

Common Sense with Uncommon Results:

An Application of Graham-Buffett Value Investing Principles

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Subject: Daniel Ruble's Honors Paper
To: Michelle Blackwell <mblackwe@utk.edu>

Hi Michelle,

Just a note to let you know that I've carefully studied Daniel Ruble's Honors Paper. It is an excellent paper (A grade), and my only minor criticism is that he could have mentioned Sears and McDonald's substantial real estate holdings.

I'm extremely pleased with the exceptional quality of Daniel's work. Please let me know if there is anything else that I need to do.

Thank you.

Al Auxier

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"The truly big investment idea can usually be explained in a short paragraph." Warren E. Buffett

Daniel Ruble's
Approval Sheet
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Overview

Last year, I set out to manage a \$20,000 stock portfolio, applying the straightforward investing approach of legends Warren E. Buffett, the second richest man in the world, and Benjamin Graham, Buffett's infamous mentor. Rather than speculating about what price a security will sell for in the future, value investing demands a focus on the underlying fundamental value of a business. Instead of relying on quantitative models or crystal balls, it relies on common sense and emotional discipline—virtues often absent from Wall Street.

By outlining my individual investing decisions, the logic behind them, and the results, I hope to demonstrate the extraordinary wisdom of this simple, yet wildly unpopular, investing philosophy. Of course, I made several mistakes along the way, and I hope to address these and to provide thoughts for improvement.

It is also important to note that I make no grand assumptions about my performance or its sustainability. In reality, a one-year record is not indicative of long-term potential, as any fool can be lucky in the short-term. However, only a sound investment philosophy and outstanding ability can consistently outperform long-term. Hopefully, through my demonstration of clear logic and solid performance, I can validate the methodology to some degree. For my absolute confidence in value investing, I rely on the wisdom and performance of famed investors Benjamin Graham and Warren E. Buffett.

Icons of Value Investing

Benjamin Graham is hailed as the “father of value investing,” and rightly so. This renowned investor, professor at Columbia University, and even classical scholar single-handedly rationalized Wall Street.

While Graham managed his partnership, the “Benjamin Graham Joint Account,” in the 1920s, he sought to buy stocks that were selling far below the actual value of the underlying businesses.²⁵ The idea was to get stocks so ridiculously cheap, that most downside risk would be eliminated. Graham wanted to buy \$1 worth of stocks for \$0.50. This was a sharp contrast to the speculative nature of Wall Street, whose primary interest was to trade little pieces of paper with no more consideration than what price the next sucker would pay. A typical “investor” on Wall Street would pay \$2 for \$1 of stocks as long as he thought he could sell it for \$3 the next day. This irrationality and emotional exuberance pushed equity prices to incredible highs, ultimately resulting in the great Crash. Graham’s prudent and rational style of investing helped him escape the early stages of the Crash with a tolerable 20% loss. However, convinced that things could not get much worse, he bought on margin, subsequently losing 70% of his partnership’s value.²⁵

His later endeavor, Graham-Newman, was much more successful. Over the partnership’s 21-year life (1936-1956), Graham-Newman demonstrated an astounding average yearly return of just below 17%, which contrasts to less than 14% for the S&P 500 over the same period.²⁷ While spectacular, this return figure neglects one of the company’s most successful investments, GEICO—whose shares were distributed to

shareholders. Assuming that these investors held the GEICO shares, their participation in Graham-Newman would have earned them a return that doubled that of the S&P 500.²⁷

Security Analysis, which Graham co-authored, emerged in 1934. At the time, the same “investors” that had once seen the stock market as a place of infinite opportunity refused to consider stocks as investments at all. Graham, unlike most of Wall Street, recognized the cyclical nature of human emotion. *Security Analysis* identifies the “intrinsic value” of a company as independent of the market’s quoted price. In the short-term, the market is a “voting machine,” in which people make decisions based on facts as well as the whims of emotion. However, in the long-term, the market will ultimately act more like a “weighing machine,” where a company’s competitive position, assets, and earnings are accurately “weighed” and reflected in a logical market quote.² Gross misstatements of price resulting from skewed investor psychology create opportunities for the value investor in the short-term. The idea is to buy a business based on calculated intrinsic value, and to wait for the market to take note over time.

Ben Graham further detailed his investing philosophy in *The Intelligent Investor* (key ideas are discussed below), which Warren Buffett describes as “by far the best book on investing ever written.”¹⁴ Indeed, it changed the life of 19-year-old Buffett in 1950 when he first read it.

Buffett had traded stocks since he was eleven, and unsuccessfully so. He had tried his share of stock tips and chart analyses, but he found a logical alternative to such unsuccessful speculation in Graham’s simple and straightforward methodologies.¹⁴ Buffett later studied under Graham at Columbia University (earning the only A+ ever

granted by Graham) and even worked for Graham at Graham-Newman Corp.²⁶ Buffett was enamored with Graham's sensible instruction. He had literally found an idol.

To say that Warren Buffett has been a successful value investor would be a gross understatement. In less than half a century, he has successfully turned a \$10,000 nest egg into a \$42,900,000,000 empire, making him the second richest man in the world—second only to his good friend Bill Gates.¹⁶

His extraordinary record can be tracked through the performance of his investment vehicle, Berkshire Hathaway. From 1964, when Buffett took the company over, until 2003, the per-share book value of Berkshire increased a total of 259,485% compared to a 4,743 increase in the S&P 500, dividends included. This equates to a 22.2% average annual gain vs. 10.4% for the S&P.⁵ The price appreciation of Berkshire has been even more phenomenal, climbing from around \$19 when Buffett took over in 1964 to over \$93,000 on April 25, 2004. This represents a total return of nearly 490,000% and an average annual return of over 24%.³⁰

Key Principles of Value Investing

In an October 2003 presentation to University of Tennessee business students, Warren Buffett explained that successful investing can be achieved through the application of three simple ideas—stocks as part of a business, Mr. Market, and margin of safety. All of these ideas are demonstrated in Graham's *The Intelligent Investor*. Buffett stresses the importance of each, stating, “You can't get rid of one leg of a three-legged stool and have a sound investment philosophy.”¹⁴

Stocks as Part of a Business:

A stock is ultimately a share in a business, giving the owner a claim against the assets and income of an enterprise. Thus, it only makes sense for an investor to be concerned with the fundamental prospects of the underlying business, not simply the price behavior of its quoted shares.

Buffett admits,

“I used to know, when I was eleven or twelve, the ticker symbol of every company virtually on the New York Stock exchange [...] but I didn’t know what was behind them. I had to start looking at these little symbols and names in the paper as businesses and decide how you value a business [...] and what counts”¹⁴

Buffett was only a child when he made this silly mistake. Amazingly, educated Wall Street professionals are often completely oblivious to the nature or value of the businesses underlying the stocks they are trading. As Graham and Dodd state in *Security Analysis*, “It is an almost unbelievable fact that Wall Street never asks, ‘How much is the *business* selling for?’”⁴

In *The Intelligent Investor*, Graham addresses this issue in a telling distinction between a silent partner in a private business and a common stockholder. The private investor would concern himself solely with the prospects of the business, and would determine the value of his investment by calculating his relative share of the company’s balance sheet items and expected earnings. On the other hand, the common stock investor, although in a very similar position, is alienated from his ownership in the business simply because his interest can be sold or purchased at whim. Because he has the luxury of a liquid market with readily quoted prices, the investor behaves more like a *speculator*. As Graham puts it,

“The speculator’s primary interest lies in anticipating and profiting from market fluctuations. The investor’s primary interest lies in acquiring and holding suitable securities at suitable prices.”¹⁸

Thus, as investors, we need to focus on the intrinsic value of our ownership in the underlying business and only concern ourselves with quoted prices when it is convenient for us to do so.

