy, 182, 251,
 254–255
 Buy process, *see* Contrarian investing;
 International investing; Strategy
- Capital appreciation:
 components of, 38, 39
 composition, fallacy of, 46–47
 corporate margins and, 47–48
 earnings, GDP, and, 44
 elements of P/E, 48–49
 P/E and, 49–52, 56
 profit margin paradigm, 44–46
 reversion beyond mean, 49–52
 reversion to mean fallacy, 48
 sources of, 38
 stock price drivers, 38, 40–43
 valuation and, 52–56
 Capital asset pricing model, 137
 Capital expenditures, 96–99
 Cash balance, 185, 253
 Cash-flow-generating asset, 13
 Catalyst, 172
 Chicken producers, 140, 174
 China, 207, 208
 Circle:
 of competence, 231, 235
 of trust, 197–198
 Claire's Stores, 173–174
 Coca-Cola, 169–170
 Colgate-Palmolive, 92–94, 106, 109,
 112, 134–135
 Competitive advantage, 48, 79–80, 81
*Competitive Strategy: Techniques for
 Analyzing Industries and
 Competitors* (Porter), 82
- Complacency, 242–243
 Complexity of financials of banks, 130
 Composition, fallacy of, 46–47, 236
 Consumer price index (CPI) and
 TIPS, 13
 Contrarian investing:
 finding stocks to buy, 193–199
 hot stock and, 189–190
 myth buster, being, 190–191
 overview of, 187–189
 quantifying and, 191–192
 time arbitrage and, 192–193
*Contrarian Investment Strategies:
 The Next Generation*
 (Dreman), 116, 158
 Corporate margins, 47–48
 Corporate restructuring, 173
 Costco, 87–88
 Cost cutting, 106–107
 Cost of being wrong, 251–252, 256
 Creative destruction, 28
 Creators of value, 124–125
 The Crocodile Hunter, 229–231,
 234
 Currency exchange-traded funds, 208
 Currency risk, 207–208
 Customer risk, concentrated, 141
 Cyclical, 129
 Cyclical market conditions, 4
- DCF (discounted cash flow) analysis,
 119–128, 132–134, 156
 Debt, 91–95
 Deciding how game will end before it
 starts, 212–213
 Decision making:
 cost of being wrong and, 238–239
 outsider point of view, taking,
 219–220
 Deflation, 26, 27–29
 Delegating selling responsibility, 213
 Dell, 82–84, 111
 Destroyers of value, 124–125
 Direct-to-customer sales, 82–84
 Discipline, definition of, 181

- Discounted cash flow analysis,
119–128, 132–134, 156
- Discount rate model, 148–151
- Dissociating from previous decisions,
219–220
- Diversification, 123–124, 234,
241–246, 248. *See also*
International investing
- Dividend payout, 59–61
- Dividends, 114–117
- Dividend yield, 57–61, 103–104,
144
- Documenting research, 200
- Dollar General, 47, 86–87, 134
- “Do nothing” time, 185, 186
- Dot-com companies, 167
- Double secret probation, 217–218
- Dow Jones Industrial Average:
1900–2006, 5
1929 crash, 27
- Dreman, David, *Contrarian Investment
Strategies: The Next Generation*,
116, 158
- Dun & Bradstreet, 101
- Earnings:
growth in, and range-bound
market, 63
predictable, 89–91
- Earnings growth formula, 102
- Earnings visibility, 141–142, 144
- Earnings yield, 57–59
- Economic growth, 7, 14, 38, 40–43
- Economy of scale, 107–108
- Emotions:
of bear market, 25–29
of bull market, 23–25, 61, 214
circle of trust and, 197–198
decision making and, 220
diversification and, 242
of range-bound market, 29–31
of selling, 212
- Enron, 89, 203
- Environmental risk, 141
- Equity mutual fund investor,
performance of, 19–20, 193
- Evaluating management team, 85–87
- Exchange-traded funds, 194, 208
- Fad quality flaw, 174
- Fair value, 122
- Federal Reserve, policies of, 26
- Fed Model, 41
- Fifth Third Bancorp, 128–129
- Financial Fine Print: Uncovering a
Company’s True Value* (Leder), 94
- Financial leverage, 130
- Financial risk analysis, 140–141
- Financials of banks, complexity of,
130
- Finding good investments, 209
- Finding new stocks, 194–199
- Fooled by Randomness* (Taleb), 230,
247, 251
- Foreign political risk, 141, 204–205
- Free cash flows, 95–101, 109
- Full market cycle:
1950–1982, 19
1966–2000, 17
- Fundamental return, 139–140
- The Future for Investors* (Siegel), 115
- Future-growth capital expenditures,
97
- Gateway case study, 82–84
- Gazprom, 204–205
- GDP, 44, 45, 62
- General Electric, 89, 173
- General Motors, 94, 166, 167
- Germany, 10–11
- Gilovich, Thomas, *Why Smart People
Make Big Money Mistakes*, 246
- Glass half empty mentality, 218–219
- Global accounting standards, 202–203
- Gold, 9, 11–14
- Graham, Benjamin, *The Intelligent
Investor*, 123, 143
- Great Depression, 6, 26
- Greenblatt, Joel, *The Little Book That
Beats the Market*, 194
- Grove, Andy, *Only the Paranoid
Survive*, 219

