Courtesy of Edwin Schloss

Walter J. Schloss

A Superinvestor of Graham-and-Doddsville

By James Russell Kelly

On May 17, 1984, Warren Buffett gave a speech at a Columbia Business School seminar, marking the 50th anniversary of the publication of Benjamin Graham and David Dodd's *Security Analysis*. In his speech, Buffett presented the extraordinary performance records of seven superinvestors who were disciples of Graham and Dodd. He said, "These investors simply focus on two variables: price and value."

Buffett's first example was Walter Schloss. He wrote, "Walter never went to college but took a course from Ben Graham at night at the New York Institute of Finance. Walter left Graham-Newman in 1955 and achieved the record shown here for 28 years (compound annual return 17.2% vs. 10% for the S&P 500 Index)."

Rare unpublished photo from the Buffett Group meeting with Benjamin Graham in La Jolla, CA, in June 1968. Warren Buffett, Charles Munger and Benjamin Graham are on the far left, and Walter Schloss is the fifth from the right in the rear.

Personal History

Walter J. Schloss (1916–2012) grew up on the Upper West Side of Manhattan with his parents, Evelyn and Jerome, and his sister, Marjorie. During the Depression years of the 1930s, the whole family, including his grandmother, Pauline Gomprecht, lived in a three-bedroom apartment at 817 West End Avenue, where horse-drawn wagons still delivered milk and the ice truck came by weekly.

He was also a proud New Yorker and an inveterate Yankees fan with a comprehensive knowledge of the history of the franchise. His interests included bird watching in Central Park, stamp collecting and playing bridge. He also enjoyed playing tennis and reading espionage novels.

After graduating in 1934 from the Franklin School, now known as the Dwight School, he went directly to work since the family did not have the financial resources during the Depression years to send him to college. He got a job working as a runner (messenger) at Carl M. Loeb & Co. in 1935 with the help of Armand Erpf, a partner, who was a friend of his mother. After a few months, Walter asked him how he could get into the "statistical department." Erpf advised reading a new

Courtesy of Edwin Schloss

Walter Schloss (in suspenders in rear) and three Tweedy, Browne partners, 1962.

book called *Security Analysis* that had just been published by a man named Ben Graham: "Read the book and when you know everything in it, you won't have to read anything else."

Schloss took his advice. He also enrolled in the New York Stock Exchange Institute (New York Institute of Finance), where he took courses in accounting and finance, qualifying him to enroll in Graham's course in security analysis. Schloss recalled that "it was a great experience and I remember taking two different classes with him. The firm paid for the classes, which I think was $10 or $20 a semester." This was where Schloss developed his personal relationship with Graham.

On December 12, 1941, immediately after Pearl Harbor, Schloss enlisted in the US Army and served as a code clerk in the 833rd Signal Company. He was then transferred to the Persian Gulf Command in Iran, which constructed Studebaker trucks in an Iranian truck factory. These trucks were loaded up with supplies and driven north to the border, where they were turned over to the Russian army for use in the siege of Stalingrad. After a year and a half, he returned to the United States to attend Officer Candidate School and was commissioned a 2nd Lieutenant. He served the balance of his military service in Washington, DC at the Pentagon.

In 1946, when he completed his World War II service, he married Louise Filer, also from New York. They had two children, Edwin and Stephanie.

Graham-Newman Corporation (1946–1955)

During the war years, he stayed in touch with Graham by postcard and letter. Graham wrote back while Schloss was still in the service and offered him a job as a security analyst in his investment firm, the Graham-Newman Corporation. Schloss joined the company on January 2, 1946 and remained until 1955, when Graham decided to retire to California.

When Schloss joined Graham-Newman, the company was already 10 years old and had established a very good track record. Its total assets on January 31, 1946 were $1.4 million consisting of $1.1 million in 37 stocks and the balance in arbitrage strategies. His first job was to prepare the annual report for that year and then to find stocks which were selling below net working capital. Graham's mantra was to buy stocks like groceries, not like perfumes. Schloss recalls that "Ben was a great believer in buying a diversified group of securities, so that he limited his risk. He was badly hurt by the Depression, and he didn't want to do that again."

A good example of Graham's conservative investment style was his purchase of 50% of GEICO for $712,000 in 1948. Schloss remembers Graham saying, "Walter, if this purchase doesn't work out, we can always liquidate it and get our money back." He recalls that Graham "had no conception of the growth potential of this thing. He was just buying an insurance company cheap."