It is important to note that while Ben Graham focused solely on the numbers to value an enterprise, Buffett places a special emphasis on understanding the factors that make a particular business special. Buffett wants predictability in his investments, even demanding that he have an idea of what a company will look like, say, ten years down the road. Buffett explains in his 1992 Letter to Shareholders:

“[W]e try to stick with businesses we believe we understand. That means they must be relatively simple and stable in character. If a business is complex or subject to constant change, we’re not smart enough to predict future cash flows.”¹⁰

This is precisely why Buffett avoids high-tech companies. Indeed, none of Berkshire Hathaway’s subsidiaries or equity holdings are “sexy” investments by any stretch of the imagination. But as Buffett notes in his 1987 Letter to Shareholders:

“Severe change and exceptional returns usually don’t mix... [T]he best business returns are usually achieved by companies that are doing something quite similar today to what they were doing five or ten years ago...”⁷

Certainly, the inflation and subsequent deflation of the dot-com bubble, contrasted with Buffett’s consistently superior historical investment performance, validates this affirmation.

In addition to simplicity and understandability, Buffett finds great predictability in companies that have a durable competitive advantage, which Buffett metaphorically

describes as a “moat around an economic castle.”¹⁴ The very nature of capitalism breeds competition. Everyone is trying to get what somebody else has. A company cannot sustain any extraordinary profitability in the long-term if it is vulnerable to competitive actions of other companies. A moat prevents, or at least delays, other companies from attacking an economic castle. A great example of a competitive moat is Wal-Mart, which enjoys an incredibly low cost structure through its massive economies of scale. Nobody can compete with Wal-Mart because nobody is large enough to realize enough cost savings to compete on price. At the Fall 2004 meeting with UT students, Buffett explained that a “moat” could even be something as intangible as an idea that consumers have about a particular company or its products. He elaborates, “There are six billion people in the world. Practically all of them have something in their mind about Coca-Cola, largely favorable. They don’t have anything in their mind about RC Cola, and if RC Cola spent \$1 billion advertising they wouldn’t have anything in their mind about RC Cola...That’s an enduring competitive advantage.”¹⁴

Mr. Market:

Ben Graham offers a simple, logical framework for dealing with market fluctuations in his famous Chapter 8 of *The Intelligent Investor*, and does so through his personification of the market, Mr. Market.

Graham explains in his famous allegory:

“Imagine that in some private business you own a small share that cost you \$1,000. One of your partners, named Mr. Market, is very obliging indeed. Every day he tells you what he thinks your interest is worth and furthermore offers to buy you out or to sell you an additional interest on that basis. Sometimes his idea of value appears plausible....Often, on the other hand, Mr. Market lets

his enthusiasm or his fears run away with him, and the value he proposes to you seems to you a little short of silly.”²¹

Buffett takes the description of Mr. Market one-step further, even referring to him as an “alcoholic manic-depressive.”¹⁴ The idea here is that people are emotional beings, and they often let their emotions run away with them. This human trait is common in both individuals and in crowds, which translates into extreme volatility in markets. At his UT presentation, Buffett noted how remarkable the stock market is, explaining that even the best American companies often sell at yearly highs that are twice the value of the lows. Such variation in perceived value would rarely occur in, say, the value of a home or any other non-traded asset.

When people are excited, they tend to become irrational on the upside, trading securities for often astronomical values. This was certainly the case during the dot-com “craze” of the late 90s. Companies such as Yahoo.com were selling for hundreds of times their expected earnings, and the reality is that most of these companies were *losing* money. While the opportunities opened up by the Internet are certainly fantastic, Wall Street became overly euphoric. In fact, even though dot-com stock prices certainly seemed to exceed value by all traditional measures, seemingly intelligent, well-educated analysts were hopelessly justifying their buy recommendations based on ridiculous measures of the “new economy,” such as price-to-sales ratios and revenue growth—all of which neglect the ultimate goal of investors: profit. It is clear that in such euphoria, instead of buying stocks with consideration of company fundamentals and earnings potential, people soon begin to buy stocks simply *because* the prices are rising, hoping to sell their already expensive shares to the next sucker that comes along at an even higher price. The result is a vicious cycle.

As Graham would have predicted, though, the exponential price performances of the dot-com companies were equally spectacular on the downside. As stated in *Security Analysis*:

“That enormous profits should have turned into still more colossal losses, that new theories should have been developed and later discredited, that unlimited optimism should have been succeeded by the deepest despair are all in strict accord with age-old tradition.”³

Indeed, at the end of 1999, Yahoo.com closed at a split-adjusted price of \$216. The following year, it sold for \$30, later selling for \$8. The NASDAQ itself reached a peak of over 5,000 in 2000, falling dramatically to under 1,500 over the subsequent three years.³⁰ The lesson here is that irrational bull markets are not sustainable, and investors will sooner or later take note of reality. This was a painful lesson to learn for many people who lost entire fortunes during the dot-com bubble. Buffett and Graham, however, would stress that the lesson has not been learned, and that people will behave just as irrationally again.

It is important to note that fear can drive the stocks to irrationally low prices just as greed and excitement can drive them to astronomically high prices. Consider, for instance, the investing climate after the great Crash. In 1934, *Security Analysis* recognized that stocks were largely discredited as an investment at all. Because people were fearful about the possibility of another Crash, what had been seen as the land of infinite opportunity and riches (Wall Street) was largely being avoided by investors altogether. As Graham noted in a June 1932 Forbes article, many companies were selling for less than their cash in the bank.¹⁷

While Graham saw value in the 1932 market, most of Wall Street did not. Why so? A common misconception is that the market serves to instruct or give signals to

investors. Indeed, many people buy *because* prices rise or sell *because* they decline. *Because* prices had declined from steep highs in the Crash, investors saw the potential for loss, neglecting even to consider the incredible value that the low prices represented. Graham points out that this defies all common business sense, for profit maximization requires buying low and selling high. By reacting to fluctuations in such a manner, investors are, “perversely transforming [their] basic advantage into a basic disadvantage.”

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By demonstrating emotional discipline, the value investor can take advantage of such market folly. As Buffett notes in the preface of *The Intelligent Investor*, “The sillier the market’s behavior, the greater the opportunity for the business-like investor.”^{vii} The great thing about Mr. Market is that an investor does not have to accept his offer unless it is advantageous. Every day, he will come along with a new one. The intelligent investor will catch Mr. Market on a bad day and, essentially, rip the poor drunk off.

