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## **Ralph's Secrets to Successful Investing**

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"You've got to do and do and do."

"When you do, you learn."

"When you learn, you become an educated investor."

"And when you become an educated investor, you're on the road to investment success."

These words sum up the message one of NAIC's most respected investment voices has for investors in today's market. He believes the words are the best-kept secret to investment success.

The voice is that of Ralph L. Seger, Jr., a professional investment manager, a Chartered Financial Analyst, a *Better Investing* columnist and for nearly 50 years a guiding beacon clubs and individuals have followed to build their wealth and knowledge of investing.

"There are no shortcuts," he told the *BI* editors while sporting a Robert Frost "I know what the secret is" grin on his face. "If you want to learn as well as earn, you've got to do and do and do. You've got to make a commitment of time and effort. If you're not willing to make that commitment -- to do the reading, the research, the networking with others -- the odds for success are against you."

### **Sharing the Workload**

"Too many investment club members sit back and expect others to do the work for them," he says. "That hurts all club members; it's a sure sign there'll be trouble ahead. The reason investment clubs work is that members learn from one another and share the workload. If there are a dozen members in my club and we all do a good job following just one company, I can put my all into following mine and count on knowing 11 others as well."

When it comes to club members working well together and supporting one another, Ralph knows what he's talking about. He began his "doing" with the help of investment clubs in 1954 while employed as an engineer at Uniroyal, then called U.S. Rubber, one of the original companies in the Dow Jones industrial average. His head was with the company's research and development efforts, but his heart was with what his father was doing.

"He was investing in mutual funds and it looked interesting and challenging to me, not to mention potentially profitable as well," Ralph says. "I told my father I'd love to

give investing a try. 'Sure,' he said, 'but you'll need \$5,000 to start.'

"Well, I didn't have \$5,000. I didn't even have \$500. Later I learned there was an investment club at Uniroyal and members only invested a few dollars a month while they were learning about stocks. Great news, but unfortunately the club's membership was full. So with the help of Howard Wilson, one of the original members of the Mutual Investment Club of Detroit who worked at Uniroyal, I started a new club. We called it the Spiral Investment Club because we kept our records in a spiral notebook -- and we wanted to 'spiral up' in wealth."

### **Engineer Turned Investor**

Soon the club sent Seger spiraling, in earnings as well as in learning opportunities. "I got involved in the local NAIC chapter, became a user and believer in NAIC's investing principles and methodology, and in no time was an engineer on his way to becoming an investor." His head and heart were together on this one.

"It was the second-best decision I ever made," he says, smiling with that Robert Frost look again. There's little secret, however, about his No. 1 decision: His wife, Jeannie, has been at his side the entire journey, supporting and enjoying his career shift almost as much as her husband has.

Thousands, if not hundreds of thousands, of others have benefited as well from Ralph the engineer-turned-investor. In the 1970s he served as architect of the Portfolio Evaluation Review Technique (PERT), one of NAIC's most popular stock study tools, and used it along with the Stock Selection Guide (SSG) to begin the NAIC Investor Advisory Service, which often outperforms both other investment advisory services and the popular equity benchmark indexes. By the end of the 1970s he was using NAIC stock study tools professionally in his own investment management firm, which today is Bloomfield Hills, Mich.-based Seger-Elvekrog, Inc.

### **Learning From the Disasters**

"I've had my share of rewarding investments as well as disasters. Disasters -- you learn from them. You learn, for example, that there has to be a reason for a company or its industry to grow. There are some industries in which superior management may be able to grow the company faster than its competition or the economy for a while, but there's an endpoint to it. That's taught me to be very careful of mature industries as well as cyclical industries.

"There are times when companies in such industries will look particularly appealing, like Ford Motor Company might look to many investors today. But one of my secrets to successful investing is to be careful when you're dealing with companies in the M & C (mature and cyclical) industries. They represent added risk, added uncertainty and often reduced prospects for growth.

"The auto industry is mature; it's also cyclical. There's about 25 percent worldwide overcapacity in automobiles and looking behind the numbers, automakers have horrendous unfunded pension liabilities. Somehow that has to be repaid. Some investors may try to play the cycle, but where's the growth?"

Even though the M & C industries are not on his radar screen, Ralph is a strong advocate of looking at potential investments from the bottom up, regardless of their industry. "I get questions for the 'Repair Shop' column on how to find a good industry to study. My response is to focus on companies, not industries. It's another secret to successful investing. Good industries can get you into just as much trouble as bad ones, so look at companies.

