Shelby Davis Resource Page

"You make most of your money in a bear market. You just don't realize it at the time." -- Shelby Davis

Shelby Davis: Background & Bio

In the pantheon of investing greats one of the least talked about, but most successful investors, is Shelby Davis. Starting at age 38, he took $50,000, provided by his wife Kathyrn, and amassed it into a $900 million fortune in 47 years. This amounts to an annual compounded rate of return of over 23% during that time span. While his investing process can be summed up as growth-at-a-reasonable-price, he hardly wrote anything down as to not waste money on paper (he often wrote on the back of envelopes and scraps of paper which were tossed away). His extreme frugality helped him to save every penny he could to invest in “compounding machines,” as he called them. When he died he left his money in a charitable trust and left little to nothing for his two children; he was the epitome of a penny-pincher.

Shelby Davis received his bachelor’s in Russian history at Princeton (1930), his master’s degree at Columbia (1931), and his doctorate in political science at the University of Geneva (1934). Before starting his investment firm, Shelby Cullom Davis & Company in 1947, he worked odd jobs as a European correspondent with CBS in Geneva, as a “statistician” (before “stock analyst” was invented) for his brother-in-law’s Delaware fund, as a speechwriter and economic advisor for Thomas E. Dewey (then Governor of New York), a freelance writer, and author. He also worked for the War Production Board in Washington in 1942. A year prior to this he bought a seat on the New York Stock Exchange merely because it was cheap, having no use for it himself. He paid $33,000 for the seat which had fetched $625,000 in 1929. By the time Shelby Davis died in May of 1994 his seat was worth $830,000. His last job before he started his working on his investment portfolio was as First Deputy Superintendent of Insurance where he worked from 1944 to 1947.

Shelby Davis' Investment Philosophy

Shelby Davis’ work analyzing insurance gave him an upper hand by the time he started his portfolio. He saw clear advantages in the insurance industry. Most insurers, he noticed, were selling well below book value. Dividends were large in this industry and if you bought an insurance company at market price you were basically getting the dividend stream for free. He also noticed that while life insurance policies were selling like hotcakes, policyholders weren’t dying. Insurance companies, he realized, were growth companies in disguise. Having studied Ben Graham’s writings Shelby knew of the power of buying these equities. Shelby bought out Frank Brokaw & Co., a street away from Wall Street, and turned it into Shelby Cullom Davis & Co. This is when his seat on the New York Stock Exchange started to show its use and he began to capitalize on that investment using it for his business.

Although he bought insurance stocks his portfolio acted like a modern day tech portfolio, rising
from $100,000 to $234,790 in one year (he always bought on margin). His biggest holding that year was Crum & Forster. By the early 1950’s Shelby Davis became a millionaire by sticking with insurance stocks. Insurance companies that had once traded at stodgy multiples (P/E’s of 3-4) and low earnings now traded at P/E’s of 15-20 with high earnings. Shelby called this the “Davis Double Play,” an initial boost from earnings and another from investors bidding up the multiple. He largely focused on fundamentals before choosing his investments, looking for a solid balance sheet and making sure the insurer did not hold risky assets like junk bonds. He then focused on the management quality and made trips to meet with management and drill them. Diversification was also one of his strategies as he believed you needed to own enough stocks so that the ones you were wrong on were compensated by the ones you were right on. Although he never gave a “magic number,” in the mid-1950’s he held up to 32 insurance companies.

After a trip to Japan in the mid 1960’s Shelby Davis was convinced that investing in Japanese insurance stocks was a winning bet. There were substantially far less insurers in Japan and many of these were selling at well below book value, sometimes even half of book value. He quickly snatched up American Insurance Underwriters (later acquired by AIG) and American Family (now AFLAC), both which had big dealings in Japan. He also added Tokio Marine & Fire, Sumitomo Marine & Fire, Taisho Marine & Fire, and Yasuda Marine & Fire to his holdings. Shelby Davis, after successfully investing in Japanese stocks, began buying stocks in Africa, Europe, the Far East, and Russia.

Like Buffett, Davis snapped up shares of GEICO when it was on the verge of failure. Shelby Davis even snapped up a large enough share to be placed on the board. Shelby Davis, enraged by a proposed stock sale plan by Buffett and David Byrne, eventually sold off all his shares and left the board, a decision he would live to regret. Shortly after, he increased his position in AIG but soon began straying from insurance holdings. Shelby Davis got ahold of Value Line during this time and used the analysis to his benefit. At this point his normal portfolio, usually 30-35 stocks, consisted of hundreds of holdings, often highly rated by Value Line, which he day-traded for small gains and actually profited in a flat market.

