Bradley, Foster & Sargent, Inc.
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Bernard Baruch: Brilliant Speculator and Elder Statesman

> If a speculator is correct half of the time, he is hitting a good average. Even being right 3 or 4 times out of 10 should yield a person a fortune if he has the sense to cut his losses quickly on the ventures where he is wrong.
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> Don't try to buy at the bottom and sell at the top. It can't be done except by liars.
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> Bernard Baruch, *My Own Story*, 1957

From time to time, we like to recount the stories of exceptional speculators and investors. Most of us have an interest in creating wealth for ourselves and for our families, and studying the investment approach and methods of hugely successful speculators and investors can be not only absorbing reading but also highly instructive.

Bernard Baruch was one such remarkably successful speculator. Like Jesse Livermore, about whom we wrote in 2015, Baruch had no capital to start with, yet he managed to build a large fortune through his wits — his ability to understand people, gauge risk properly and gamble successfully. But unlike Jesse Livermore, Baruch was both a hugely successful speculator as well as a financier, philanthropist, and close advisor to several U.S. presidents. He led an exemplary life and died a greatly admired elder statesman at the ripe old age of 95.

Early Life

Baruch was born to an upper middle class Jewish family living in Camden, South Carolina, in 1870. The name Baruch has a great Jewish heritage, as it means "blessed" in Hebrew, and the Book of Baruch is a book in the Apocrypha in the Old Testament. Bernard was the second of four boys. His mother, Belle Wolfe, traced her American lineage back to the 1690s. His father was a physician and had come to the United States at the age of fifteen to avoid conscription into the Prussian Army. Befriended by his sole contact in America, Mannes Baum, he went to Medical College in Charleston and later to another medical school in Richmond, and upon the outbreak of the Civil War, he enlisted in the Confederate Army. As a battlefield surgeon, he saw the saddest and most grisly side of the war, and in his duties was captured by Union forces several times but always treated kindly and exchanged for Union physicians captured by the Confederates. After the war, with the South still suffering from its defeat, his father, finding it difficult to make a living, moved the family to New York City. Bernard was enrolled in P.S. 69 on 54th Street and was a good student. So good, in fact, that he enrolled in the City College of New York at the age of 14. CCNY was a college where a boy could get a good liberal arts education free. The curriculum included Latin and Greek, and students were expected to deliver a "declamation" at assembly — a recital of prose or poetry, and as a junior and senior, to give an "oration" written for the occasion. There were few electives. Later, when Baruch was a trustee of the college, he fought to maintain this kind of classical education at

CCNY but to no avail. He graduated at the age of 18 and had an adventurous spirit. At the age of 19, Baruch traveled with a friend to seek his fortune in the silver and gold mines of Cripple Creek, Colorado. After working as a mucker and driller in a silver mine for some months and spending money rather than accumulating wealth, he returned to New York, where his mother, who moved in upper class Jewish circles, used her contacts to introduce him to a Wall Street broker who gave him a job. He was employed as an office boy and runner at $5 a week — a salary which thrilled him.

Learning the Ropes on Wall Street

After working for a few years as a clerk at the Wall Street brokerage firm A.A. Housman, Baruch accumulated a modest amount of capital and began to speculate on margin. In the late 19th century, one only had to put up 10% of the price of the purchase, unlike the 50% that is needed today. Baruch speculated primarily in railroads in receivership and industrials. In the 1890s, the railroad industry was going through a major consolidation after several decades of overexpansion. Railroads were the equivalent of social media stocks today; railroads were where the action was. In these early learning years, Baruch would often make successful trades, but as he pyramided his holdings (adding shares via margin as the price rose), he would be wiped out, including his original capital, when the stock retrenched. He lost not only all of his capital repeatedly but also some of his father's capital as well. Rather than despairing of his losses, he began a habit which all investors should do — analyzing his losses to determine his mistakes. Usually his mistakes came in two categories: 1) insufficient knowledge of the securities in which he was dealing; 2) overleveraging his positions so that when a stock pulled back modestly, his capital would be wiped out. After four years of trading, he had accumulated very little, but he did persuade Arthur Housman to make him a junior partner in the firm; at the age of 25, he received an equity interest in the firm.