"If you look at industries that are great growers, for example, chances are their price-earnings ratios already reflect those high-growth expectations, and you have to pay a premium price to buy shares. A high purchase price limits how profitable the investment will be.

"Look at what people were willing to pay for EMC. I know because Jeannie and I held shares in a family partnership with our son and daughter and their spouses. The stock was a bargain when it was selling at around \$5, and we were pleased to have bought shares at that level. It was exciting to watch the market price soar all the way up to \$102. I decided to sell some of the shares on the way up, and you should have heard my family members squeal about the capital-gains tax they were going to have to pay. About a year later when the price dropped below \$10, they stopped squealing.

"The price fell because of overcapacity, but for many that didn't become apparent until it was too late," he adds. You had to be a good reader, a good researcher to see it coming. There were clues, of course, like there usually are in newspaper and magazine articles and investment reports, but it's hard to predict when a disaster will come. We don't have a crystal ball, so staying as informed and well-read as possible is important."

One often-overlooked area Ralph thinks should remain on an investor's radar screen is financial stocks. "Don't shy away from them just because their financial statements are different from other companies," he says. "You should never invest in what you don't understand, but with a little bit of study you'll be surprised how much you can understand about the earning prospects of a bank or insurance company. The accounting is not that difficult, and I've found that the management of financial companies is the biggest factor in their success. AIG's Hank Greenberg (CEO of this month's [Stock to Study](#)) is a good example."

### **Do Your Reading**

Ralph finds reading to be another not-so-secret secret to successful investing. "You've got to look for possible investments because the ideas don't come and land in your lap," he says. "Do a lot of reading -- and looking. My reading includes *The Wall Street Journal*, *Barron's*, *Fortune* and *BusinessWeek*. From reading you get ideas. Sometimes you find a kernel of gold among all that sand.

"In my investment firm I periodically receive a box of annual reports on growth companies. The stack usually is about 12 inches high. The last time I



went through it I found one company that seemed to meet my criteria. That's one out of 25 or 30 -- perhaps a kernel. We'll see. (*Editor's note: The company was Chico's FAS.*)

"There's usually something about the others that I've learned from experience raises a red flag. Like seeing a string of deficits; a balance sheet that's overloaded with debt; a cash flow statement that's not very healthy; or the company is in an industry you know has problems."

Reading is the primary way he keeps track of what's going on, and often it's political developments outside the company that changes things.

A good example is the regulatory changes in the telecommunications industry in today's market. To encourage more competition at the local level, the FCC said existing local telephone companies must supply competitors with that last mile of access to consumers in their area at a price that was below their cost.

"I was a long-term owner of Verizon and SBC," Ralph says. "I got their third-quarter reports last year and could see that their sales were down. I read the reports, including the fine print, and concluded they've got problems. Under federal regulations they were being forced to provide competitors with equipment and services below their costs.

"To say it as bluntly as I can, the government was telling them to sell \$5 bills for \$3. You can't make a profit on that basis. So I sold my Verizon and SBC holdings -- not because there was anything wrong with the management of either company, but because there was a political situation they were facing that looked to be very unfavorable to their longer-term profitability. Now I could be wrong; only time will tell. But the important point is that I wouldn't have found out about the problem if I hadn't read and studied their quarterly reports. That's why reading is a must for successful investing."

### **Follow Your Investments**

"When I get a quarterly report on a company I own, I read it thoroughly," Ralph says. "That includes the fine print. Then I'm very religious about using PERT to spot any trends that may be happening. If sales growth begins to slacken, a flag goes up. If pre-tax profits begin to slacken, that's another flag. If pre-tax margins start to decline as well, there are real problems ahead. So that's important to keep track of. In the Verizon and SBC example, PERT confirmed my interpretation of what the quarterly reports were saying."

PERT celebrates its 30th anniversary this year. "When we started the NAIC Investor Advisory Service in 1973, we had a whole group of stocks -- about 80 of them -- that we wanted to keep track of and periodically report on their progress to our subscribers," he says. "We couldn't just look at the numbers on our last SSG; we had to look at what was happening since we did the SSG. Was the company progressing as we thought it would?"