- Growth:
- by acquisitions, 131
 - asset utilization and, 111
 - of banks, quality of, 130–131
 - dividends and, 114–117
 - economic, 7, 14, 38, 40–43
 - emphasizing, over quality and valuation, 167
 - future engines of, 112–113
 - from margin improvements, 106–108
 - past, and forecasting, 111–112
 - quality and, without valuation, 168–171
 - of revenue, 105–106
 - sources of, 103–105
 - stock buyback and, 108–111
 - valuation and, without quality, 173–174
 - value in, 117
 - visibility of, 141–142
- “Growth investors gone wild” strategy, 214–215
- Growth pyramid, flipped, 104
- Growth stocks, 161
- GuruFocus.com web site, 197
- H. J. Heinz, 165–166
- High-beta growth strategy, 253, 254–255
- High P/E and bear market, 6
- Hindsight, 231–232
- Historical paths, alternative, 231–234
- Hitting the bottom screen, 195
- Home builders, 90–91
- Home Depot, 111
- Hot stock, 189–190
- Ignorance, 243–244
- IMS Health-VNU Inc. merger case study, 100–101
- Incentives, 198
- Industry structure and economy of scale, 107
- Inflation:
- absolute model and, 144
 - Federal Reserve and, 26
 - market performance and, 38, 40
 - range-bound market and, 62
- Instant gratification, desire for, 18–21, 192
- Integrity of management team, 85–86
- Intel, 219
- The Intelligent Investor* (Graham), 123, 143
- Interest rates, 41, 43, 144
- Interest rate volatility, 130
- International investing, 10–11, 201–209
- Intrinsic value, 122, 124
- Investment horizon, 17–21
- Jackson Hewitt, 113
- Japan, 6, 10–11, 27–29
- Jefferson Pilot, 95
- Joint venture, 101
- Law of large numbers, 169, 180
- Leases, operational, 94, 95
- Leder, Michelle, *Financial Fine Print: Uncovering a Company's True Value*, 94
- Leverage, 91, 130, 239
- Lincoln Financial, 95
- Lionsgate Entertainment, 88
- Lipper 1000 index, 20
- Litigation risk, 141
- The Little Book That Beats the Market* screen, 194–195
- Long-Term Capital Management, 233–234
- Long-term investing, as attitude, 181–182
- Long-term market, 7–10
- Long-term value creation, 87–89
- Low price to anything screens, 195
- Low price to normalized anything screens, 195
- Maintenance capital expenditures, 97, 98–99
- Management
- case study, 82–84
 - change in, 173

- long-term value creation and, 87–89
- qualities of, evaluating, 85–87
- skepticism regarding comments of, 84–85
- stock buyback and, 108–109
- Mapping market, 194
- Margin improvements, growth from, 106–108
- Margin of safety, 77, 123, 171–172
- Margin of safety model, 151–155
- Market timing, 182–183
- Marsh & McLennan, 242–243
- Math, false precision of, 137–139
- MCI WorldCom, 89, 203
- Mean reversion, 48
- Media, as amplifiers of myths, 198–199
- Mental accounting trap, 244–248
- Mergers, 101
- Microsoft, 97–98, 105, 116
- Mobile Oil, 116
- Modern portfolio theory, 137–138
- Money market funds, 185
- Mutual fund industry, 192, 203
- Myth, 190–191, 198–199
- Myth Busters* (TV show), 190, 191