Marriage Plans Lead to Maturity

In 1896, his first full year as a partner, Baruch's share of the profits was $6,000 — a great deal of money in those days. This was a godsend to Baruch, as he was courting Annie Griffen. Her father was not in favor of the courtship, believing that the difference in their religions would prove an insurmountable barrier to their happiness. Her mother was more positively inclined. At the same time, Baruch made his first killing in the stock market. He did it by taking a position in American Sugar Refining, a company which Baruch had thoroughly analyzed. The action in the stock was influenced primarily by whether Congress would act to lower the tariffs on sugar, thereby dramatically reducing the profits of American Sugar. Baruch correctly wagered that the high tariff would be maintained, and as the stock climbed, Baruch bought more and more. When he liquidated his position, his profits were $60,000 — the equivalent of $1.7 million today. With these funds in hand, Annie Griffen consented to marry him, defying the wishes of her father, who declined to attend his daughter's wedding. In time though, her father was won over. Baruch and his wife later agreed to raise their two daughters in the Christian church and let their son choose his faith.

In his autobiography, Baruch writes with great magnanimity about the discrimination that he and his family faced from time to time. For example, his daughters were not accepted at the same private girls' school in New York that their mother, an Episcopalian, had attended. Baruch writes in his autobiography, *My Own Story,* "Above all, I have told my children not to be blind to the greatness of America by the pettiness of some of the people in it. The men who wrote the Declaration of Independence were wise in this regard. When they came to define what they conceived as man's

Key Events in the Life of Bernard Baruch

1870	Born in Camden, South Carolina
1880	His father, formerly a physician in the Confederate Army, moved the family to New York City
1884	Entered the City College of New York at the age of 14
1889	First job on Wall Street as an office boy and runner at $3 a week
1891	Worked as a mucker in a silver mine in Cripple Creek, Colorado; later joined a Wall Street brokerage firm as a clerk, office boy and runner at $5 a week
1896	Became junior partner in Wall Street Firm A.A. Housman and earned $6,000 his first year (equivalent of $171,000 today)
1897	Speculation in American Sugar Refining netted $60,000 ($1.7 million today)
1899	Managed his first stock pool in the acquisition of Liggett & Myers Tobacco Company, earning equivalent of $6 million in 2017 dollars
1901	Made a big profit in E.H. Harriman - J.P. Morgan battle for control of Northern Pacific Railway through shorting the market
1902	Net worth of $3.2 million ($117 million in current dollars)
1903	Opened his own brokerage house
1909	Most profitable deal of his career — Texas Gulf Sulphur
1918	Appointed Chairman of the War Industries Board by President Wilson
1919	Served on President Wilson's staff at Paris Peace Conference
1929	Acted to mitigate his friend Winston Churchill's stock market losses
1935	Became a member of President Roosevelt's "Brain Trust" and Roosevelt's trusted friend and advisor
1942	Appointed Advisor to War Mobilization Board by President Roosevelt
1946	Appointed by President Truman to United Nations Atomic Energy Commission where Baruch proposed "Baruch Plan" to control use of atomic energy
1965	Died at age 95

inalienable rights, they chose the words carefully — 'life, liberty and the *pursuit* of happiness.' Not 'happiness' but the 'pursuit of happiness.' They made no promise of Utopia. They promised only the *opportunity* to better one's living .... The priceless heritage which America has given us — the heritage which *is* America — is this opportunity of being able to better oneself through one's own striving. No form of government can give a person more than that."