Margin of Safety:

The margin of safety concept is the crux of sound investing. In Graham’s famous Chapter 21 of *The Intelligent Investor* he states, “[To] distill the secret of sound investing into three words, we venture the motto, MARGIN OF SAFETY.”²³

Basically, Graham suggests that an investor should buy a company at a *deep* discount to its intrinsic value. While bargain hunting certainly seems like a no-brainer recommendation, how can an investor ever know whether or not he or she is buying \$1.00 for \$0.50? The answer is simple: one does not know!

The problem is that investors have to make heroic assumptions in determining the intrinsic value of a company (see Valuation Model section below). Without a crystal ball that actually works, nobody can know for sure how profitable a company will be in the future. Unknown factors such as catastrophic litigation, changing industry dynamics, and corporate fraud can seriously impede future earnings growth...if not even bankrupt an enterprise. Moreover, the lay investor only has limited access to company information and, thus, may have difficulty in deriving appropriate estimates in the first place. Leaving some “cushion” room to compensate for this ambiguity is only logical. By demanding a discount to *calculated* intrinsic value, an investor is protecting him or herself against inevitable uncertainty.

Buffett explains this simple logic in his appendix to *The Intelligent Investor*, “The Superinvestors of Graham-and-Doddsville”:

“You don’t try and buy businesses worth \$83 million for \$80 million. You leave yourself an enormous margin. When you build a bridge, you insist it can carry 30,000 pounds, but you only drive 10,000-pound trucks across it. And that same principle works in investing.”²⁴

My Portfolio

On February 11, 2003, I began investing \$20,000 through an online brokerage account with Ameritrade, Inc. With no personal investing experience and no professional advice, I produced a twelve-month return of 56.70% (after brokerage fees), beating the vast majority of professionally managed equity funds. This return compares to a 41.79% return for the S&P 500 over the same twelve-month period (February 11, 2003 – February 11, 2004).

*Note that the S&P 500 is the most appropriate benchmark with which to compare my investing results. This capitalization-weighted index includes 500 companies that span every part of the U.S. economy. By tracking its performance, investors can approximate the average return of U.S. equities, and, thus, have a good measure of alternative investment opportunities. In contrast, the Dow includes only 30 large industrial companies, and the NASDAQ is largely comprised of small, obscure companies. Moreover, the risk/reward profiles of these two indexes are largely skewed, as the Dow is very conservative, while the NASDAQ is very risky. Note that an investor would have assumed more risk (possibility of loss) to achieve the higher returns that the NASDAQ produced over this 12-month period. Given the volatile nature of the NASDAQ and its components, this short-term performance might not be indicative of long-term results.

Below, I describe the factors that contributed to this performance, the logic of some of my individual decisions, and a multitude of dumb mistakes.

Concentration versus Diversification:

At any given time, I held no more than eleven different stocks in my portfolio.

Notice the table depicting my portfolio on the last day of the investment period. Not only was my entire account invested in just ten companies, but I was also very willing to commit substantial capital to a select few. In fact, almost one third of my entire portfolio was invested in just two companies, Cardinal Health (CAH) and Honda Motor Company (HMC).	2/11/2004					
	Symbol	Price	Shares	Value	Weight	
	KO	\$ 51.80	50	\$ 2,590.00	8.26%	
	PFE	\$ 38.15	50	\$ 1,907.50	6.09%	
	GE	\$ 33.08	75	\$ 2,481.00	7.92%	
	HD	\$ 36.83	75	\$ 2,762.25	8.81%	
	BRK.B	\$ 3,057.00	1	\$ 3,057.00	9.75%	
	HDI	\$ 53.36	40	\$ 2,134.40	6.81%	
	HCA	\$ 43.89	65	\$ 2,852.85	9.10%	
	CAH	\$ 65.75	78	\$ 5,128.50	16.36%	
	HMC	\$ 21.62	230	\$ 4,972.60	15.87%	
	TAP.B	\$ 18.20	175	\$ 3,185.00	10.16%	
	Cash			\$ 268.01	0.86%	
	Total:				\$ 31,339.11	100.00%

This is in sharp contrast with academia's view that a portfolio should be widely diversified, often suggesting more than thirty stocks. The simple logic here is iterated in the old saying, "Don't put all your eggs in one basket." By spreading funds over many

holdings, an investor reduces the risk of loss. If one “basket” falls, then all of the eggs are broken, and nobody wants that.

Buffett would argue otherwise. In his 1978 Letter to Shareholders, he states:

“Our policy is to concentrate holdings. We try to avoid buying a little of this or that when we are only lukewarm about the business or its price. When we are convinced as to attractiveness, we believe in buying worthwhile amounts.”⁶

By following a concentration strategy, an investor will be much more successful if he or she can select sound investments. Of course, successful concentration depends on the time, effort, and skill an investor is willing to devote to researching and understanding businesses. An enterprising investor can actually *reduce* risk by concentrating in a handful of stocks. This is certainly contrary to statistical theory, but the idea makes perfect sense. By holding only a handful of companies, an investor can exercise a much deeper and more sophisticated understanding of the positions held. With this superior knowledge, an investor can make much more rational decisions, and can anticipate and monitor the business prospects and risk profile of specific companies. As long as the decisions are sound, concentration can be relatively safe. In a 1998 speech to the Foundation Financial Officers Group, Charlie Munger—Buffett’s famed business partner and Vice Chairman of Berkshire Hathaway—stressed, “In the United States, a person or institution with almost all wealth invested, long-term, in just three fine domestic corporations is securely rich.”²⁹

On the other hand, if an investor is passive and is not willing to commit time and effort to carefully scrutinize and select individual securities, or if potential investments are particularly risky, then a diversification strategy makes sense. The more securities held in a single portfolio, the less any single mistake or loss will affect overall return. A

passive investor, however, can only expect to earn average returns. After all, the more diversified a portfolio is, the more it will emulate the broad market.

Another argument for concentration is that good investment ideas are simply hard to come by. In his 1993 Letter to Shareholders, Buffett even claimed, “[W]e’ll now settle for one good idea a year. (Charlie says it’s my turn.)”¹¹ When a “fat pitch” or “no-brainer” (as he puts it) comes along, it makes sense to make a meaningful investment. If an investor does not commit heavily to his or her best ideas, remaining funds must be dispersed among less attractive opportunities. Again, in his 1993 Letter to Shareholders, Buffett comments:

“I cannot understand why an investor ... elects to put money into a business that is his 20th favorite rather than simply adding that money to his top choices – the businesses he understands best and that present the least risk, along with the greatest profit potential.”¹¹

*See the “Mistakes” section below for a description of my failure in pulling the trigger on my favorite investments.

Valuation Model:

To buy a company at a deep discount to its intrinsic value, an investor must have a framework for approximating this value. For my portfolio, I use a Price/Earnings model adopted by the University of Tennessee’s TVA Investment Challenge team, which has been immensely successful in substantially beating the S&P 500 every year since its 1998 inception.

