



Sir John Templeton's 16 Rules for Investment Success

In 1993, Sir John Templeton wrote an article that first appeared in the magazine “World Monitor: The Christian Science Monitor Monthly”, entitled “16 Rules for Investment Success”. Here is Sir John’s list, with some commentary about each point and how it relates to what we are experiencing in the financial world today:

1. Invest for maximum total real return

When Sir John says “real” return, two things come to mind: taxes and inflation. On the first front, we have traders, who jump in and out of securities without any regard for the eventual taxes to be paid; a simple Excel spreadsheet calculation shows that a trader who earns 20% nominal returns per annum (and pays 35% on their profits) ends a 10 year period with the same after tax profit as someone who generated returns of less than 15% per annum, but sent Uncle Sam just one check (at 15% for long term capital gains) in year 10. The same can be said for inflation; buying 30 year treasuries at 3% yields, is a serious concern that should cause you to think twice before falling for these “safe” investments (a safe way to lose purchasing power).

2. Invest – don’t trade or speculate

This point hits at the taxes/commissions issue, but also comes back to a basic tenant of investing: you are buying percentage ownership in that business. Procter & Gamble has been a great business for well over a century, and there is nothing but opportunity ahead as the company stretches to all corners of the globe; grow with the business as an owner, don’t jump in and out because of short term issues like commodity pressures or an earnings miss.

3. Buy low

This goes back to what was said in rule #3. Many investors loved Microsoft (MSFT) and Wal-Mart (WMT) at the turn of the century (at 40-50x earnings), but won’t go near them today with P/E’s in the low single digits and low teens, respectively. As Mr. Templeton notes, follow Ben Graham advice: “Buy when most people, including experts, are pessimistic, and sell when they are actively optimistic”.

4. When buying stocks, search for bargains among quality stocks

When Sir John talks about quality, it most closely resembles to Buffett-followers those companies with sustainable competitive advantages.

5. Diversify. In stocks and bonds, as in much else, there is safety in numbers

For many individual investors, there is no need to hit a home run; for a success investment career, singles and doubles year after year will do just fine; as such, diversify accordingly to avoid unforeseen catastrophes.

6. Do your homework or hire wise experts to help you

The best method I have seen for keeping true to yourself in investing is Peter Lynch's two minute drill, where you must be able to explain to anyone, in two minutes, why the investment makes sense (and to subsequently explain any holes that may pop up in the story). During the dot com bubble, there are stories of stocks that unexpectedly shot through the roof, with many perplexed as to why; in some cases, these were stocks with ticker symbols similar to those of internet companies, which investors accidently bought in an attempt to snag the high-flying dot com stocks. If you don't know the correct ticker for the stock you're buying, this may be a sign that should apply rule #8 to your investment process.

7. Aggressively monitor your investments

Note that Mr. Templeton says your investments, not their stock prices. The point is that you shouldn't just buy a stock and forget about it; keep up on the story, and make sure that management is making intelligent decisions and acting in the best interests of the owners; on the other hand, don't stare at a computer screen all day and sell for some ludicrous reason (like the stock's chart) that has nothing to do with the actual business.

8. Don't panic

This goes along with point #9; if you have standing sell orders on stocks that you own, you should seriously consider why you own them in the first place. If Procter & Gamble fell 5% tomorrow from pure market volatility and you took that as a sign to sell, you should get out today and reconsider whether or not you should be managing your own money.

The same is true on the upside when it comes to panicking; recently, I found a stock that I would love to own, but the price is a bit above where I think I have an adequate margin of safety. Don't panic; if they stock doesn't eventually come down to your target price, move on and look for the next opportunity.

9. Learn from your mistakes

My advice on this is simple: keep a journal. When you buy a stock, write down exactly why you're buying it, and what could happen in the future that would cause you to exit the position; attempting to retrospectively critique your rationale without written evidence of your thinking at the time is likely an exercise in self-deception.

10. Outperforming the market is a difficult task

For the individual investor, outperforming the market means doing better than the best of the best. Are you one of these?

11. An investor who has all the answers doesn't even understand all the questions

This goes back to my article entitled "The Arrogant Investor"; investing is an inherently arrogant act, with the buyer saying "I know more" than the seller on the other side of the trade. As I noted in that piece, mitigate this need for arrogance with hard facts and due diligence; in Bruce Berkowitz's terminology, "try to kill the business". If you can walk away from this exercise with the thesis still intact, you are on your way to investment success.

12. There's no free lunch

This goes back to our last point: if you think you've found a free lunch, there's a good chance that you don't understand all the questions.

13. Do not be fearful or negative too often

At the end of the day, the future is inherently uncertain; between sovereign debt concerns, record high profit margins, and the potential for a double dip, it's easy to crouch into a ball and wait for better days. Unfortunately, following the media will leave you doing exactly the opposite of what you need: to be greedy when others are fearful and fearful when others are greedy. Try to stay away from the extremes (down in the dumps and up in the clouds), and simply remember the key tenants of investing: buying fractional ownership in businesses at a discount.

For half a century (1954 to 2004), Sir John Templeton's flagship fund (Templeton Growth Fund) achieved annual returns of 13.8%, compared to 11.1% for the S&P 500; to put that in perspective, \$1,000 in the Templeton Growth Fund grew to \$641,376, or roughly \$450,000 more than the return from the S&P (\$193,000). For investors looking to generate outsized returns like Sir John Templeton, following his 16 rules for investment success would be a good place to start.