- NCR Corporation, 100
- Net-net stocks, 195
- Noise, acting on, 247–248
- Nokia, 96, 133, 203

- Oakmark Fund, 192–193
- Off balance sheet, 94–95
- Oil prices, predicting, 236–237
- Only the Paranoid Survive* (Grove), 219
- Operating efficiency, 106–107
- Outsider point of view, taking, 219–220
- Overconfidence, 214
- Overdiversification, 243–244

- Packard, David, 101
- Payback market, 6
- P/CF (price-to-cash flow ratio), 125, 126, 127
- P/E, see Absolute P/E model; Price-to-earnings ratio (P/E)
- Pension assumptions, 94
- Permanent loss of capital, 227–228
- Pharmaceutical industry, 205
- Pilgrim's Pride, 140
- Political risk, 205
- Porter, Michael, *Competitive Strategy: Techniques for Analyzing Industries and Competitors*, 82
- Portfolio, stress testing, 244
- The Power of Gold* (Bernstein), 11–12
- Precision of math, 137–139
- Prenuptial agreement with stocks, 216–218, 219
- Price-to-cash flow ratio (P/CF), 125, 126, 127
- Price-to-earnings ratio (P/E):
 - application of, 128–131
 - compression, dealing with, 158–164
 - elements of, 48–49
 - expansion, as finite source of stock appreciation, 56
 - factors determining basic, 143
 - range-bound market, 63, 65
 - valuation and, 52–56
 - See also Absolute P/E model
- Price to sales screen, 196
- PricewaterhouseCoopers, 202–203
- Pricing stock, 183–185
- Proactive approach to selling stocks, 217
- Process, value of, 179–181
- Product disposability, 90
- Product risk, concentrated, 141
- Profit margin paradigm, 44–46

- Quality:
 - balance sheet and, 91–95
 - brand and, 81
 - competitive advantage and, 79–80
 - emphasizing, over valuation and growth, 165–166
 - free cash flows and, 95–101
 - growth and, without valuation, 168–171
 - of growth of banks, 130–131
 - management and, 82–89
 - margin of safety and, 152

- Quality (*Continued*)
 predictable earnings and, 89–91
 return on capital, 102
 valuation and, without growth,
 171–173
- Quality, Valuation, and Growth
 framework:
 compromising on one dimension of,
 167–174
 compromising on two dimensions of,
 165–167
 linkage between and inside
 dimensions, 234–235
 minimizing impact of randomness
 through, 237–238
 overview of, 77–78
See also Growth; Quality; Valuation
- Quantifying:
 myths, 191–192
 risk factors and earnings
 predictability, 139
- Quarterly earnings numbers, 217
- Randomness:
 advantages of, 248–249
 alternative historical paths and,
 231–234
 cost of being wrong and, 238–239
 identifying impact of on value
 creators and destroyers,
 235–238
 learning from, 181
 management of, 230–231, 234–235
 market timing and, 183
 mental accounting and, 246–248
 properties of, 228–229
 spotting, 234
- Range-bound market:
 annual returns, 1966–1982, 71
 average, description of, 15
 bear market compared to, 6
 beginning of, 52
 bond-only strategy and, 255–256
 bull market and, 7, 15, 61
 characteristics of, 77
 definition of, 4
 dividends and, 114–115
 emotions of, 29–31
 framework for, 62–65
 1966–1982, 30
 P/E compression and, 157–162
 performance of strategy in, 253–255
 predictions about, 3
 stocks and, 69, 71–72
 valuation of, 178
 volatility of, 31–35, 182–183
- Real estate, migration from stocks to,
 29, 30
- Real returns of stocks versus fixed
 income instruments:
 1937–1950, 68
 1950–1966, 70
 1966–1982, 68
 1982–2000, 70
- Recurrence of revenues, 89–91
- Regions Financial, 131
- Relative valuation tools, 125–130,
 134–136, 155–157
- Religion stock category, 168–171
- Reputation, 239
- Research, documenting, 200
- Resistance levels, 220
- Return on capital, 102
- Returns, sources of, 152
- Revenue growth, 105–106
- Reversion beyond mean, 49–52
- Reversion to mean fallacy, 48
- Risk:
 in bull market, 214
 business and financial, 140–141
 currency, 207–208
 definition of, 227–228
 hidden and observed, 232–233
 political, 205
 randomness and, 228–229
- Risk amnesia, 24
- Risk premium, 122
- Risk tolerance, 24