Essentially the model takes the current annual earnings of a company and projects them out five years into the future. The resulting future earnings figure is then applied to a future Price/Earnings ratio to derive a future price for the enterprise. This value is

discounted back to determine the present value of this future price. To account for dividend income, an annuity due function is applied in which future dividends are discounted back to their present value. The combined capital gains and dividend components result in an approximation of intrinsic value—which basically tells an investor what future cash flows are worth today after being discounted at an appropriate rate to account for risk and alternative investment opportunities.

The applied formulas are as follows:

$$\text{FV_Price} = \text{PE} * \text{EPS} * (1 + g)^n$$

where: “FV_Price” represents the future price of the stock
 “PE” represents the future price/earnings ratio
 “EPS” represents the most recent annual earnings per share figure
 “g” represents expected earnings growth rate
 “n” represents the holding period for the investment

$$\text{PV_Price} = \text{FV_Price} / (1 + i)^n$$

where: “PV_Price” represents the present value the future price
 “i” represents the periodic discount rate

$$\text{PV_Div} = \text{DIV} * (1 + g_d) * [(1 - ((1 + g_d) / (1 + i))^n) / (i - g)]$$

where: “PV_Div” represents the present value of an annuity due for dividends
 “DIV” represents the current annual dividend
 “g_d” represents the expected growth rate for dividends

$$\text{Intrinsic Value} = \text{PV_Price} + \text{PV_Div}$$

To simplify these calculations,
 I use the TVA Investment Challenge
 team’s excel-based model, as depicted
 here in my 2/10/2004 valuation of the
 Coca-Cola Company:

Notice that in this particular
 case, I calculated an intrinsic value of

The Coca-Cola Co. (KO)

Current Price				\$39.51
Intrinsic Value				\$47.79
Margin of Safety				20.95%
Expected Return				14.42%
FV Price				\$70.86
	Future P/E	25		
	EPS (Dec 02)	\$1.76*		
	Long Term Growth Rate	1.1**		
	Holding Period	5		
PV Dividend				\$3.79
	Current Dividend	0.8		
	Long Term Growth Rate	1.08***		
	Discount Rate	1.1		
PV Price				\$44.00
Tangible Book Value		\$3.26		
Price * Book Value		12.12		
Current P/E		22.45		
Historical P/E****		36.75		

\$47.79, representing a 20.95% margin of safety. This value, however, is not intended to be extremely accurate. It should only serve as a guide for intelligent decision-making. To determine this intrinsic value, I had to make numerous assumptions about the company's future earning prospects, a possible future price/earnings ratio, and an appropriate discount rate. Even a slight change in any of these estimates leads to strikingly different calculations.

For the earnings growth expectations, I typically rely heavily on the First Call consensus estimates, which can be obtained from Yahoo.com. This is essentially the average expectation of all Wall Street analysts covering the stock. If I suspect that analysts are overly optimistic, I typically reduce the rate by several hundred basis points for the sake of conservatism. While the Coca-Cola Company offered guidance for earnings growth of 11-12%, I felt that 10% was a more prudent assumption given the company's large size and the mature industry in which it operates. Had I assumed an earnings growth rate of 12%, the intrinsic value calculation would have jumped to \$51.94, representing a 31.45% margin of safety.

The future price/earnings assumptions are even more ambiguous. Essentially, this ratio represents what investors are willing to pay for every dollar of a particular company's earnings per share. Thus, this factor is entirely psychological. Since a value investor is not in the business of predicting investor sentiment, it only makes sense to analyze historical information and future prospects to derive a normalized P/E estimation. In the case of Coca-Cola, its 10-year historical P/E is 36.75 (average of highs and lows on S&P Stock Reports). This is huge premium to the broad market (selling for about 18 times forward earnings on 4/29/2004), but this premium is largely warranted due to Coca-

Cola's durable competitive advantage (brand image and economies of scale), financial prowess, and consistent historical performance. Even so, I assume a much lower P/E multiple of 25x. Had I assumed a multiple of 30x, the valuation model would have yielded an intrinsic value of \$56.59, representing a 43.22% margin of safety. However, my reduced estimate is only prudent, as a conservative investor should shy away from valuations that are contingent on extremely high P/E multiples, and thus investor optimism.

Discount rate assumptions are also extremely fuzzy. This rate should reflect the return demanded by an investor for a company with a particular risk profile. In the TVAIC model, I typically assign a discount rate of 10% or so to the safest companies (like Coca-Cola), and vary the rate up to 15% for riskier companies. Admittedly, this is largely arbitrary and off the Wall. These figures are certainly larger than the 7% returns that Warren Buffett told UT students to expect over the next 40 years, but higher discount rates yield more conservative calculations.¹⁴ Therefore, 10-15% discount rates seem to be quite sensible.

The bottom line is that any intrinsic value calculation is going to be very fuzzy. This is precisely why an intelligent investor should demand a huge discount to intrinsic value. In fact, the margin should probably be so large that a precise calculation of value is not even necessary. At Berkshire Hathaway's 1996 Annual Shareholder Meeting, Buffett stated,

"If you have to actually do it with pencil and paper, it's too close to think about. It ought to just kind of scream at you that you've got this huge margin of safety."¹³

Such was the case with my purchase of Sears (discussed below).

Portfolio “Risk”:

Buffett is very critical of academia’s definition of risk with respect to securities. Even the Investments course at the University of Tennessee (Finance 425) teaches students that **beta** is the appropriate measure of risk for individual securities. Beta is essentially measured by the coefficient (slope) of a regression that plots the historical performance of a particular company’s stock against that of the broad market (S&P 500). For instance, if a stock has consistently risen 20% while the S&P 500 has gained 10% over a given period, the stock would have a beta of approximately 2.0. This high beta indicates that the stock is much more volatile than the overall market. If the S&P 500 were to fall 10%, an academic would expect the stock to fall lose 20% of its value.

Fundamentally, this makes absolutely no sense as a measure of “risk.” Beta measures no more than a stock’s volatility. An investor with a long-term focus should not be concerned by the manic depressive and alcoholic nature of Mr. Market. As long as an investor buys a *business* at a fair price, Mr. Market’s changing attitude toward the individual *pieces* of that business should be of no concern to the investor. In fact, this “risk” is actually to the value investor’s benefit, since volatile price behavior presents many opportunities for an investor to capitalize on Mr. Market’s idiocy.

What’s more, by focusing solely on the price behavior of securities, academics entirely neglect the underlying characteristics of the businesses in which they are investing. Buffett elaborates in his 1993 Letter to Shareholders:

“In assessing risk, a beta purist will disdain examining what accompany produces, what its competitors are doing, or how much borrowed money the business employs. He may even prefer not to know the company’s name.”¹¹

This line of thinking is absurd. Buffett might say that it can be equated to watching a scoreboard instead of the baseball game itself or driving through the rearview mirror.