Becoming a Millionaire

By his late twenties, Baruch was already recognized as a man with uncommonly good financial judgment. And perhaps more importantly, a man who kept his word and could be trusted. When Baruch opened his own brokerage firm, his father gave him a photograph of himself inscribed with these words: "Let unswerving integrity always be your watchword." And Baruch in his life stayed true to this exhortation. Thus, at the age of 29, Baruch was engaged to advise Liggett & Myers Tobacco Company's shareholders and manage a stock pool to help them fend off Duke Tobacco and enhance their market share in the lucrative cigarette market. He succeeded brilliantly and earned a great deal of money. In 1901, E.H. Harriman and J.P. Morgan were in a fierce duel for control of the Northern Pacific Railway. There is not time to elaborate on this battle, which involved a corner in Northern Pacific stock and was the cause of the Panic of 1901, other than to state that Baruch kept his head and, while many were ruined, he made a very large profit by shorting stocks and then covering his shorts at the appropriate moment. From 1897 to 1902, Baruch parlayed his capital of $60,000 into $3.2 million (the equivalent of $117 million today). Having already bought a seat on the New York Stock Exchange, he opened his own brokerage firm in 1903 and over the coming years, became known as the "Lone Wolf of Wall Street," because he typically kept his own counsel. He was famous for abhorring tips, writing in his autobiography, "beware...of anyone bringing gifts of 'inside' information or 'tips.'" His modus operandi of avoiding those peddling inside information occurred decades before the Securities and Exchange Commission, which was formed in 1934, outlawed trading securities on the basis of inside information.

In 1909, he became involved in the most profitable deal of his entire career — the creation of what came to be known as the Texas Gulf Sulphur Company. As he typically did, Baruch immersed himself in the facts and figures of the world sulphur trade and came to the conclusion that America's rapid economic growth would require the development of the sulphur industry in the U.S. Previously, the island of Sicily was the source of 95% of the world's sulphur. The patent on the Frasch process for extracting sulphur, the only economic method of recovering sulphur from elemental deposits, expired in 1908 and could be used to mine the major deposit that they were investigating in Texas. In discussions with J.P. Morgan about the deal, Baruch inadvertently used the word "gamble" to describe the potential investment in the sulphur industry, and J.P. Morgan immediately said that he was not interested, as he did not "gamble." Later Baruch famously wrote: "Still, the truth is there is no investment which does not involve some risk and is not something of a gamble." Baruch went on to invest a sizable amount of money in what became Texas Gulf Sulphur, making more than twentyfold on his investment. During the period before World War I, Baruch also made investments in gold mines and companies producing key commodities such as copper and rubber. He rarely, if ever, lost money on these investments.

Statesman and Presidential Advisor

During World War I, as it looked increasingly as if America might have to join the Allied war effort, President Woodrow Wilson appointed Baruch, a great patriot, to the Advisory Commission of the Council of National Defense. When America entered the war in 1917, he became Chairman of the Council. In 1919, Baruch was a member of the Supreme Economic Council at the Versailles Peace Conference and a personal advisor to President Wilson on the terms of peace. He counseled against the draconian reparations required of Germany and Italy. As an expert in wartime economic mobilization, he was employed as an advisor to President Franklin Roosevelt during World War II. Baruch became one of Roosevelt's trusted friends, and in April 1944, an exhausted President Roosevelt journeyed to Baruch's 17,000-acre plantation in South Carolina, Hobcaw Barony, where he spent a month with Baruch, during which time he tried to recuperate from the stress of directing the American war effort. President Harry S. Truman also appointed Baruch to the U.N. Atomic Energy Commission in 1946. Another great statesman, Winston Churchill, considered Baruch a great friend. Baruch visited Churchill on numerous occasions at Chartwell, and Baruch reciprocated this hospitality whenever Churchill visited America. In 1929 during the stock market crash, Baruch mitigated Churchill's significant losses by buying some of the shares that Churchill was shorting and shorting the shares he was buying. Altogether, he transferred $7,200 (about $100,000 in today's dollars) to Churchill to help counter Churchill's inept speculation.

