HORIZON KINETICS

Industry Thoughts

JOHN TEMPLETON: A POOR INVESTOR OR OUTSTANDING INVESTOR?

Perhaps the greatest contrarian investor of all time was John Templeton. Ironically, he managed the Templeton Growth Fund, except he was a value investor. John Templeton started this fund at the end of 1954. Here's food for thought: If you compare the Templeton Growth Fund to the S&P 500, cumulatively for the 14 years from inception through 1968, John Templeton underperformed the S&P 500. (Data appears on following page.)

Subsequently, although he only outperformed in about half the years, he ended up having one of the greatest investment records of all time, spanning from the end of 1954 to the end of 1991, when he retired. Cumulatively, over the course of those 37 years, the Templeton Growth Fund generated a return of 17,862%. In contrast, the S&P 500 returned 5,243%. The cumulative return of the Templeton Growth Fund was more than three times that the S&P 500.

I do not know of anybody else for that time period who earned returns that were more than triple those of the S&P 500. Interestingly enough, in the last 12 years of his career, starting at the end of 1979, he underperformed during seven of them. How does one reconcile this? Templeton really focused on a couple of big trends, and he stayed with them and that gave him his edge. One trend is that he was the first investor to discover Japan. He noticed, in the 1950s, that Japanese companies were growing, by and large, at higher rates than elsewhere in the world, yet had very low P/E ratios, which he found attractive. He stayed with Japan for a very, very long time.

Many years later, he became a very big investor in Telefonos de Mexico. When Templeton became an investor, depending on the day, Telefonos de Mexico traded for a P/E ratio of between 1x and 2x, as it did not appear that the Mexican government had much interest in developing its telephone network. In those days, if you wanted a telephone in Mexico you had to wait a very long time. There was a waiting list. A telephone was very expensive and, in fact, as a condition of securing a telephone, one was forced to buy stock in Telefonos de Mexico, because the company was always in need of capital and no one wanted to invest capital with the company.

So as soon as customers got their telephone, they would sell the stock. Accordingly, the way the world looked at Telefonos de Mexico, there would be a limitless supply of stock as long as there were Mexicans who want phones. However, as John Templeton looked it, there is a company that trades at a P/E between 1x and 2x and demand for telephones is ultimately finite, so that once that demand stops the stock will trade at a more realistic price to earnings ratio. Ultimately, this is what happened, and Templeton made a very substantial rate of return.

One way to characterize the differing world view between those few who might have decided to buy Telefonos de Mexico shares and everyone else is that the former find something that is interesting and that they know a lot about and they stay with it. For the preponderance of the market, particularly the index- and asset allocation-model investors, every quarter or certainly every year they gravitate from the set of investments that were popular that year to the set of investments that are popular in the next year. When

you think about it, the reason that this is not a very successful strategy is that it implies the manager has to know a great deal about a lot of investments, whereas John Templeton only had to know a great deal about a few investments, and he understood them very well. He simply left them alone and let compounding do the rest. This is a very worthwhile lesson that is too often forgotten.

When the United States entered the Second World War—you can see this if you read old newspapers—the general consensus was that the war would not be very good for business. The recommendation of the noteworthy financial analysts of the day was to put money in good old safe 2% U.S. Treasuries with the longest-term maturities available. That way, it was reasoned, one could lock in that 2%, because the rate might even go lower; and a lot of people did that. John Templeton basically bought every stock on the New York Stock Exchange that was trading for less than $1, and he made some incredible amount of money.

Table 10: Templeton Growth Fund vs. S&P 500

Year	Templeton Growth Fund: Annual Return	Templeton Growth Fund: Cumulative Return	S&P 500: Annual Return
1955	7.04%		31.41%
1956	4.64%		6.48%
1957	(16.92)%	(6.94)%	(10.72)%
1958	48.81%	38.48%	43.15%
1959	14.00%	57.87%	11.95%
1960	13.84%	79.72%	0.45%
1961	18.29%	112.59%	26.88%
1962	(13.52)%	83.85%	(8.66)%
1963	(5.14)%	74.40%	22.76%
1964	28.59%	124.26%	16.43%
1965	22.14%	172.25%	12.46%
1966	(5.30)%	157.82%	(10.02)%
1967	13.74%	193.24%	23.89%
1968	37.76%	403.97%	11.04%
1969	19.66%	503.05%	(8.40)%
1970	(6.44)%	463.49%	3.94%
1971	21.93%	587.06%	14.30%
1972	68.56%	1,058.11%	19.00%
1973	(9.92)%	943.23%	(14.69)%
1974	(12.07)%	817.31%	(26.47)%
1975	37.60%	1,162.22%	37.23%
1976	46.74%	1,752.18%	23.93%
1977	20.37%	2,129.47%	(7.16)%
1978	19.21%	2,557.77%	6.57%
1979	26.84%	3,271.12%	18.61%
1980	25.89%	4,143.90%	32.50%
1981	(0.24)%	4,133.71%	(4.92)%
1982	10.81%	4,591.37%	21.55%
1983	32.91%	6,135.30%	22.56%
1984	2.17%	6,270.60%	6.27%
1985	27.79%	8,040.99%	31.72%
1986	21.24%	9,527.66%	18.67%
1987	3.11%	9,827.08%	5.25%
1988	23.60%	12,169.87%	16.61%
1989	22.56%	14,937.95%	31.67%
1990	(9.05)%	13,577.02%	(3.09)%
1991	31.33%	17,862.03%	30.74%

Source: Fund Documents

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