In his appendix to *The Intelligent Investor*, “The Superinvestors of Graham-and-Doddsville,” Buffett further explains the absurdity of the beta measurement for risk by describing his investment in The Washington Post, which was selling for \$80 million in the market and, as Buffett claims, was worth \$400 million in assets alone:

“[I]f the stock had declined even further to a price that made the valuation \$40 million instead of \$80 million, its beta would have been greater. And to people who think beta measures risk, the cheaper price would have made it look riskier. This is truly Alice in Wonderland. I have never been able to figure out why it’s riskier to buy \$400 million worth of properties for \$40 million than \$80 million.”²⁴

Indeed, the entire concept of a risk/reward tradeoff is largely skewed here. While academia teaches us that we must assume more “risk” if we are to expect greater returns, value investing demonstrates that buying stocks cheap can actually *decrease* risk (by minimizing potential loss) and *increase* profit potential simultaneously. Certainly, by buying The Washington Post at \$40 million, Buffett could have achieved both of these ends.

The invalidity of beta is likewise demonstrated by my own investment

		2/11/2004										
performance.	As of	Symbol	Price	Shares	Value	Weight	Beta	Weighted Beta				
2/11/2004, the weighted average beta of my personal portfolio was approximately 0.55. If beta were an accurate		KO	\$ 51.80	50	\$ 2,590.00	8.26%	0.286	0.0236				
		PFE	\$ 38.15	50	\$ 1,907.50	6.09%	0.378	0.0230				
		GE	\$ 33.08	75	\$ 2,481.00	7.92%	1.103	0.0873				
		HD	\$ 36.83	75	\$ 2,762.25	8.81%	1.401	0.1235				
		BRK.B	\$ 3,057.00	1	\$ 3,057.00	9.75%	0.415	0.0405				
		HDI	\$ 53.36	40	\$ 2,134.40	6.81%	1.095	0.0746				
		HCA	\$ 43.89	65	\$ 2,852.85	9.10%	0.15	0.0137				
		CAH	\$ 65.75	78	\$ 5,128.50	16.36%	0.105	0.0172				
		HMC	\$ 21.62	230	\$ 4,972.60	15.87%	0.531	0.0843				
		TAP.B	\$ 18.20	175	\$ 3,185.00	10.16%	0.6	0.0610				
		Cash			\$ 268.01	0.86%		0				
				Total:	\$ 31,339.11	100.00%		0.5486				

indicator of risk and, thus, expected relative performance, my portfolio should have returned something along the lines of 22% (41% S&P 500 return multiplied by my .55 beta). Thus, by achieving a return of over 56%, I actually earned money on risks that I did not even take! Academia might simply explain this “abnormality” to be a freak occurrence. The intelligent investor knows better.

A Quality Bias:

An investor should have a preference for strong, high-quality companies. In his 1989 Letter to Shareholders, Buffett declared, “It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price.”⁸ If an investor pays too much for a great company, it is far more likely that he will eventually recoup his investment. With a poor quality company, future prospects are not as predictable, and, thus, mistakes are much more painful.

In building my portfolio, I made sure that I established a solid foundation of

Purchases		Value Line Metrics	
Symbol	Financial Strength	Earnings Predictability	
KO	A++	85	quality companies. In my first day of investing, I purchased Coca-Cola, General Electric, Pfizer, and Home Depot, all of which carried high rankings Value Line's metrics for both financial strength and earnings predictability. I maintained this commitment to
PFE	A++	100	
GE	A++	95	
HD	A++	90	
BRK.b	A+	5	
MCD	A++	95	
WEN	A	95	
HDI	A	100	
S	A	85	
HCA	A	40	
SNV	B++	100	
BAX	A+	85	
CAH	A	100	
HMC	B++	75	
TAP.b	B++	5	

quality throughout the investment period, and I am confident that this quality bias

significantly contributed to my performance. Indeed, two of my best performers were my high-quality holdings in Home Depot and McDonald's, returning 70.27% and 61.11% (after fees but excluding dividends), respectively. (See appendix for more detailed return information.)

Two Illustrations: MCD and S

MCD: Before considering these two investments, it is important to understand that value investing requires more common sense and simple thought than complex mathematical models and meticulous calculation. The logic behind a decision should be so simple that it can be explained in a few words. In his 1994 Letter to Shareholders, Buffett notes, "The truly big investment idea can usually be explained in a short paragraph."¹²

McDonald's enjoys one of the strongest brands in the world, generates tons of cash, and maintains a solid balance sheet. However, leading into 2003, the company's same-store sales began to suffer from poor quality, slow service, and an un-kept appearance at many of its locations, from a shift in eating preferences toward casual dining (Panera Bread, etc.) over fast food chains, and from growing social concerns over obesity and other health issues. Moreover, low-priced items (such as the dollar menu) were eating into margins due to a looming price war with Burger King. Needless to say, times were tough.

All of these problems, to me, seemed to be short-term concerns. First of all, social trends shift all the time, so the obesity and casual dining factors had little to no influence on my long-term outlook for the company. Additionally, the price wars are common, and I expected that this too would normalize in the future. The main problem

was that management seemed incapable of keeping the company on top. The concerns over deteriorating quality and service were valid in that these issues could have seriously injured the company's strong brand image and, thus, long-term competitive advantage. Luckily, new management was already in place, and the new CEO, Jim Cantalupo, seemed very committed to dramatically improving the quality, service, and cleanliness at all existing restaurant locations. In short, it looked like this ship would soon turn around, and the company certainly had a fantastic capital structure to facilitate the process.

Mr. Market, however, was back to his old self, off drinking somewhere in the corner. Mr. Market, in a drunken stupor, was only concerned with the short-term, unable to look past the most recent decline in same-store sales or quarterly earnings disappointment. This great company, which expected to earn \$1.35 for the year, was selling for a mere \$13.50. This represented a P/E multiple of just 10x. Not only did this contrast sharply to the company's historical P/E of 23.3x, but it also traded at a steep discount to the broad market.²⁸

Regardless of my estimates in valuing the company, it was obvious that MCD was a steal at \$13.50. I calculated an intrinsic value of \$21.17, representing a whopping 56.16% margin of safety. Not

McDonald's Corp. (MCD)

Current Price		\$13.56
Intrinsic Value		\$21.17
Margin of Safety		56.15%
Expected Return		21.98%
FV Price		\$32.40
	Future P/E	17.5
	EPS (Dec 02)	\$1.32*
	Long Term Growth Rate	1.07**
	Holding Period	5
PV Dividend		\$1.95
	Current Dividend	0.4
	Long Term Growth Rate	1.1
	Discount Rate	1.11
PV Price		\$19.23
	Tang. Book Value	\$6.88
	Price * Book Value	1.97
	Current P/E	10.27
	Historical P/E***	23.3

