



SHARE SLEUTH



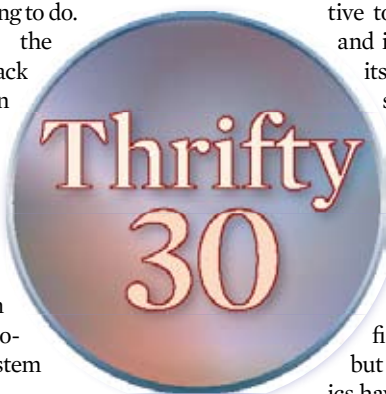
Get a lift from thrift

Richard Beddard favours a return to the prudent share-buying principles advocated by the economist and investor Benjamin Graham

As we move into November, the relentless rise in share prices that started in March continues. It's not the best time to accumulate a portfolio of good companies at cheap prices, because there are few to choose from, but that's what I'm trying to do.

The idea behind the Thrifty 30 goes back before my time as an investor to an interview published in the journal *Medical Economics* in 1976, in which the great US investor and educator Benjamin Graham described a semi-automatic stockpicking system he'd developed.

The magazine didn't call his system the Thrifty 30, it merely described it as 'the simplest way to select bargain



stocks'. *Money Observer* used the term when it revived the idea for its April 2009 cover story.

Graham was thrifty. He focused on just two variables: a company's price relative to its earnings (profits) and its liabilities relative to its assets. He only bought shares when they were cheap and the company owned more than twice what it owed.

Research has confirmed that companies with low stock market valuations and strong finances do better than average, but money managers and academics have ignored it. Finance professionals often favour trendy, but expensive companies, while professors cling to the now-discredited theory that shares cannot remain cheap for long because investors will simply buy them, forcing prices back to realistic levels.

Market mayhem

The theory might hold in a simple and logical world. However, as the behaviour of investors during the technology and credit booms demonstrates, markets aren't always logical and tend towards extremes.

Graham's system was, in part, a reaction to the Nifty Fifty craze for good companies, and particularly big companies, at any price. My plan, like Graham's, is to exploit the fact that healthy companies can remain cheap long enough for investors to profit.

These days we have more data than Graham's audience did, so the variables I use are more sophisticated, notably the long-term price earnings ratio and Piotroski's F_Score. But the outcome should be the same. Individual compa-

MY THRIFTY 30

| Current holdings | EPIC | Cost | Value now | Return % |
|------------------------|------|------------------|------------------|----------|
| Chime Communications | CHW | 999.88 | 939.65 | -6 |
| Dart | DTG | 999.96 | 975.84 | -2 |
| Dewhurst | DWHT | 997.94 | 970.55 | -3 |
| Games Workshop | GAW | 998.10 | 1017.9 | 2 |
| Haynes Publishing | HYNS | 998.68 | 1253.18 | 25 |
| Holdings Technology | HDT | 999.35 | 1099.31 | 10 |
| OPD | OPD | 999.70 | 1358.8 | 36 |
| printing.com | PDC | 999.90 | 1043.7 | 4 |
| Solid State | SSP | 999.75 | 906.75 | -9 |
| Total current holdings | | 8,993.26 | 9,565.68 | 6 |
| Cash | | | 21,006.75 | |
| Total portfolio | | 30,000.00 | 30,572.43 | 2 |

Notes: First transaction: 9 September. Valuation date: 1 October. Cost includes £10 broker fee and £5 stamp duty. Cash earns no interest. Dividends and sale proceeds are credited to the cash balance.

nies in the Thrifty 30 portfolio might fall in value, but collectively they should achieve a return of 15 per cent a year on average over any period of more than five years.

So far I have invested an imaginary £1,000 in nine companies. It might seem odd buying shares at low prices when the market has recently risen by 45 per cent, but over a period of five years or more the thrifty approach should still pay off handsomely.

Magic number

In many ways, the opposite of thrifty is risky. If a company is heavily indebted, it's risky. If it's not making money, it's risky. If its share price is too high, it's risky.

By investing in 30 companies, rather than a lesser number, I'm seeking safety. I am reducing the impact on the portfolio of the failure of any one of them. The fewer the companies in the portfolio the greater the risk that trouble with just one or two will seriously damage it.

But there is also a rationale for keeping the number down: discovering and analysing good prospects takes time, and the more companies there are in a portfolio the longer it takes to manage it. Also, stocks included simply to make up the Thrifty 30's numbers unnecessarily threaten returns.

We want a manageable number of good ideas. Benjamin Graham thought 20-30 was right.

More information

Thrifty 30: <http://blog.iii.co.uk/category/thrifty-30/>
Long-term price earnings ratio: http://blog.iii.co.uk/ltp_e_F_Score: <http://blog.iii.co.uk/piotroski/>

Update

Sharp-eyed readers of last month's Share Sleuth will wonder why Delta, which galvanises metal and makes steel structures such as lamp posts and motorway guard rails, is not one of the inaugural members of the Thrifty 30. I said I was likely to include it, but the price has since risen from 163p to 180p. Although it's a rise of little more than 10 per cent, Delta was at my upper limit anyway. Now it's over the limit and, tempting though it is to make an exception, as I said last month, limits protect us from rash decisions.

Richard Beddard (richard.beddard@iii.co.uk) is companies and markets editor of Interactive Investor and a keen private investor. He writes about shares on the Interactive Investor blog.