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## These Stocks Are Short on Glamour, Long on Returns

By BEN STEIN

BACK in roughly 1977, my clever screenplay agent, a wizard of an investor named George Diskant, referred me to his stockbroker at [Merrill Lynch](#). That man, a likable fellow named Steve Van Brunt, told me that I should buy a reference book called "Walker's Manual of Western Corporations" to find unknown companies for investment with my few shekels of savings.

By an amazing stroke, one of the first companies I came upon was called the Los Angeles Athletic Club Company. It was a microcap, a tiny little limited partnership owned predominantly by the Hathaway family.

As its name implied, it owned a lovely athletic club in a choice location in downtown Los Angeles. But it also owned probably as good a piece of property as there was in Los Angeles - the Riviera Country Club in Pacific Palisades - as well as a long-term lease on a large peninsula in Marina del Rey where it operated as the California Yacht Club, and many other bits and pieces, including a parcel of hundreds of acres in Malibu, a place you may have heard of.

The price seemed amazingly cheap, and the stock paid a good dividend, and so I bought some. As years went by, I bought more, although it was always hard to find. It traded, as they say, "by appointment." If I recall correctly, I paid from about \$60 to about \$110 a share for it in the late 1970's.

It always amazed me that no one in the investment world followed it, and that no one noticed the seemingly obvious contradiction between the share price of the company, formally known as Laaco Ltd., and the value of the company. I bought anyway - not a lot, but some.

Now, flash forward. It's 2005. Laaco sold the Rivera Country Club back in about 1990. For this plum, we stockholders got a special dividend of about \$550 a share. They sold the Malibu property to the state of California as a scenic area. For this we got another huge slice, although I don't recall the exact amount - maybe \$150 a share payable into the company. And the company has used its formerly sizable cash stash to buy ministorage warehouses all over the Southwest and has become a big factor in that glorious industry, which has been a money machine.

Now, some hotshots from the East are trying to buy a big stake in the company and are offering about \$800 a share. The listed price is now \$830 a share. And did I mention that it now pays a dividend of about \$42 a share? (It switched from limited partnership to corporation maybe 15 years ago.) If I counted correctly, Laaco has - from my earliest purchases - paid me very roughly 17 percent a year, counting those lovely special dividends paid out mercifully early.

This has turned out to be as good an investment as I ever have made, except for [Berkshire Hathaway](#). I don't tell you about it to brag about my being a great investor, because I promise you, I also make staggeringly stupid investment decisions. I am telling you about it because of some data that my investment-guru pal, Phil DeMuth of Conservative Wealth Management, recently slipped under my door.

Here is what it says, in a nutshell: If you had put \$1 into the Standard & Poor's 500-stock index in 1927 and held it until 2004, you would have the staggering sum of \$2,273 of total return (dividends and capital gains). But if you had put \$1 into so-called small-cap value stocks - that is, a basket of the smaller half, measured by market capitalization, of the companies listed on the New York Stock Exchange, then winnowed them into the approximate third of them

that had the lowest ratios of price to book value - that dollar would have grown to the astounding sum of \$58,992.

To look at the same issue from a slightly different perspective, imagine that you bought the S.& P. 500 in 1979 and held it until 2004. Even with all of the sturm und drang of the recent market gyrations around high tech, you would have seen your investment achieve an average annual total return of roughly 14.9 percent, which is fabulous. But if you had put the same investment into the small-cap value stocks, you would have had an average annual total return of slightly more than 21 percent - an improvement of almost 50 percent. On a compounded basis, that turns into serious money.

What is going on here? Why do small-cap stocks do so well over long periods, especially small-cap value - that is, unglamorous - stocks?

First, they are a tiny portion of the total stock market capitalization. All small caps - again, roughly, the bottom half of the New York Stock Exchange stocks as measured by capitalization, or the aggregate value of their shares - make up only about 8 percent of all stock market capitalization. That means fewer analysts follow those stocks, so their prices are subject to being mistaken and misjudged and out of date.

Second, because they are the "value" stocks with lower price-to-book ratios - that is, they are cheap when compared with the assets they own - they tend to have little market enthusiasm built into their price. They are the ugly ducklings waiting to blossom into swans. They are small, overlooked and underloved.

Big-cap growth stocks have a lot of hope and glory built into the price. Small-cap stocks have much less hope and hype in them. This means that they have more room to grow. And, grow they do, historically speaking, as they are discovered.

NOW, a few cautions: The standard deviations of the small-cap value stocks tend to be larger than those of large-cap growth or value stocks: Their prices fluctuate more. Patience is required. Second, do not take Laaco as an example of how these stocks will go. Laaco is a micro-cap - far, far smaller than the small-cap stocks that trade on the New York Stock Exchange - and it was a lucky strike illustrative of general principles only.

(And, no, if you are a rich hedge fund manager, you cannot buy Laaco as a whole. The supersmart Hathaways still control it, and I don't think they want to sell - and, at \$830, it is no longer a great bargain.)

But should small-cap value be in your portfolio? Past performance is no guide to future returns, but I would say history tells us that a diversified basket of small-cap should be at least a part - maybe a fairly big part - of a portfolio meant to endure for a few years.

There are a number of ways to buy small-cap stocks inexpensively. One is to buy the Russell 2000 Value Index fund. Another is to buy the S.& P. Small Cap 600/Barra Value fund. And other funds are coming out all the time in this index-mad, E.T.F.-crazy world. Talk to your financial adviser. I don't want you to be poor in your old age.

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