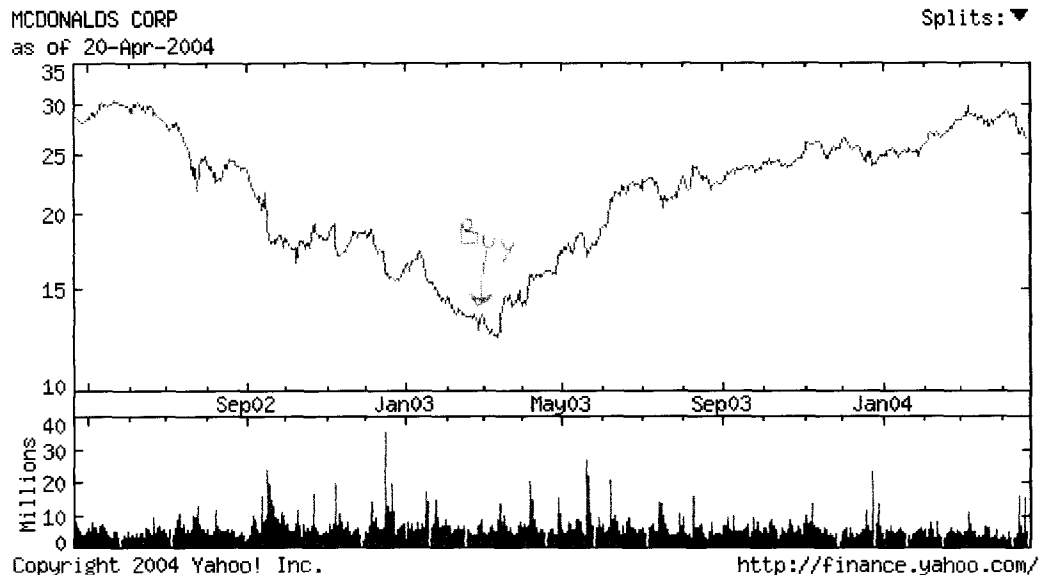
*Est. 2003 EPS is \$1.35

**First Call lists 8% future 5-yr growth)

***Average of High/Low Averages for the last 10 years.

only was I buying a wonderful company, but also I was buying it at a wonderful price.

Looking at the chart, it is interesting to note the great price at which I purchased MCD. While I certainly bought near a low, I was not trying to make any grand



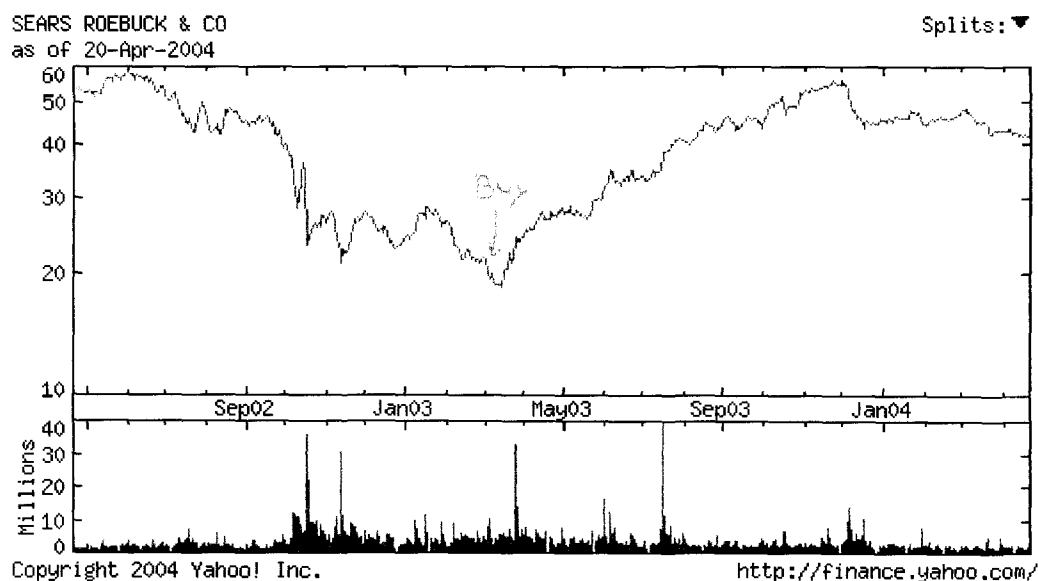
predictions about the price at which the stock would sell in the near future. I simply found great value in what I was getting for my money. Luckily, I did not have to wait long for Mr. Market to sober up. A momentum investor, on the other hand, would have seen my entry point as a horrible time to buy, simply *because* the stock had been on such a decline. Likewise, a momentum investor would have likely bought MCD at a later date after the stock had already risen substantially...missing a great opportunity.

Postscript: I purchased 100 shares of MCD at \$13.56 and sold just four months later for \$22.01 per share. This was a 61.11% return. (I outline a couple of mistakes here in the “Mistakes” section below.)

S: Sears was a rare “fat pitch” and “no-brainer.” The company has been around for over a century, and is a household name, but in early March 2003, its stock was selling for less about 4x earnings! The company was expected to earn \$4.89 in 2003 was paying

a \$1 dividend per share. Yet, the stock was selling for under \$22. Again, Mr. Market was scared to death about Sears' increasing default risk in its credit card portfolio, stronger competition in appliances from the likes of Best Buy and Home Depot, and weak results in the company's soft lines business. Additionally, the company was highly leveraged with a 79.5% debt/capital ratio. These fears were certainly legitimate, but the poor drunkard (Mr. Market) was basically giving his stock away. Moreover, Sears is a cash cow, so its dividend was stable, and the company could have easily met its debt obligations through refinancing or a simple securitization and liquidation of its credit card portfolio. The company was also well on its way to revitalizing its apparel business and had signed valuable exclusive contracts with Land's End and other popular outfitters. In short, Mr. Market was "making a mountain out of a molehill" as Ben Graham might say, and was grossly overcompensating for relatively short-term concerns.

As Buffett would say, this presented a margin of safety that literally "screamed" at me. The stock was selling for an ENORMOUS discount to its historical P/E of 13.25.¹



Postscript: I basically took advantage of Mr. Market's ignorance and bought 100 shares of Sears at \$21.95 per share, knowing very well that it was worth over \$30. Sears soon announced that it was indeed selling its credit card portfolio, and the price jumped dramatically. I ended up selling three months after purchase for \$33.76 and \$39.10, representing an overall capital gain of 64.72%. (I outline some mistakes below).

Mistakes:

While I did outperform the S&P 500, I did make several large mistakes that kept somewhat hindered my overall returns. I briefly outline these mistakes below.

My most difficult challenge was in exercising emotional discipline. In *The Intelligent Investor*, Ben Graham suggests that “[an] investor with a portfolio of sound stocks should expect their prices to fluctuate and should neither be concerned by sizable declines nor become excited by sizable advances.”²² Having never previously committed personal funds to marketable securities, I watched my holdings like a hawk the majority of the time. While this alone is no major crime, it certainly is a bad habit for me to develop since my ultimate goal as a value investor is to invest with logic without consideration of or influence by emotion.

Because I was paying so much attention to the price activity of certain stocks, I ended up letting Mr. Market instruct me a time or two as I made a buy or sell decision. I had already made the decision to act, but I let the market influence the *timing* of my trades. Specific examples include both my purchase and sell of Sears. I knew that \$21.95 was a great price to buy; otherwise, I would not have bought the stock at all. However, after watching the stock dart upward on the day, I bought hurriedly for fear that

I would miss it altogether. Because I “chased” the stock, I ended up buying near the high of the day, from which it subsequently fell 2.5% to close at \$21.40...and then \$19.70 the following day. Moreover, even though I still liked the value offered and was not quite concentrated enough in Sears, I neglected to buy more when the stock traded down to just over \$18 per share on March 14 2003, representing a P/E of just 3.8x earnings! Basically, I had endured over a 17% loss in my Sears position at that time and was too frightened to pull the trigger again.

