

“The Great Debate”

Spring 2015

Grant's Conference





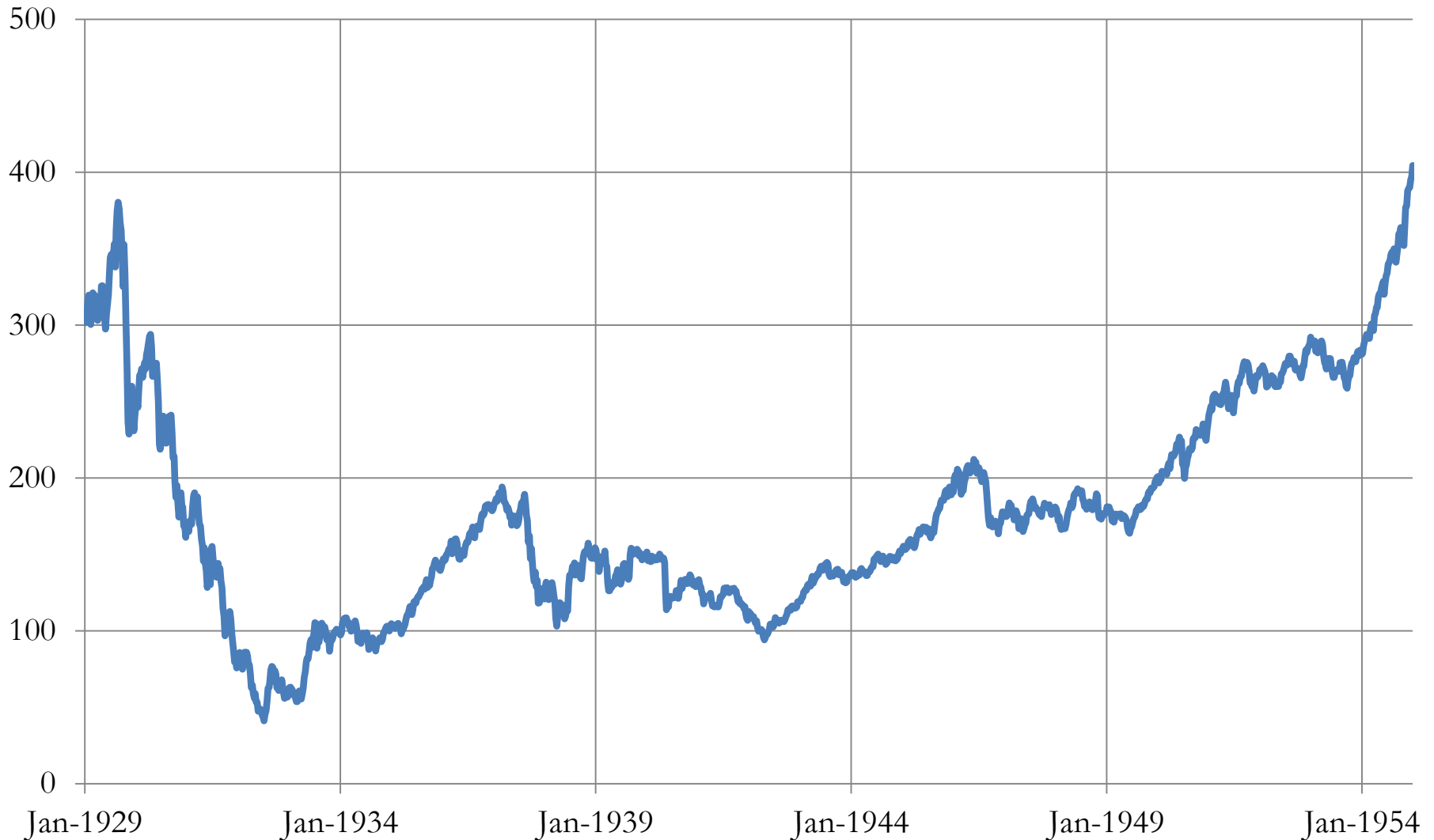
“The market,” a.k.a. the S&P 500, comprises:

- 99 stocks with a short interest over 5%,
- 149 stocks with a P/E ratio over 25 times — or no P/E ratio

“Executions don’t kill. Research kills.”

