

THE BIG MONEY

Here's how to make it! One of the great masters of the market, Fred Kobrick, offers up the lessons of a lifetime. The *Big Money* reads like a novel and teaches without pain. For those few among us whose investment strategies are sometimes marred by timidity, impatience, the wrong information or simple greed, Fred's approach can build assets and perhaps even character.

BY HENRY SCAMMELL

Several years ago, possibly around the time Frederick Kobrick was a child, a researcher conducted a study into the psychology of delayed gratification. His subjects were first-grade children, interviewed one at a time. A couple of minutes into each session, the scientist would pretend to recall a prior appointment, saying he had to leave the room for an unspecified length of time. He gave the child a marshmallow, and with it a proposition: eat it right away or win a second marshmallow by holding off until he returned. Most ate the sweet on the spot, some struggled with the temptation and lost, and a handful managed to control themselves long enough to double the prize.

If longtime EQUITIES columnist Fred Kobrick had been in that study, he would have wound up with all the marshmallows in the bag. "I think of the 'big money' as...making 10 times, 25 times — even 100 and 200 times — your investment by owning the greatest companies, and owning them with true insights and patience over the long term."

This is not just big talk. Described by his boyhood friend, Fidelity's legendary Peter Lynch as, "one of the best stock pickers I have ever met," Kobrick has spent the better part of a distinguished professional lifetime practicing what he now preaches (and teaches, part-time at Boston University, where he has also served as a trustee). That career includes 15 years managing the State Street Research Capital Fund, ranked by USA Today as one of the five best performers

in the industry. Money magazine included Kobrick's Capital Management Fund in its "Six Funds of the Decade" in 1996, and USA Today named it as one of the five best funds of the entire bull market. Starting his own firm in 1997, he ran three public mutual funds as well as a hedge fund. His Kobrick Capital Fund was named USA Today's All-Star Fund of the Year for 1998 and 1999, the only mutual fund ever to win twice.

After speaking at an EQUITIES Conference, Fred wrote 13 consecutive annual columns for EQUITIES every October, the month of stock market corrections and crashes. His annual tables listed wonderful technology and other Up and Comer growth stocks, which did extremely well for our readers when we looked back each year or so. Because he wrote in October, when most other prognosticators hid, we dubbed him "Fearless Fred."

After being frustrated in the dot.com bubble when he couldn't find many stocks worth buying, Fred withdrew from the money management rat race in 2000. Instead of trying to increase his financial return on investment, he sought something more important — a higher return on his life. Wisely, he traveled abroad with his wife and next taught at Boston University, where he had the pleasure and privilege of giving back and serving others. Now refreshed, Fred is at it again. He has tried to put his life's lessons in his new book.

One such lesson that, as important as patience can be in earning more marshmallows; there are obviously times in the stock market when it can

be a serious mistake. It's one thing to be steadfast while Microsoft or Wal-Mart continue to appreciate, and quite another to remain stubbornly loyal as an Enron or a World Com slides off your plate. Investors who learn and follow Kobrick's Seven Steps to Picking Great Stocks and Finding Financial Security will acquire the tools of discernment — "the wisdom to know the difference" as they say in another well-known multi-step program.

Even with good stocks, there is a balance between patience, to which Kobrick devotes a whole chapter, and taking some of the profits for things like a child's education. "Investors will have stocks that go up 50 % or 100% or 200%, but that won't go up 200 times. So learning how to be patient means learning to identify a true wealth stock (a keeper) that you want to hold for five to 25 years and also being able to identify good stocks (flippers) that you may want to buy and sell along the way. Very often, the great companies that can make an investor rich are surrounded by winners that will generate good returns, if on a far lower scale." How does an investor distinguish between the best companies and the good but ordinary ones at a very early stage? "You can't really make that kind of judgment until you get repeatability," he says.

Repeatability is the reason why Microsoft beat Lotus in spreadsheets even when Lotus started with 70% market share. "Microsoft's business model was based on Bill Gates' assumptions about how people buy software, which the Lotus model didn't even consider. Lotus was all product centered, and Microsoft was all business centered. Lotus didn't have repeatability, and Microsoft did. "People get blinded by the oncoming headlights of dazzling products," Kobrick says. "They should just focus on simple stuff like what is the engine of all those products, because if the engine is there it will assure repeatability, which means a high valuation and a lot of years. Valuation is largely based on how long a company will be able to continue doing whatever it does that makes it successful."

For most of the big investments — like Microsoft, Dell, Home Depot,

Federal Express — the really huge money can be made in the first 10 or 15 years. Wal-Mart is an exception.