Once the price jumped on the news that the company was selling its credit card portfolio, I sold half of my position because the stock had quickly jumped over my intrinsic value calculation. I failed to consider, however, the true implications of the news and the conservatism of my original estimates. I basically sold way too cheap. After all, at \$33.76, the company was still selling for less than 7x earnings. Had I not let my emotions control me and held my position longer, I could have potentially realized well over a 150% gain as the stock soared to \$56 per share.

This brings me to another mistake: excessive activity. Excluding the activity to get fully invested, my portfolio turnover for the 12-month period was a whopping 58.9%. This means that I sold over half of my holdings to buy new companies at some point in the period. At a February 2003 meeting with UT Finance

Turnover: Symbol	Bought	Sold	
KO	\$ 1,988.49	\$ 2,187.90	MCD
PFE	\$ 1,476.50	\$ 1,674.93	S
GE	\$ 1,694.75	\$ 1,943.91	S
HD	\$ 1,624.25	\$ 1,622.43	WEN
BRK.b	\$ 2,120.00	\$ 2,960.87	BAX
MCD	\$ 1,358.00	\$ 1,946.91	HCA
WEN	\$ 1,256.00	\$ 2,797.97	SNV
HDI	\$ 1,576.00		
S	\$ 2,197.00		
HCA	\$ 1,969.49		
SNV	\$ 1,931.99		
BAX	\$ 2,517.99		
HCA	\$ 1,615.99		
CAH	\$ 2,547.56		
HMC	\$ 3,025.99		
HMC	\$ 1,567.79		
CAH	\$ 2,008.09		
TAP.b	\$ 2,627.24		
Totals:	\$35,103.12	\$ 15,134.92	
Sum:		\$ 50,238.04	
Less Initial Investment:		\$ (20,000.00)	
		\$ 30,238.04	
		/2	
		\$ 15,119.02	
Divide by Avg. Value		\$ 25,669.56	
		58.90%	

students in Omaha, Buffett explained that it only makes sense to sell when there is another investment option that offers better value.¹⁵ If this is true, and if it is only common to come up with good investment ideas once per year like Buffett says (quoted above), then I must have transferred money too frequently among less-than-spectacular investments. Indeed, I did sell my two favorite investments (MCD and S) way too early, and, thus, I missed out on some spectacular gains. My failure to “buy and hold” also has significant tax implications. Because I neglected to hold many of my investments before holding them for one year, my capital gains tax rate will be higher than it would have otherwise been. Moreover, because I was so active, I had to pay many more commission fees to my broker. Considering that I made a total of 25 trades and commissions cost \$10.99 per trade, I spent a total of \$252.75, or 1.26% of my principle investment in fees alone. The lesson here is that it pays to be a patient investor. In his 1991 Letter to Shareholders, Buffett claims, “Our stay-put behavior reflects our view that the stock market serves as a relocation center at which money is moved from the active to the patient.”⁹ This is certainly something that I will need to continue to work on.

Buffett makes a distinction between two types of mistakes—those of commission and those of omission. In his October 2003 presentation to UT students, Buffett insisted, “Our biggest mistakes have been those of omission rather than commission.”¹⁴ I believe the same is true for me. Although it does not show up as a loss on my performance record, my failure to demonstrate courage and buy a meaningful amount of my favorite investments seriously hindered my performance potential. For instance, I only purchased \$1,356 worth of MCD, which represented a modest 6.8% of my total portfolio. Similarly, I only bought \$1,622 of HD and \$2,195 of S, representing

only 8.1% and 11% of my portfolio, respectively. These were my favorite investments, yet they comprised a relatively small portion of my portfolio. I have since become better at concentrating, even investing well over 16% of my portfolio into my current CAH position. This kind of concentration is necessary to achieve above average results.

Closing Thoughts

While the performance of my portfolio is certainly not indicative of future potential, grand conclusions about value investing or my ability were never intended. As for value investing, the successes of Benjamin Graham and Warren Buffett speak for themselves. As for me, only time can tell.

The important lesson here is that managing this portfolio has been an invaluable experience in and of itself. To be a successful investor, a person needs to practice investing. As demonstrated by my own failures, it is not enough to simply understand *how* to value a company and what to look for. Investing a substantial amount of personal capital can be very emotional, and it takes a great deal of practice to discipline oneself so that emotion does not interfere with clear and simple logic. At a February 2003 meeting in Omaha with UT students, when answering a student's question about the value of real-money investment programs such as the TVA Investment Challenge, Mr. Buffett replied, "There is no substitute for *losing* your own money." ¹⁵ While I did not *lose* any money, I certainly agree that there is no substitute for this invaluable learning experience. I would strongly encourage anyone interested in investments to put their own money on the line.

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Appendix

Transaction Data:

Date	Type	Description	Value	
1/26/2004	Dividend Receipt	GE	15	
1/15/2004	Dividend Receipt	CAH	2.34	
12/29/2003	Dividend Receipt	HDI	3.2	
12/19/2003	Dividend Receipt	HD	5.25	
12/15/2003	Dividend Receipt	KO	11	
12/4/2003	Dividend Receipt	PFE	7.5	
12/1/2003	Dividend Receipt	HCA	2.3	
11/21/2003	Buy or Sell Security	BUY 175.000 SHARES TAP B @ 14.95	-2627.24	
11/21/2003	Buy or Sell Security	SELL 100.000 SHARES SNV @ 28.091	2797.97	
11/7/2003	Buy or Sell Security	BUY 35.000 SHARES CAH @ 57.06	-2008.09	
11/7/2003	Buy or Sell Security	SELL 50.000 SHARES HCA @ 39.16	1946.91	
10/27/2003	Dividend Receipt	GE	14.25	
10/23/2003	Buy or Sell Security	BUY 80.000 SHARES HMC @ 19.41	-1567.79	
10/15/2003	Dividend Receipt	CAH	1.29	
10/1/2003	Buy or Sell Security	BUY 150.000 SHARES HMC @ 20.10	-3025.99	
10/1/2003	Buy or Sell Security	SELL 100.000 SHARES BAX @ 29.72	2960.87	
10/1/2003	Buy or Sell Security	SELL 50.000 SHARES WEN @ 32.67	1622.43	
10/1/2003	Dividend Receipt	KO	11	
10/1/2003	Dividend Receipt	SNV	16.5	
9/30/2003	Dividend Receipt	HDI	1.6	
9/18/2003	Dividend Receipt	HD	5.25	
9/4/2003	Dividend Receipt	PFE	7.5	
9/2/2003	Dividend Receipt	HCA	2.3	
8/18/2003	Dividend Receipt	WEN	3	
8/8/2003	Buy or Sell Security	BUY 43.000 SHARES CAH @ 58.99	-2547.56	
7/25/2003	Dividend Receipt	GE	14.25	
7/16/2003	Buy or Sell Security	SELL 50.000 SHARES S @ 39.10	1943.91	
7/11/2003	Buy or Sell Security	BUY 50.000 SHARES HCA @ 32.10	-1615.99	
7/3/2003	Buy or Sell Security	BUY 100.000 SHARES BAX @ 25.07	-2517.99	

