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The Heresy That Made Them Rich
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A FEW weeks ago, **Columbia** Business School held its 15th Annual Graham & Dodd Breakfast. The guest speaker was Jean-Marie Eveillard, a successful (and now retired) mutual fund manager, who used to beat the market regularly by adhering to the ''**value investing**'' principles first articulated by the great investor Benjamin Graham and his co-author, the **Columbia** professor David L. Dodd, in their 1934 classic, ''Security Analysis.''

The host was Bruce Greenwald, the Robert Heilbrunn professor of finance and asset management, whose **value investing** course is one of the school's most popular offerings. Heilbrunn, a Graham disciple who died in 2001, donated the money for Mr. Greenwald's chair, and also gave the university $5 million to establish a Graham and Dodd research center. Among the 300-plus value investors in the audience were the famed fund manager Mario J. Gabelli (class of '67), who is a strong backer of the **Columbia** program, and Paul D. Sonkin (class of '95) of the Hummingbird Value Fund and an adjunct professor at the school, where he teaches **value investing**.

And present in spirit, if not in the flesh, was another Graham devotee, the greatest value investor of them all: Warren E. **Buffett** (class of '51).

I hadn't quite appreciated, before going to the breakfast, the extent to which **Columbia** Business School is an outlier in the world of academic finance. (A disclosure: for the last year and a half, I've taught a class at **Columbia** Journalism School.) Most business schools emphasize modern portfolio theory, which has as its central tenet that the market is so efficient it can't be beaten with any regularity. Portfolio theory stresses, sensibly enough, diversification as the best way to spread market risk, but it also generally holds that because the market is efficient, those who beat it are lucky rather than skilled. As Mr. **Buffett** put it to me recently, ''You couldn't advance in a finance department in this country unless you taught that the world was flat.''

Although **Columbia** has its share of portfolio theorists, the **value investing** program that Mr. Greenwald runs preaches something else: that the world is round. Or, more precisely, that the market can be beaten. Not easily, mind you, and not mindlessly. A ''value'' stock is, at bottom, a cheap stock. And a value investor is someone who has the facility to ferret out cheap stocks that don't deserve to be cheap, the acumen to understand why certain such companies have what Mr. **Buffett** calls ''a sustained competitive advantage'' that will be borne out over time, the patience to wait for the market to come around to his view of things, and the discipline to stick to his value parameters through thick and thin.

''For a value investor, the only relevant questions are: Is it a good business? And will it be a better business in five years?'' said Jason Zweig, a columnist with Money magazine who, a few years ago, published an annotated version of Mr. Graham's other classic work, ''The Intelligent Investor.'' If this be heresy, the world could use a little more of it.

''EFFICIENT market theory is basically dead,'' Mr. Greenwald exclaimed, as he began to tell me the story of how he abandoned portfolio theory for **value investing**.

I've always found **value investing** appealing because it seems to reward virtue. If you put in the effort, focus more on the business than the stock, and have patience, you have a decent chance of making money. It seems right, somehow, that that's how the world should work.

Mr. Greenwald, an economist and an expert on business strategy, likes to make grand, provocative statements that are likely to tick off the academic establishment, like saying efficient market theory is dead. I suspect that Mr. Greenwald finds **value investing** appealing at least in part because it puts him at such odds with his academic brethren.

In fact, **Columbia**'s **value investing** roots go back to Graham, who not only went to the school as an undergraduate, but taught there until the mid-1950's. (Mr. **Buffett** took his course and worked for his small investment firm, Graham Newman, from 1954 to 1956.) By the time Mr. Greenwald arrived at **Columbia** in 1991, though, the business school had largely abandoned the field.

Not long after he arrived, Mr. Greenwald attended a series of lectures, as a courtesy, he says, by a retired professor named Roger F. Murray. Murray, who died in 1998, had taught **value investing** for 20 years after Graham, and one of his prize students had been Mr. Gabelli (whose 20-year track record at the Gabelli Asset Fund, in case you were wondering, is

an annualized 14.11 percent). Gabelli was underwriting the lectures -- and also videotaping them, a little like an anthropologist trying to capture a dying language while there was still someone around who spoke it.

To his surprise, Mr. Greenwald came away impressed. ''I thought,'' he recalled, ''this is not stupid; there is a discipline and a process here.'' In his own financial life, Mr. Greenwald was the rankest of speculators, to sometimes spectacular and sometimes dismal effect. **Value investing** was the opposite of that.

In addition, academic studies were beginning to be published that showed value stocks regularly outperformed the market. One important study, for instance, showed that a basket of value stocks outperformed a basket of growth stock about 80 percent of the time. Although finance professors have subsequently engaged in a furious debate as to why this is so, a debate that largely consists of trying to square these findings with efficient market theory, Mr. Greenwald became convinced that they told an unambiguous truth: **value investing** worked. By 1994, he had revived the school's **value investing** course.

A decade-plus later, Mr. Greenwald has his own proteges, including Mr. Sonkin -- just as Ben Graham once had Mr. **Buffett** as a protege, and Murray had Mr. Gabelli. Among the many benefits for Mr. Greenwald is that he now gets to invest with some of the people he once taught --Mr. Sonkin's fund, for instance, has an annualized return of 17.3 percent since January 2000. And, of course, as they become successful, they contribute money to the Graham and Dodd program.

Still, the **Columbia** program -- and **value investing** in general -- feels a little like a cult. Despite the obvious success of people like Mr. **Buffett** and Mr. Gabelli -- and the studies that seem to bear out that success as something more than luck -- it is not yet fully accepted by either mainstream Wall Street or mainstream academia. In his remarks at the breakfast, Mr. Eveillard said he thought that maybe 5 percent of professional money managers are true value investors.

But why? If it works, why don't more investors use it? Everybody I spoke to had a different answer. Mr. Zweig said he thought the biggest issue was that **value investing** was just plain hard. ''**Buffett** is looking to buy great businesses at good prices,'' he said. ''That's not an easy thing to do.'' He pointed to the example of Mr. **Buffett** buying a stake in Anheuser-Busch this year after having read the company's annual report for 25 years. ''He was watching and waiting for a quarter of a century,'' Mr. Zweig said.

Mr. **Buffett** said he thought that most people regarded themselves as value investors, even if they weren't. ''Very few people will say they think they are buying something overvalued,'' he pointed out. But he added that most people looked at the wrong measurements or were overly focused on short-term results, something value investors try to look past.

Mr. Greenwald thought it was because ''people love the idea of getting rich quickly''-- which is the antithesis of **value investing**. ''People buy lottery tickets, too,'' he said.

At the Graham & Dodd Breakfast, Mr. Eveillard's remarks suggested that he thought it was all of the above. ''It goes against human nature,'' he said. ''You have to be very patient. You're not running with the herd -- and it's much warmer inside the herd.''

Toward the end of the breakfast, a young investor asked him whether he tried to look around for a catalyst -- ''such as a corporate raider'' -- when a stock he owned refused to move up, the way he thought it should. Mr. Eveillard laughed. No, he said, he just waited. ''I've been frustrated forever,'' he said. ''I accept that.''

Would that we could all accept it. But then, that's why he is a successful investor, and most of us are not.

Last week, I told an anecdote -- probably apocryphal, I said -- about the former president of Harvard, Derek Bok, firing the man who had run the Harvard Management Company in the 1980's. Neither man returned my calls before the column went to press, but this week, Mr. Bok called to express his dismay that I had published the anecdote. ''It never happened,'' he said.

Photo: Benjamin Graham

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