After 20 years with Wal-Mart, an investment of \$1,600 or just 100 shares had turned into \$3.2 million — more

be the question mark on how Google will respond to competition from Microsoft and Yahoo.”

Some investors followed the analysts’ advice and after 20 years of phenomenal appreciation switched out of

one that will go the distance — is to see how management evolves the business model to the times, as Wal-Mart and General Electric did.

Sun Microsystems, by contrast, did not adapt its model, and investors suffered as a result. “Investors can have such short memories. Many now forget how good Sun once was. At the start, the king of the work station segment of the computer industry was Apollo, just outside Boston, with the fastest and best computer and the largest market share. Sun’s Scott McNealy sat back and asked the same questions Gates had asked in starting Microsoft. What’s going to be the shape of this market, who’s going to buy them, how are they going to buy them, and what are they going to want? The business model he created was based on his answers to those questions: keeping close to the customer; open architecture, and the kind of software and computer power that were exactly what engineers needed. His model was so precisely right that he was able to accomplish a feat that probably no other company was able to do before or since: he made Sun the fastest-growing company in America, based on the Forbes rankings, for five years running. And in the 14 years between 1986 and 2000, the

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than the average American dreams of retiring on. Most Wall Street analysts don’t focus as much on repeatability in the business model, Kobrick claims, as they will on such factors as price. At the beginning of the 1990s, a lot of them compared Wal-Mart, which was already very big and expensive, with Sears which was lots cheaper. “They advised investors that the time was right to switch out of Wal-Mart, that Sears management was doing good things and saying good things. It didn’t matter to them that most of what Sears management was doing and saying was about superficial changes and none of it was about a new business model. If a company in decline isn’t fixing its business model, it isn’t fixing its problem. That’s the story on Amazon today and by the end of the year it will

Wal-Mart to Sears — just in time for the bull markets of the 1990s. “Sears was a terrible investment for any market, and even in a bull market instead of going up it went slightly down. But what those investors lost by the switch was much more than the relatively small depreciation in the value of their Sears stock; they lost another ten-fold increase in the value of the Wal-Mart shares they had sold to make the switch. If they had stayed in Wal-Mart for the value instead of switching to Sears for the price, their \$3.2 million holding would have grown to \$32 million — or 2,000 times what they paid for their original 100 shares.”

Most stocks are not the kind an investor will want to hold for 30 years. But Kobrick says the only way to tell a good stock from a true wealth stock —

company’s stock appreciated something like 26,000 percent.”

Everybody Kobrick talks to — graduate students, friends, neighbors, casual investors, professionals — ask him the same questions: How do they recognize the differences between great-great, average and bad companies? What do they look at in a potential investment? And when they already own a stock, how do they know whether to sell in a bad market, to hold on or to buy some more? Most investors center almost entirely on numerical report cards and earnings, which Kobrick considers a mistake. Instead, he relies on a powerful analytical methodology he has named BASM, an acronym for the four critical factors — Business model, Assumptions, Strategy, Management — that serve as his lens for identifying the golden geese that create the golden eggs of earnings. To an old-time Captain Marvel fan, it sounds — and works — like an

amalgam of BAM and SHAZAM.

Kobrick points out that individual investors and professionals have a common basic problem today. Both are overwhelmed with information. They read too much. Beyond a certain point, the more data they absorb, the less able they are to make a balanced, rational decision. This was true before the era of personal computers, and even more so today. For unfocused, undisciplined investors, the information superhighway can be a drowning pool. But once the investor learns what’s important and what to ignore, Kobrick believes, then less is more.

When he was in college, a professor told Kobrick that there were only seven great themes in all of literature. When students could identify the dominant themes in what they read — jealousy, hope, fear, love, etc. — they had new insights to the author’s intentions and a standard for measuring the success of a

work by comparing like to like. There may be a few more than seven dominant themes in investing he says, but not many. BASM meets the information problem head-on, sharpening investor focus and reducing data complexity. Combined with the seven steps in the book’s subtitle — knowledge, patience, disciplines, emotions, time horizon, market timing and benchmarks — BASM arms investors with all the tools they need to cull prospects and to draft reliable treasure maps.

“The seven steps help people with the historic problems of being human, of beating themselves because they have emotions,” Kobrick says. “Once you have some buy-and-sell disciplines, and once you realize that knowledge doesn’t have to overwhelm you because there are only four things—BASM—to look at. It’s like learning how to make your arms and legs work in a way that allows you to master riding a bicycle.”