Graham-Newman was the incubator for several of the superinvestors of Graham-and-Doddsville. In addition to Walter Schloss, there was Tom Knapp, who went on to co-found Tweedy, Browne Partners, and, of course, Warren Buffett, who founded the Buffett Partnership and bought control of Berkshire Hathaway. They all worked there from 1954 to 1956. Buffett recalls, "I offered to go to work at Graham-Newman for nothing after I took Ben Graham's class (at Columbia Business School), but he turned me down as overvalued. He took this value stuff very seriously! After much pestering, he finally hired me."

When Buffett joined Graham-Newman as an analyst in 1951, the work dynamic of the company changed as the other employees, including Schloss, recognized his genius. Schloss was 14 years older than Buffett with a lot more seniority at the company, but he did not react defensively. In fact, he reached out and became an informal mentor to him. Thus began a lifelong friendship. They both enjoyed playing bridge—Schloss even joined some games with Buffett and Bill Gates in later years.

The other superinvestors were Bill Ruane, who founded the Sequoia Fund; Charlie Munger, Buffett's long-time partner at Berkshire Hathaway; Rick Guerin of Pacific Partners; and Stan Perlmeter of Perlmeter Investments. Buffett maintained friendships with his fellow superinvestors by arranging meetings every two years, including a famous pilgrimage to visit Graham in La Jolla, CA in 1968.

The Buffett Group, 1995. Left to right: Warren Buffett, Tom Knapp, Charles Munger, Roy Tolles, Sandy Gottesman, Bill Scott, Marshall Weinberg, Walter Schloss, Ed Anderson and Bill Ruane.

In 1955, Graham decided to retire and move to Los Angeles. Schloss remarked, "I think he was kind of bored. I said, 'If he's going to retire, I might as well go into business for myself.' So, I got myself 19 partners and they each put up $5,000. One guy put up $10,000. The people had confidence in me, so we started. And really, it kind of built up from there." His wife, Louise, was very supportive of his decision, which was fraught with uncertainty.

Walter J. Schloss Associates (1955–2001)

"I don't like to lose money," Schloss often said in published articles and recorded speeches. This conservatism and frugality reflected both his personality and his family's financial experience before and during the Depression.

One way he minimized expenses was by using a small working space at Tweedy, Browne Company, a dealer specializing in closely held and inactively traded securities. Tweedy was Graham's lead brokerage company in executing orders for Graham-Newman. To facilitate trading, Tweedy's office was located on the same floor as Graham-Newman at 52 Wall Street. They moved to 67 Wall Street and 52 Vanderbilt Avenue in later years.

Schloss arrived at work each day in a suit with suspenders and a brightly colored tie, but he immediately removed his coat and replaced it with a blue cotton working jacket like those worn by the floor traders on the New York Stock Exchange. He was very high energy and could be impatient, running from his desk to the trading room to place orders to buy stocks. He recalled, "When Howard Browne let me have a desk in his office, he never thought I'd still be there 40 years later." In 1993, his office expense was only $11,000 and fixed assets were carried at only $2,605, as compared to a net income of the fund of $19 million.

Buffett commented on Schloss's conservative style in his lecture, "The Superinvestors of Graham-and-Doddsville": "Walter has diversified enormously, owning well over 100 stocks. He knows how to identify securities that sell at considerably less than their value to a private owner. *And that's all he does*. He simply says, if a business is worth a dollar and I can buy it for 40 cents, something good may happen to me. And he does it over and over again."

In 1994, Schloss outlined 16 factors needed to make money in the stock market on a one-page memo typed on his old-fashioned manual typewriter. Among the most salient were:

- Price is the most important factor to use in relation to value.
- Use book value as a starting point to try and establish the value of the enterprise. Be sure that debt does not equal 100% of the equity.
- Have patience. Stocks don't go up immediately.
- Have the courage of your convictions once you have made a decision.
- When buying a stock, I find it helpful to buy near the low of the past few years.
- Try not to let emotions affect your judgment. Fear and greed are probably the worst emotions to have in connection with the purchase and sale of stocks.

Note his reliance on the balance sheet, especially book value and the relationship between market price and book value. In fact, the price/book ratio was the primary metric he used in screening for investment opportunities. In a *Forbes* interview, Schloss was asked why he focused on book value. He responded, "I really have nothing against earnings, except that, in the first place, earnings have a way of changing. Second, your earnings projections may be right, but people's idea of the multiple has changed. So, I find it more comfortable and satisfying to look at book value." It would be problematic to apply a simple price/book ratio in today's market, given the dominance of intangible assets in many companies' asset valuation.

Edwin Schloss Joins the Partnership (1973–2002)

In 1973, Schloss's son Edwin joined the partnership, and the name was changed to Walter & Edwin Schloss Associates. Edwin received a Bachelor of Fine Arts degree in playwriting from the North Carolina School of the Arts. After graduation he studied security analysis at the New York Institute of Finance. Together, Walter and Edwin very successfully co-managed the fund until its liquidation in 2002.