Speculating in Securities

In *My Own Story,* Baruch writes, "I have defined a speculator as a man who observes the future and acts before it occurs." The dictionary defines speculation as "engaging in risky business transactions on the chance of a quick or considerable profit." Speculation in the capital markets typically involves a willingness both to buy and short securities, using significant debt (margin). Pyramiding positions in securities is very risky and can often lead to the complete loss of principal. This happened over and over again in Baruch's youth. Gradually, Baruch learned that successful speculation was not just shooting in the dark but rather involved assembling all of the facts of a situation or an opportunity and then forming a correct judgment on the opportunity. Finally it meant acting in a timely fashion before it was too late. Baruch gives as an example of timely action the steps he took upon learning over a July 4th weekend of the U.S. Navy's destruction of the Spanish fleet at Santiago during the Spanish-American War. Rather than waiting until the stock market opened on Monday, he hired a special train to take him to New York Sunday evening. Before dawn Monday morning, Baruch bought stocks on the London market at good prices and sold them later that day in New York at a sizable profit.

Baruch's Ten Rules of Successful Speculation

- Don't speculate unless you can make it a full-time job.
- Beware of barbers, beauticians, waiters — of anyone — bringing gifts of "inside" information or "tips."
- Before you buy a security, find out everything you can about the company, its management and competitors, its earnings and possibilities for growth.
- Don't try to buy at the bottom and sell at the top. This can't be done — except by liars.
- Learn how to take your losses quickly and cleanly. Don't expect to be right all the time. If you have made a mistake, cut your losses as quickly as possible.
- Don't buy too many securities. Better have only a few investments which can be watched.
- Make a periodic reappraisal of all your investments to see whether changing developments have altered their prospects.
- Study your tax position to know when you can sell to greatest advantage.
- Always keep a good part of your capital in a cash reserve. Never invest all your funds.
- Don't try to be a jack of all investments. Stick to the field you know best.

In addition to these trading principles, Baruch mentions several other key rules about speculation in his autobiography. He cautioned against averaging down, although admitting that an investor might occasionally buy stocks at lower prices than their original purchase, if the fundamentals justify it. He also wrote about how to preserve capital in a severe bear market or a panic. Baruch writes: "Value in an investment is like character in an individual. It stands up better in adversity and overcomes adversity readily." This is a core principle in the investment approach of Bradley, Foster & Sargent, Inc. Capital is best preserved in a bear market by owning stocks in quality companies with good brands, strong balance sheets, robust cash flow and excellent management teams, as they usually emerge stronger after a recession. Baruch also emphasizes that the time when really big money can be made in the stock market is when the economy emerges from a recession. Finally, he warns that stock market participants should be on their guard whenever the term "New Era" is being bandied about. He maintains that it is usually the sign of extravagant hopes and an overheated market. This still rings true, as during the Internet bubble at the end of the last century, one heard a great deal about the "New Era" that we were in. And between the top of the market in early 2000 and the bottom in late 2002, the NASDAQ Composite was down 77%.

Summary

As we have written in other commentaries, investing in stocks is very different than speculating in stocks. Investing in stocks involves the commitment of money in order to create appreciation of capital and growth of income over the longer term. Speculation in stocks primarily involves the goal of quick and large profits through methods which involve the significant risk of losing much or all of one's capital. Rather than focusing on speculating in the short term, investors know that the long-term trend of stock prices in the U.S. has been up — with the total return of the S&P 500 Index achieving an average annual return of approximately 10% since 1926. The Dow Jones has shown an increase of 290 fold, appreciating from 68.13 in 1900 to 19,762 at the close of 2016. Thus, investors seek to invest in stocks for the long haul rather than holding cash for much of the time and then making quick forays into the market in the hopes of making a killing based on short-term trading.

In closing, it should be noted that most professional investors do, in fact, follow a number of Bernard Baruch's trading rules. For example, it is wise to sell your losers quickly and let your winners run, or as famed Fidelity mutual fund manager Peter Lynch wrote, "water your flowers and pull out your weeds." Generally, when an investor buys a stock that goes down and then holds it, the temptation is great to sell it if and when it gets back to breakeven, thus generating no profit from the trade. It is also imperative to learn everything one can before buying a security in a company. Periodically reappraising one's holdings is also a vital discipline. At Bradley, Foster & Sargent, we are investors, not speculators. And since our inception nearly 23 years ago, our investment approach of investing in quality stocks for the long haul, with careful attention to risk, has served to preserve our clients' capital in times of economic adversity and increase it in times of prosperity. And like Baruch's father, we believe that integrity should always be our watchword.

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