

# Price's Growth Stock Philosophy

*In today's post, we take a look at a new book: T. Rowe Price: The Man, The Company and The Investment Philosophy by Cornelius Bond...*

In 1965, Thomas Rowe Price, Jr. (1898-1983), published a list of seven stocks he had held since the 1930s and 1940s: DuPont, Black & Decker, 3M, Scott Paper, Merck & Co., IBM and Pfizer.

Their average appreciation: 36x.

Wow. If I were writing *100-Baggers* today, I'd have to include a section, or a perhaps a chapter, on Mr. Price. He knew how to buy winners and let them run. Somehow, I had forgotten to include him.

The above tidbit comes from Bond's book, which is partly a biography of Price, partly a history of the firm he founded and partly an exploration of Price's investment philosophy.

You will learn more than you probably care to know about Price's early years and family. But things quickly get interesting once he starts his professional career. One thing I found intriguing: He worked for John Legg, of Legg Mason fame, before he started his own firm.

In 1931, with the markets way down, Legg advised Price to sell his stocks and "take [his] licking." Price couldn't do it. Even at this early stage, he had the kernel of his investment style already in place. Price wrote:

"The realities are that most of the big fortunes of the country had resulted from investing in growing businesses and staying with them through thick and thin rather than switching from one security to another."

Price finally resigned in 1937. The main reason was that Legg and Price didn't see eye-to-eye. Price felt like a misfit in Legg's firm. Amazing that the firms of both men, founded in Baltimore, would grow to become household names.

When Price started his firm he was 39 years old. The Great Depression was on. And many firms had gone bust, including The Baltimore Trust Company, which was the largest banking institution south of Philadelphia at the time, writes Bond.

Price got lucky and swung a deal to take some of BTC's vacant office space at 10 Light Street. This was, and remains, a landmark building in the city, completed in December of 1929. (Anecdotally, perhaps supporting the Skyscraper Effect.) It has an Art Deco exterior, complete with gargoyles and a copper roof with gold plating.

The bank closed during the 1933 bank holiday and never reopened. Interesting side note here: Unlike today, the directors of the bank were held accountable. They were sued. And they eventually had to pay \$250K (or \$4.7 million in today's dollars) for their poor risk management.

In any event, it was a tough time to start a new firm. Even as late as 1941, Price could barely pay for lunch. (Price held a director's lunch and the bill \$3, which he and his directors struggled to pay.) Bond relates how on December 3, 1941, the firm had \$11.07 in its bank account. His secretary lent the firm her Christmas savings to pay bills. For quite a few years there it was touch and go. Price thought about closing shop. But he persevered and the rest, as they say, is history.

My favorite chapter is "Chapter 9: The Growth Stock Philosophy." Price developed his ideas about investing in the 1930s. Over his 45-year career, these ideas did not change much.

His hurdle for what he calls a growth stock seems low by our standards today, which may say something about how the internet and the opening up of global markets has colored our perceptions. Price wrote:

"The goal is a portfolio of companies that will double earnings over a ten-year period. It is believed that dividends and market value would do the same." That's a 7.2% growth rate, per the rule of 72, which doesn't seem like all that much does it? And yet it worked out well for Price.

When Price first wrote about these ideas, people thought they were radical. As Bond tells us, the investment world then focused on dividends and preservation of capital. No surprise, when people back then looked over their shoulder they saw the smoldering ruins of the Great Depression.

Knowing this, you can start to appreciate Price's shift in focus – finding growth and sticking with it through boom and bust, even buying more when they go down:

"Such names as Ford, Du Pont, Rockefeller, Duke, Carnegie, Woolworth and many others are well-known to all. These names are legend. Fortunes are still being made in this way and you and I can participate in their continued growth as their shares are available in the market."

Price studied past winners of the stock market, as many of us do. I liked this passage, by Price, which shows how some things never change:

"I observed Du Pont's stock, which always seemed too high to buy when compared to most other stocks, grew and grew and grew in market value. Another observation which made a lasting impression on me was the fact that those employee shareholders who tried to make a greater profit in the stock of their own company, by selling when they thought it was too high and then trying to buy it back at lower prices, did not do as well as those who held their shares throughout the market cycle."

How many times have you not bought a great business because you thought it was bit pricey, only to watch the thing go higher and higher and higher? It's a common lament, I would think. And how many times have you traded around a position, only to later wish you had left it alone?

Price didn't blindly hold everything. He developed a life cycle theory of companies with three phases: growth, maturity and decadence. He tried to stick with growth and sold when they were no longer growth companies (by his definition).

He believed risk rises as companies reach maturity. Life insurance companies understand that as a person ages, they need to charge a greater premium. In the same way, Bond writes, "Price noted... that common sense dictates that investment in a business offers more gain and less risk while the earnings are growing strongly than when they reach maturity and decline."

Price also took into account the environment a company found itself in:

"It is easy to grow in a fertile field, whether a seed of corn or a company. Just as weeds will impede the growth of corn, so will competition impede a company. No

matter how good the farmer and how hard he works, his output and his profits are limited if the soil is thin and rocky.”

Price believed in boots-on-the-ground research as primary. He instituted a rule at his firm that analysts must meet with the management of a company before the firm invests – and at least annually thereafter.

I have mixed feelings about this. I have done it both ways and I am not sure my results are better when I know management. CEOs often have charisma and persuasive powers. That is partly why they are in their positions. And we are people, after all. It can make it harder to be coldly objective if you know management.

Price was also more of a macro thinker than I would’ve expected. He frequently made market calls and had detailed forecasts about big picture economics.

Nonetheless, the core of his approach was to buy growing companies and hang on. I love the little bits Bond includes about Price’s portfolio over time. For example, Price did not emphasize dividends in his initial selection of which stocks to buy. But he appreciated their value over time and how they could grow. Bond writes that Price’s Model Growth Portfolio, which began in 1934, yielded 20% on his cost by 1950.

By 1969, Price had at least a couple of 100-baggers. One was 3M, which he first bought in 1939. Another was Merck.

There is a lot more to the story, of course. But I will stop here. Suffice to say, I enjoyed Bond’s book. It is certainly the definitive work on Mr. Price, an investor often overlooked in the pantheon of great investors.

Thanks for reading.

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