Edwin has had a lifelong passion for the performing arts. He worked on Wall Street during the day and attended Broadway shows at night, often passing performance notes to the lead producer of the shows. Eventually, he became a voting member of the Tony Awards and regularly attended over 40 productions each season. He is an accomplished producer and was co-producer of *Kiss Me Kate*, *Sweet Charity*, *Grey Gardens*, *Wonderful Town* and *La Cage aux Folles*. He won a Tony for the revival of *La Cage aux Folles* in 2010.

Performance of the Fund (1955–2000)

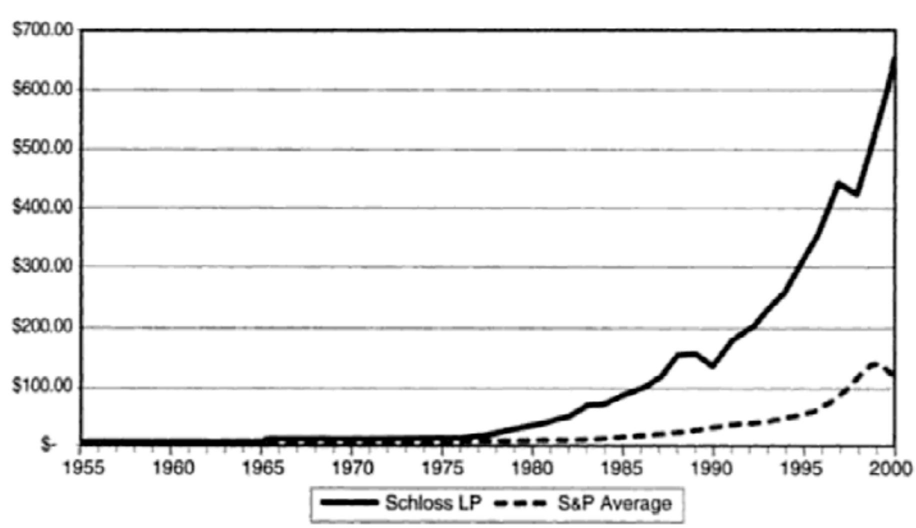
For the 45-year period ending on December 31, 2000, the compound annual rate of return for limited partners was 15.7%, compared to 11.2% for the S&P Industrial Average. The fund had only seven down years in 45 years, compared with 13 down years for the S&P Industrial Average. The maximum drawdown was only –12.8% in 1990. It grew in size from $100,000 to $130 million, even though it paid out relatively large distributions of realized gains each year. The partners of the fund were ordinary individual investors who needed the cash flow to finance their living expenses. Over these 45 years, the average holding period was three to five years. The portfolio was highly diversified, including everything from a few large-cap "blue chips" to a multitude of obscure small caps. Many of the companies no longer exist today.

Walter and Edwin worked together closely in their tiny closet-sized office at Tweedy, Browne. They relied on basic company financial reports and Value Line. Edwin recalls that they focused on companies that were lower rated in timeliness in the Value Line rankings, which were being ignored by investors. "In the early days, it was like shooting fish in a barrel. We initially found stocks selling below net working capital, then at 50%, 75% and 100% of book value as the market traded up over time."

Buffett commented that "they never came within a mile of inside information. Indeed, they used outside information only sparingly, generally selecting securities by certain simple statistical methods Walter learned while working for Ben Graham. When Walter and Edwin were asked in 1989 by *Outstanding Investors Digest*, 'How do you summarize your approach?' Edwin replied, 'We try to buy stocks cheap.' So much for Modern Portfolio Theory, technical analysis, macroeconomic thoughts and complex algorithms."

Schloss used an unusual egalitarian fee structure in his partnership. "I wanted to be in the same position as my partners. If they didn't make money, I didn't make money. If they made money, I wanted to be part of it. So, I got 25% of the realized profits, but that's it. If the market went down, we would have to make up the loss until my partners were whole."

Value of $1.00 Invested in the Schloss partnership versus the S&P Industrial Index, 1956–2000



Courtesy of Edwin Schloss

Edwin and Walter Schloss.

Going out on Top

Shortly after the peak of the dot-com bubble in 2000, Walter Schloss recalled, "When Edwin said to me in 2001 that he couldn't find any cheap stocks—and that was a great call—it was a great excuse for us to quit. I have a list of stocks that could be on our buy list and I find that invariably when it gets down to less than five stocks the market's too high and when it gets down to two or three it's a danger signal." They liquidated the fund over the next two years, realizing additional gains of 11.6% and 5.7% during the bear market.

