

## Greenblatt, Joel - You Can Be A Stock Market Genius

Fireside, 1997, [Equity Investing] Grade ★★★★★

With this his first book, superstar investor Joel Greenblatt tried to bring the process that gave him his early success to the general public. Even though the author is broad within his niche - special situations - the area in itself is specialized and also highly labor intensive making the venture doomed to failure. Instead the book became an instant classic among hedge fund managers.

The basic premise of the book is that it pays off to search for areas where there is a high probability of finding undervalued equities. In contrast to many other ventures, when it comes to investments you have the possibility to choose your battles and even your playing fields. No one will punish you for not doing something, only for doing stupid things. Therefore you can specialize in a specific type of investing. If there are no immediate opportunities in the chosen area you can always keep money in cash. So how do you find corners of the market where the competition is lower? The underlying theme in Greenblatt's hunt is change, in the form of spin-offs, mergers, restructurings, rights offerings, liquidations, asset sales, distributions etc. *"Essentially, it all boils down to a simple two step process. First identify where you think the treasure [...] lies. Secondly, after you've identified the spot (preferably marked by a big red X), then, and only then, start digging. No sense (and no fun) digging up the whole neighborhood"*.

The author dedicates chapters to several types of special situations such as merger securities, corporate restructurings and others. Spin-offs for example, have had a massive outperformance over the three years that follows the separation. The spun-off company's shares are often sold regardless their merits either as the original investor was interested in the mother company in the first place or because the new company is too small. Combined with the fact that the management gets a real boost from being liberated from the old corporate overhead, this opens up for

outsized returns. However, the investor should wait for the selling to ebb out before making his purchases. Which spin-offs offer the best value? Greenblatt advises to let insider buying be the judge of which spin-off's to invest in.

There will in general be very little possible downside to a stock coming out of bankruptcy. After a bankruptcy the old equity holders will be wiped out and the old debt will have been turned to a combination of new debt and new equity. Hence the equity holders are the old bondholders. As they in most of the cases are fixed income investors the shares will be sold regardless of their merits which will make them cheap. Corporate information from the bankruptcy proceedings is available, most investors will be traumatized from previous ownership and the sell side doesn't want to touch the stock. The author further advises to seek the good businesses that can deleverage.

There are only a very few books written on special situations investing making the book relatively unique. Despite the slightly esoteric area there is no doubt that Greenblatt is a devoted value investor seeking margins of safety, seeing risk as "permanent loss of capital" etc. He argues for deep research and focusing on the best ideas instead of broad diversification. Over time the portfolio will have many positions and it will have diversified over time instead of at any given time. *"It's better to do a lot of work on one idea than to do some work on a lot of ideas"*. The book is written in a breezy easy-going style of writing that might fool you into doubting the quality of its advice. This would be a serious mistake. The logic is explained and there are some examples but – to bring up a negative - practical details are in rather short supply.

To succeed is probably two parts being at the right place at the right time and only one part perseverance, skill and intelligence. However, to navigate to the right place at the right time is a rare and underappreciated competence in itself.

Mats Larsson, December 12, 2013