"I've found there are very few permanent investments," Ralph says. "Look at the Dow Jones industrials. How many of the companies that were in it 30 years ago are

still in it today? I can tell you it's less than half.

"Too many things can change, like the industry, political climate, economy or management. Situations don't persist. Things that looked very favorable at the time the SSG was done may not continue to look favorable. PERT is useful in helping to spot such changes, especially PERT-A, which shows the trailing four quarters of sales, pre-tax profits, earnings per share and pre-tax profit margins. You look at those four trends and things just pop out at you."

Ralph is the first to admit that PERT can lead to wrong conclusions, too. "Sometimes you make mistakes like prematurely selling a company that looks like it's in bad shape, and it's really not -- it's just going through some short-term difficulty, and in a couple of quarters it's back on track. In this business, however, if you're right 80 percent of the time, you'll do well. Accept the fact that you're going to make mistakes. Don't worry when you do. It's not a perfect world."

PERT can help with numbers and trends, but Ralph sees it as no substitute for reading. "The best way to follow your investments is to read. That's the only way to truly understand what the numbers are telling you." He offers the semiconductor industry and Intel Corporation as examples.

"At the present time Intel looks terrible on an SSG and PERT. Its profits are going down, and its sales are headed south, too. Using Value Line estimates, its PEG ratio (current price-earnings ratio as a percent of the expected earnings growth rate) is more than 500 percent.

"For the long run, however, it's spending a tremendous amount of money on productive research and development, and it's applying microchips to a lot of other applications besides the PC. Just think about how much innovation may lie ahead. Look what smart weapons have done in Iraq. Think about the expanding applications in our everyday life, and how many more are likely to come. Maybe that PEG of 500 percent has little meaning because Intel's current P/E has little meaning."

Another Ralph example takes us back to the telecommunications industry and one of its suppliers, ADC Telecommunications. "There was such an overload of sales to the telecommunications industry in the late 1990s," he says, "that I can sit back today and ask myself, how can it sell to an industry whose outlook is so poor? It may be a fine company with a fine history, but where's the growth going to come from? I can say that now, but I was blind to the sales overload as it was happening.

"I followed the company for years and years and years -- probably 15. It was both one of my biggest successes and one of my biggest disasters. The company was very innovative in its research and development, in its small acquisitions, very well managed -- but it hit a stone wall. And its price dropped like a rock. I remember looking at the drop and could hardly believe my eyes.

"I was late in selling because I thought this had to be a buying opportunity -- the price was falling and the fundamentals weren't. That's because the price started to decline before earnings declined. It was difficult to find any signs of the upcoming disaster even in PERT. The answer was in reading and understanding what was happening in the industry ADC Telecom was supplying."

That experience led Ralph to add one more secret to his successful investing list. "After doing an SSG and selecting my low price estimate, I watch the market price closely. If it drops below the low that I estimated for the company, I don't buy more; rather I conclude somebody knows something I don't know. I tell myself this is probably not a buying opportunity; it's people bailing out of a stock because they know something I don't. And until I find out what that is, I don't buy more shares."

A warm smile appeared on his face as he shared his final secret. "I needed to add that final one because I think a saying I picked up from my mother is true: 'Hope springs eternal in the human breast.'"

Ralph Seger is one of *Better Investing's* most prolific editorial contributors and a popular speaker at NAIC national and regional events. At this month's CompuFest he will present a "Portfolio Repair Shop" seminar and participate in a "When To Sell" panel on June 28.

### **My Secrets To Successful Investing**

Suggestions from Ralph Seger for individuals trying to build their wealth and knowledge of investing.

1. Read all you can. If you don't have a healthy appetite for information, the odds for success are against you.
2. Commit priority time in your daily or weekly schedule to learn about stocks. It doesn't need to be a lot of time, but it needs to be quality time.
3. Share the workload. If you're a member of an investment club, don't count on others to do the work for you; and don't tolerate other members who don't carry their share of the load. You lose in both cases.
4. Learn from your mistakes. You'll make them, but you can benefit from them as well.
5. Keep your focus on good companies, not good industries. Good industries can get you into just as much trouble as bad ones.
6. Be careful when you're dealing with companies in the M & C (mature and cyclical) industries. Conversely, don't shy away from financial stocks just because they're hard to study.
7. Don't buy more shares when a company's market price falls below your low price estimate on the SSG. Instead, find out what others know that you don't know. They know something.