Although he deviated somewhat from insurance companies over his lifetime 11/12 most successful investments were still in that industry. These included AIG, the four Japanese companies above, Berkshire Hathaway, AON, Torchmark, Chubb, Capital Holdings, and Progressive. The odd man out was Fannie Mae. He had some other minor successes but the bulk of his portfolio was due to these 12. If anything can be learned from his investing it’s that holding a few big winners for a long time can go a long way.

**Shelby Davis' Lasting Legacy**

Shelby Davis wasn’t the last in his family to be a successful investor. Shelby Cullom Davis, died in 1994 at 85 and his son, also Shelby Davis, founded what would become the $40 billion mutual fund powerhouse Davis Selected Advisers in 1969; and his grandsons, Christopher and Andrew, manage several of those funds today.

**Davis Funds**
At Davis Advisors, we seek to purchase durable, well-managed businesses at value prices and hold them for the long term to allow the power of compounding to work.

The Davis Investment Discipline begins with the premise that stocks represent long-term economic interests in real businesses. With that in mind, our research process begins with two essential questions:

What kind of businesses do we want to own?

How much should we pay for them?

Identifying the Types of Businesses We Want to Own

To answer this question, we try to determine if the businesses possess characteristics that foster creation of value over long periods of time. These characteristics include:

Proven management.

Durable, financially strong business models.

Sustainable competitive advantages.

To learn more, see What We Look For In A Company.

Determining the Price We Should Pay

Once we have identified businesses we want to own, we wait patiently for opportunities to purchase shares at a discount to our estimate of their intrinsic worth. We believe this provides a margin of safety that can enhance our potential return while mitigating risk. Components of our proprietary valuation methodology include:

Calculate Owner Earnings rather than taking GAAP earnings at face value.

Determine a company’s true Enterprise Value.

Calculate the Owner Earnings Yield.

Compare the Owner Earnings Yield to the risk-free rate.

How Much Should We Pay?

Our goal is to purchase durable, well-managed businesses when they are trading at a discount to our estimate of intrinsic value in order to establish a margin of safety, which can enhance prospective returns while reducing investment risk.
To determine how much we should pay for a business, our investment process considers four factors: Owner Earnings, Enterprise Value, Owner Earnings Yield, and Reinvestment Rates.

Owner Earnings

Owner Earnings are the excess cash a business generates after reinvesting enough to maintain current capacity and competitive advantages but before investing for growth.

To calculate Owner Earnings, we pore over income statements and make extensive adjustments.

We pay close attention to extraordinary items, differences between maintenance capital spending and depreciation, the cost of stock options, and pension assumptions, among other items.

We also consider where a business may be over-earning or under-earning versus its potential over full market cycles and try to normalize line items where appropriate.

Enterprise Value

After determining Owner Earnings, we compare that figure to the price we would realistically have to pay to own the business, which we refer to as Enterprise Value.

Enterprise Value takes into account equity, debt and off-balance-sheet liabilities as well as certain technical balance sheet adjustments and represents the price we would have to pay to purchase the entire business and own it free and clear.

Owner Earnings Yield

By comparing Owner Earnings to enterprise value we can value a business on a multiple-of-earnings basis or, inversely, on an earnings-yield basis where we divide Owner Earnings by Enterprise Value and calculate the going-in yield – i.e., the initial return we would earn if we purchased that business in its entirety at today’s prices.

The Owner Earnings Yield is a standardized method by which we may judge the attractiveness of a business relative not only to the prevailing risk-free rate (e.g., the interest rate on short-term U.S. Treasury bills) but also relative to the earnings yield offered by other potential investments in the market.

Reinvestment Rates
Finally, we consider a range of growth rate assumptions that are partly based on organic growth and partly based on assumptions about future returns on capital.

Davis Funds Resources

Here’s a small sample of the resources available on the Davis Funds website. For any readers interested in the funds, or value investing in general, I recommend heading over to http://davisfunds.com/literature/ where you can find plenty of additional reading material.

- Essential Wisdom For Today's Market
- The Wisdom of Great Investors
- Breakpoints - How To Reduce Your Sales Charge On Class A Shares
- How to Read Mutual Fund Advertisements Describing Total Return
- Davis Advisors: A Tradition of Success
- The Davis Research Methodology
- The Davis Family of Funds Distinctive Attributes
- A Conversation with Chris Davis
- How to Read Mutual Fund Advertisements Describing Total Return