Appendix

7/1/2003 Dividend Receipt	SNV	16.5
7/1/2003 Dividend Receipt	S	23
7/1/2003 Dividend Receipt	KO	11
6/30/2003 Interest Receipt	INTEREST CREDIT	0.07
6/26/2003 Dividend Receipt	HD	4.5
6/20/2003 Dividend Receipt	HDI	1.6
6/18/2003 Buy or Sell Security	SELL 50.000 SHARES S @ 33.76	1674.93
6/18/2003 Buy or Sell Security	SELL 100.000 SHARES MCD @ 22.01	2187.9
6/5/2003 Dividend Receipt	PFE	7.5
6/2/2003 Dividend Receipt	HCA	1.3
6/2/2003 Interest Receipt	INTEREST CREDIT	0.05
5/19/2003 Dividend Receipt	WEN	3
4/28/2003 Interest Receipt	INTEREST CREDIT	0.36
4/25/2003 Dividend Receipt	GE	14.25
4/25/2003 Buy or Sell Security	BUY 100.000 SHARES SNV @ 19.19	-1931.93
4/23/2003 Buy or Sell Security	BUY 65.000 SHARES HCA @ 30.10	-1963.49
4/1/2003 Dividend Receipt	KO	11
3/31/2003 Interest Receipt	INTEREST CREDIT	0.39
3/28/2003 Dividend Receipt	HD	4.5
3/24/2003 Dividend Receipt	HDI	1.4
3/3/2003 Buy or Sell Security	BUY 100.000 SHARES S @ 21.95	-2197
3/3/2003 Interest Receipt	INTEREST CREDIT	1.16
2/24/2003 Buy or Sell Security	BUY 40.000 SHARES HDI @ 39.35	-1576
2/19/2003 Buy or Sell Security	BUY 50.000 SHARES WEN @ 25.08	-1256
2/19/2003 Buy or Sell Security	BUY 100.000 SHARES MCD @ 13.56	-1358
2/19/2003 Buy or Sell Security	BUY 1.000 SHARES BRK B @ 2118.00	-2120
Miscellaneous Corporate 2/10/2003 Action	COMMISSION ADJUSTMENT 774684025 1094194495	10.99
2/10/2003 Buy or Sell Security	BUY 75.000 SHARES HD @ 21.63	-1624.25
2/10/2003 Buy or Sell Security	BUY 75.000 SHARES GE @ 22.57	-1694.75
2/10/2003 Buy or Sell Security	BUY 50.000 SHARES PFE @ 29.49	-1476.5
2/10/2003 Buy or Sell Security	BUY 50.000 SHARES KO @ 39.51	-1983.49
2/3/2003 Interest Receipt	INTEREST CREDIT	0.11
1/30/2003 Cash Receipt		20000

Appendix

The Portfolio											
2/11/2004											
Symbol	Price	Shares	Value	Weight	P/E	Div	Div. Yield	Beta	Weighted Beta		
KO	\$ 51.80	50	\$ 2,590.00	8.26%	24.67	0.68	1.70%	0.286	0.0236		
PFE	\$ 38.15	50	\$ 1,907.50	6.09%	16.03	0.68	1.78%	0.378	0.0230		
GE	\$ 33.08	75	\$ 2,481.00	7.92%	18.69	0.8	2.42%	1.103	0.0873		
HD	\$ 36.83	75	\$ 2,762.25	8.81%	17.97	0.28	0.76%	1.401	0.1235		
BRK.B	\$ 3,057.00	1	\$ 3,057.00	9.75%	24.68	0	0.00%	0.415	0.0405		
HDI	\$ 53.36	40	\$ 2,134.40	6.81%	16.94	0.32	0.60%	1.095	0.0746		
HCA	\$ 43.89	65	\$ 2,852.85	9.10%	13.63	0.52	1.18%	0.15	0.0137		
CAH	\$ 65.75	78	\$ 5,128.50	16.36%	15.51	0.12	0.18%	0.105	0.0172		
HMC	\$ 21.62	230	\$ 4,972.60	15.87%	9.7	0.16	0.74%	0.531	0.0843		
TAP.B	\$ 18.20	175	\$ 3,185.00	10.16%	7.95	0.32	1.76%	0.6	0.0610		
Cash			\$ 268.01	0.86%					-		
Total:			\$ 31,339.11	100.00%	16.577				0.5486		

Return Information		
Beginning Cash Balance:	\$	20,000.00
Performance:	56.70% (After Fees)	
S&P 500 Performance:	41.79%	
2/11/2003	829.2	
2/11/2004	1157.76	
div	18	
adjusted	1175.76	

Appendix

Symbol	Realized Gains			
	Basis	Proceeds	Profit	% Gain
MCD	\$ 1,358.00	\$ 2,187.90	\$ 829.90	61.11%
S	\$ 2,197.00	\$ 1,674.93	\$ 1,421.84	64.72%
		\$ 1,943.91		
WEN	\$ 1,256.00	\$ 1,622.43	\$ 366.43	29.17%
BAX	\$ 2,517.99	\$ 2,960.87	\$ 442.88	17.59%
HCA	\$ 1,615.99	\$ 1,946.91	\$ 330.92	20.48%
SNV	\$ 1,931.99	\$ 2,797.97	\$ 865.98	44.82%
Totals:	\$ 10,876.97	\$ 15,134.92	\$ 4,257.95	39.15%

2/11/2004		Unrealized Gains						
Symbol	Price	Shares	Value	Price Paid	Basis	Unreal G/L	% G/L	
KO	\$ 51.80	50	\$ 2,590.00	\$ 39.51	\$ 1,975.50	\$ 614.50	31.11%	
PFE	\$ 38.15	50	\$ 1,907.50	\$ 29.49	\$ 1,474.50	\$ 433.00	29.37%	
GE	\$ 33.08	75	\$ 2,481.00	\$ 22.57	\$ 1,692.75	\$ 788.25	46.57%	
HD	\$ 36.83	75	\$ 2,762.25	\$ 21.63	\$ 1,622.25	\$ 1,140.00	70.27%	
BRK.B	\$ 3,057.00	1	\$ 3,057.00	\$ 2,118.00	\$ 2,118.00	\$ 939.00	44.33%	
HDI	\$ 53.36	40	\$ 2,134.40	\$ 39.35	\$ 1,574.00	\$ 560.40	35.60%	
HCA	\$ 43.89	65	\$ 2,852.85	\$ 30.10	\$ 1,956.50	\$ 896.35	45.81%	
CAH	\$ 65.75	78	\$ 5,128.50	\$ 58.12	\$ 4,533.66	\$ 594.84	13.12%	
HMC	\$ 21.62	230	\$ 4,972.60	\$ 19.86	\$ 4,567.80	\$ 404.80	8.86%	
TAP.B	\$ 18.20	175	\$ 3,185.00	\$ 14.95	\$ 2,616.25	\$ 568.75	21.74%	
Cash			\$ 268.01					
Basis:	\$ 20,000.00	Total Value:	\$ 31,339.11			\$ 6,939.89	34.70%	