NYSSA Honors Walter Schloss (2006)

In 2006, on the occasion of Schloss's 90th birthday, the Value Investing Committee of the New York Society of Security Analysts (now known as the CFA Society NY) paid homage to him with a dinner at the Harvard Club. More than 100 of his friends and partners attended. Carol Loomis, editor-at-large at *Fortune*, moderated the discussion.

Some of his longtime friends and business associates gave tributes. "Walter's goal is the right one for a value investor: go your own way," stated Paul J. Isaac, Walter's nephew. "Don't chase or envy other investors… Enjoy life while it's occurring. Value invest to enrich your life, and don't subordinate your life to your portfolio… Having held to [these principles] is the reason Walter may not be the richest man in the illustrious professional circles in which he travels, but by any objective analysis, he's always among the most successful."

David Gottesman, senior managing director of First Manhattan Co., noted, "One of the qualities that has made Walter a very successful man is his optimism, and if you buy deep value and combine that with optimism, I think you have a winning combination."

Recollections

Buffett affectionately called Schloss "Big Walter." He described him as "one of the good guys of Wall Street, my long-time friend… [who] managed a remarkably successful investment partnership, from which he took not a dime unless his partners made money." Buffett notes admiringly that "Walter did not go to business school, or for that matter, college. His office contained one file cabinet in 1956: the number mushroomed to four by 2002. Walter worked without a secretary, clerk or bookkeeper, his only associate being his son, Edwin."

Bob Wyckoff of Tweedy, Browne Company remembers Walter Schloss as "a wonderful, kind and thoughtful friend and colleague. He shared office space with us for what had to be well over 50 years. Edwin has continued to share space with us since his passing…they were both treasured members of the Tweedy, Browne family and adored by all at the firm." Wyckoff goes on to remember Walter's striking generosity, "high energy and his complete independence when it came to making decisions about stocks. He really didn't seem to care what stocks other value investors were buying, even his old friend Warren. He had his own unique way of doing things—seems to be a theme with highly successful investors."

Will Browne of Tweedy, Browne considers Walter Schloss to be "an extraordinary practitioner of the concept of value investing and his decades-long record is irrefutable proof. His approach was tilted toward asset type business, but that was most likely a function of the period in which Walter was most active. I think he understood intuitively the ideas that were the basis of behavioral finance and how they could play havoc with good judgment and that perhaps fortified his ability to lean against the wind."

John Spears of Tweedy, Browne remembers Walter's sense of humor. "If one of his stocks was going down, he would joke that 'I can't take the pressure.' He marched to his own drummer. He was also very frugal, living simply, below his means. He always took the subway to work. He liked to lean against the wind, by buying more and more shares in a company as the stock price declined." Two examples were Hudson Pulp & Paper and Mercantile Stores. Each resulted in large gains for the fund.

Above all, Will Browne recalls Walter's "integrity as a person and a fiduciary before that was commonly spoken about. I will always remember my father's [Howard Browne, co-founder of Tweedy, Browne] admonition on his retirement, 'if you ever get in an argument with Walter, you are wrong; there is no finer person in the business.' A life well lived and worth emulating."

In retirement, Walter continued to invest for his family, as well as serve on the Board of Directors of Freedom House, which monitors democracies around the globe. His wife, Louise, died in 2000. A year later, he married Ann Pearson, who he met on a retirement tour to France. They traveled together extensively around the world until Walter's passing in 2012.

Walter Schloss passed away on February 19, 2012, at the age of 95, from leukemia. His personal and professional values have been carried on by his son and partner, Edwin W. Schloss.

Observations by Edwin Schloss

In a recent interview, Edwin recalled that Walter was similar to Graham in that both were negatively impacted in their youth by financial losses in their families. This made them both very conservative investors. He was also similar to Buffett in his overwhelming bullishness on America.

Walter was a contrarian who bought early in a business cycle. "He often said that their portfolio resembles a department store which buys an inventory of winter coats in the spring for sale in the fall."

Edwin also commented that the market environment has changed substantially since he and Walter closed the partnership in 2002. Some companies with seemingly attractive price/book or price/earnings ratios may be "value traps." It all depends on the dynamics of each industry, some of which, like retail, are being disrupted by advances in technology.

Nevertheless, he noted that the core principles of value investing are alive and well. As Buffett stated in his "Superinvestors" lecture, "[These] investors simply focus on two variables: price and value."

Through 2002, when they completed the liquidation of the fund, Walter & Edwin Schloss Associates earned a 20.5% annual gross return before profit sharing fees for 47 years, versus 22.2% for 37 years at Berkshire Hathaway.

As they neared the end of their partnership, Walter reminisced about their long-term performance record noting that "we would have done better if we just had bought Berkshire Hathaway stock and held on." Edwin reluctantly agreed but noted that "we would not have had so much fun!" $

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