—*Alan Abelson*

25 years between new highs Dow Jones Industrial Average



“I think it is roughly right that the market is efficient, which makes it very hard to beat merely by being an intelligent investor. But I don’t think it’s totally efficient at all.”

—*Charlie Munger*

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Over the cliff with Morgan Stanley

Alone among the Wall Street financial-services providers that used to style themselves, simply, as "brokerage houses," or—with a little more tone—"investment banks," Morgan Stanley is the owner of a \$1 trillion balance sheet. It cleared the 13-figure mark on the May 31 statement date. The former white-shoe partnership has expanded its footings at the rate of 21.5% per annum since 2003. It has left Goldman Sachs in the dust, size-wise. And while no lawful, privately operated financial

the late-cycle relaxation of lending standards and the widely credited myth that the Federal Reserve will pull the market's chestnuts out of the fire before they're even so much as singed? Admittedly, this might seem a hard point to carry in the wake of a quarter in which Morgan's earnings from continuing operations jumped by 61% and its return on equity totaled 23%. We reason, however, that whether or not this is the top of the credit cycle, it certainly isn't the bottom, and to generate the returns it does, Morgan Stanley is reaping through minefields. In the

Mack did not return triumphantly to the chief executive's chair in 2005 to err on the side of caution. His remit is to run the ball down the field and into the end zone, "end zone" being an undefined term but perhaps taking the form of a merger with a giant commercial bank. In the wake of its protracted executive-suite soap opera, Morgan is probably the least likely firm on Wall Street to beat a tactical retreat from risk on account of the dangers that a turn in the credit cycle may present on some indeterminate future date (which date this publication expected long before now). The regenerated Morgan Stanley seems determined to make money while the making's good.

A long way back for the S&P Financials



Diversification: Can there be too much of a good thing?

“There is one thing of which I can assure you. If good performance of the fund is even a minor objective, any portfolio encompassing 100 stocks (whether the manager is handling \$1,000 or \$1 billion) is not being operated logically.”

–1966 Buffett Partnership Letter

“Over time, our policy of concentration should produce superior results. . . .”

—*1984 Berkshire Hathaway Letter*

“If my universe of business possibilities were limited, say, to private companies in Omaha, I would, first, try to assess the long-term economic characteristics of each business; second, assess the quality of the people in charge of running it; and, third, try to buy a few of the best operations at a sensible price. I certainly would not wish to own an equal part of every business in town.”

—1991 Berkshire Hathaway Letter

“Once you are in the business of evaluating businesses, and you decide that you are going to bring the effort and intensity and time involved to get that job done, then I think diversification is a terrible mistake to any degree. . . . If you really know businesses, you shouldn’t own more than six of them.”

—Buffett lecture at the University of Florida School of Business, Oct. 15, 1998

Vanguard S&P 500 index fund

selected holdings as of Feb. 28, 2015

Name	Shares held	Market value
Legg Mason Inc	1,118,247	\$64,042,006
BlackRock Inc	1,418,833	\$526,982,953
T Rowe Price Group Inc	2,889,118	\$238,641,147
Invesco Ltd	4,798,743	\$193,245,381
Ameriprise Financial Inc	2,055,355	\$274,657,089
Franklin Resources Inc	4,367,271	\$235,090,198

“I’m convinced that everything that’s important in investing is counterintuitive, and everything that’s obvious is wrong.”

*-Charlie Munger, quoted in
Howard Marks’s “Dare to be
Great II,” April 8, 2014*

“Successful investing is having everyone agree with you — later.”

—Joe Robillard