BUFFETT and Beyond

SECOND EDITION

Uncovering the Secret Ratio for Superior Stock Selection

DR. JOSEPH BELMONTE

WILEY
Contents

Preface: From Then Until Now xiii
Introduction: A Sea Story xvii

Chapter 1: The Purpose of This Book—Your Journey 1
Chapter 2: About Warren Buffett 5
Chapter 3: Determining the Earning Capacity of a Company (Now Really, Can It Be This Easy?) 11
  The Beach Factor 12
  Clean Surplus 13
  Determining an Efficient Company 14
  Take Your Bank Account 14
  Bonds 15
  Earning Capacity 15
  How to Determine the Operating Efficiency of a Company 17
  Sooo Important 19
  You See . . . ROE Tells Us Everything 19
  Let’s Ask Warren 20
  Summary—the Key to the Investing Business 21
  Why Hasn’t the Entire World Figured This Out Yet? 21
  You Will Learn 22
Chapter 4: My Theory of Why Most Money Managers of the World Cannot Outperform the Market Averages 25
My Contest—Beware How You Select the Random Portfolio 29
One Step Beyond Buffett 30
You Don't Have to Worry 30
Fun with Our Portfolio Reviews 31
In Summary 32

Chapter 5: A Very Simple Income Statement and an Even Simpler Balance Sheet 35
The Income Statement 36
The Balance Sheet 36
Tying Together the Income Statement and Balance Sheet 37

Chapter 6: The Return on Equity Ratio 41
This Chapter and the Next and the Next 43

Chapter 7: The Return Portion of the Return on Equity Ratio 47
The Income Statement: Return 47

Chapter 8: The Equity Portion of the Return on Equity 53
Earnings 55
Accounting Statements and the Link between Them 55
The General Motors Story 57
The Central Flaw of Traditional Accounting 60
Let's Not Forget the Main Question 60
Addendum to The General Motors Story 61

Chapter 9: How to Determine an Equitable Equity Number 65
Let's Review Just a Bit 65
Our New Return on Equity Equation 67
What Does Warren Buffett Say about All This? 69

Chapter 10: The Predictability of Finance Valuation Models 71
Efficiency Is the Key 73
College and Finance Valuation Models—They Just Don’t Work Very Well 74

Chapter 11: Clean Surplus ROE—the Only Comparable Efficiency Ratio 79
Clean Surplus 81
I Forget, What Are We Looking For? Let's Review! 83
Chapter 12: What Buffett Looks for in a Company, or How Clean Surplus Accounting Recognizes the Quality of a Company 87

Buffett 88
The Consumer Monopoly versus the Commodity Type of Business 89
The Commodity Type of Business: Companies Buffett Avoids 89
The Consumer Monopoly: The Type of Business Buffett Loves 92

Chapter 13: General Electric Then and Now 97
The Purchase Price 97
Back to Basics 99
A Very Important Point 100
Back to the Good Bank 100
Beware, Beware, Beware 102
A Real Stock 103
The P/E Ratio 105
Back to the Future 107
Let's Discount Back—the All Important Purchase Price 108
Important Note: Approximately 110
Very Important Addendum 111

Chapter 14: General Motors Then and Now 115
Let's Look at General Motors 116
High ROE 116
Consistency Up to 2002 117
Compare 118
The Blind Kid—a Sea Story 119
A Lesson to Be Learned 120
So You See, Folks 121
Addendum to the General Motors Saga 121

Chapter 15: The Beginning: The Initial Research 125
Why Work with the Dow 30? 126
Constructing the Portfolio: My First Research into Clean Surplus 127
Methodology 127
1987: The Year of the Anomaly 129
Buffett the Anomaly 129
More Parameters: The Simple Rules 130
The Test Period Parameters 130
CONTENTS

The Results 131
Compounded Returns 132
Is There a Correlation Between the ROEs and the Returns? 133
Getting Published in an Academic Journal 135

Chapter 16: Continuing Research: The Doctoral Research on the S&P 500 137
Finally, a Lead for Clean Surplus Accounting—Buffett, Graham, Ohlson 138
The Results of the Research 139
Methodology 139
Notice the Difference 141
Standardized Against the Market 142
Portfolio Construction 142
Results: First Test Period 143
Results: Second Test Period 144
Bias 144
Summary of Results 145

Chapter 17: Rules for Structuring a Great Growth Portfolio 149
Debt 153

Chapter 18: Great, Great Job, but You’re Fired 155
A New Definition 156
The Research Begins 156
The First Class 157
To Teach or Not to Teach? 159

Chapter 19: Stocks on Our Radio Show 163
Back in 2012 163
The Structure of This Report 165

Chapter 20: Stories of Audience Hecklers 169
The Know-It-All Half-Back 170

Portfolio Parameters 175
The Four Stages of the Business Life Cycle 176
The Maturity Stage 179

Chapter 22: A Great Dividend Income and Growth Strategy—Part II: Selecting Stocks That Are Growing Their Dividends for Our Portfolio 183
Philip Morris International 192
AT&T 194
A Pretty Good Portfolio Stock 195

Chapter 24: Enhanced Income 199
Covered Option Writing 201
What Does This Have to Do with Options? 202
What? Give Up My Stock? Shame on You! 203
A Bit of Technical Analysis 204

Chapter 25: Portfolio Insurance 207
What Does Buffett Do? 209
So What Can We Do? 209
Ok, So What Can We Do to Take the Guessing out of Investing? 210
The Amazing Thing About Portfolio Insurance 210
Market Crash Mentality 211
Back to the Crash Mentality 211
Which Scenario Do You Prefer? 211
How Do We Insure Our Portfolios? 212
Cash, Cash, Cash 213
But How Much Cash? 213
What Do We Mean by Market Conditions? 215

Chapter 26: What Have You Learned? A Summary 217
Dividend Income and Growth Strategy 220
Portfolio Insurance and Enhanced Income 221
Putting the Odds of Success on My Side 222

Chapter 27: We Won't Leave You Out There Alone 225
www.wiley.com/go/buffettandbeyond 225
The Weekly Video 226
The Computer Program 226
Tutorial Videos 227
For Individual Investors 227
For Professional Money Managers, Wealth Managers, and Investment Advisors 228

About the Author 231
Index 233