- Rogers, Jim, *Adventure Capitalist*, 206
- Royal Dutch/Shell, 204–205, 238
- Russia, 204–205, 207
- Sanderson Farms, 140–141
- Sara Lee, 81
- Screens, 194–196
- Secular market:
- bear, in Japan, 27–29, 28
 - definition of, 4
 - examples of, 6
 - guessing animal in, 40
 - 1929 crash as, 26
 - range-bound, 29–31
- Selling too soon, 253
- Sell process, 211–220
- Shiller, Robert, web site of, 49
- Short-term performance, focus on, 87–89, 192–193
- Siegel, Jeremy:
- The Future for Investors*, 115
 - Stocks for the Long Run*, 10
- Sources:
- of future earnings growth, 112–113
 - of returns, 152
- Standard & Poor's Backtester, 157
- Stealing ideas from others, 196–197
- Stock buyback, 91–94, 108–111, 114
- Stock Cycles* (Alexander), 7–8
- Stock market:
- average returns on, 14–15
 - definition of, 145
 - multiple personalities of, 56–57
 - performance of, 1802–1906, 7
- Stock market math, 37
- Stockpickr.com web site, 197
- Stocks:
- finding new, 194–199
 - growth, 161
 - hot, 189–190
 - international, 10–11, 201–209
 - long-term market and, 8–10
 - migration to real estate from, 29, 30
 - net-net, 195
 - prenuptial agreement with, 216–218, 219
 - pricing, 183–185
 - proactive approach to selling, 217
 - range-bound markets and, 69, 71–72
 - real returns on, 68, 70
 - religion category of, 168–171
 - timing, 183–185
 - total return on, 9, 37–38, 39, 42, 58
 - volatility of individual, 248
- See also* Stock buyback; Stock market
- Stocks for the Long Run* (Siegel), 10
- Stop-loss strategy, 215
- Strategy:
- in bear and range-bound markets, 253–255
 - in bull markets, 252–253
 - cash balance, 185
 - cost of being wrong and, 251–252, 256
 - for “do nothing” time, 186
 - “growth investors gone wild,” 214–215
 - pricing stock, 183–185
 - process, value of, 179–181
 - stop-loss, 215
 - think long-term, act short-term, 181–182
 - volatility and, 182–183
- Stress testing portfolio, 244
- Sun Microsystems, 188–189
- Support levels, 220
- Survivorship bias, 161, 189
- Sysco, 107–108
- Taleb, Nassim, *Foiled by Randomness*, 230, 247, 251
- TCI Inc., 100
- Technology improvements, 46–47
- Terminal value, 120
- Tevye the Milkman example, 119–128
- “This time is different” attitude, 24

- 3M, 203
- Time arbitrage, 192–193
- Timing:
- market, 182–183
 - stocks, 183–185
- TIPS (Treasury inflation-protected securities), 13
- Toll Brothers, 84–85, 90
- Total annual rate of return:
- from average bull to average range-bound market, 18
 - from average range-bound to average bull market, 16
- Total return on stocks, bonds, gold, inflation, 1925–2006, 9
- Treasury inflation-protected securities (TIPS), 13
- Trendless market, *see* Range-bound market
- Turkmenistan, 206
- Tyco, 107
- Underdiversification, 242–243
- Underleveraged company, as acquisition target, 95
- U.S. Bancorp, 130, 157–158, 218–219
- U.S. Surgical, 107
- U.S. Treasury bonds, returns on, 67–69, 70
- Valuation:
- at beginning of range-bound market, 52
 - capital appreciation and, 52–56
 - emphasizing, over quality and growth, 166
 - growth and, without quality, 173–174
 - quality and, without growth, 171–173
 - Tevee the Milkman’s approach to, 119–128
 - volatility of, 216
- Value creators and destroyers, 124–125, 235–238
- Value investing, 123, 196–197
- Visibility of growth, 141–142
- Volatility:
- of bull and range-bound markets, 31–35
 - of free cash flows, 99–100
 - of individual stocks, 248
 - of interest rates, 130
 - risk and, 227–228
 - strategy and, 182–183
 - of valuation, 216
- Wall Street, 88–89, 217
- Wal-Mart, 46–47, 99, 137, 138, 170
- Westwood One case study, 110
- Why Smart People Make Big Money Mistakes* (Belsky and Gilovich), 246
- Yardeni, Ed, 41