

CHAPTER

ONE

When I went to business school back in the late seventies (note to my kids: that's the 1970s!), we learned one important thing about stock market investing. It was simply this: there are so many smart people out there, *you* can't outsmart them. In other words, thousands of intelligent, knowledgeable people buy and sell stocks all day long, and as a result, stock prices reflect the collective judgment of all these smart people. If the price of a stock is too high, these smart people will sell until the price comes down to a lower, more reasonable price. If a stock price is too low, smart people will go in and buy until the stock's price rises to a fair level. This whole process happens so quickly, we were taught, that in general stock prices correctly reflect all currently available information. If, indeed, prices are accurate, there is no use in trying to "beat the market." In other words, according to my

JOEL GREENBLATT

professors, the only way I was going to find a bargain-priced stock was by luck.

Naturally, I didn't listen (which, unfortunately, made this no different from most of my other classes).

But flash forward a few decades and now I'm the professor. Each year I teach a course in investing at a top Ivy League business school. The students are clearly smart, accomplished, and dedicated. In short, they are the best and the brightest. But every year for the last fourteen, I have walked into class on the very first day and told my students something eerily familiar and very disturbing. I tell them this: "Most of your peers and predecessors who learn about investing at business schools across the nation and beyond will go out into the real investing world and try to 'beat the market.' And almost all of them will do one thing in common—fail."

How can this be? If brains and dedication aren't the deciding factors in determining who can be a successful investor, what are? If an Ivy League business school education doesn't determine investment success, what does? Are we really just back to where we started? After decades of investment experience and learning, were my business school professors right after all? The only way to beat the market is by luck?

THE BIG SECRET FOR THE SMALL INVESTOR

Well, not exactly. I'm still glad I didn't listen to my professors. Investors *can* beat the market. It's just that becoming a successful investor doesn't have much to do with being one of the best and the brightest. It doesn't have much to do with attending a top business school (though being stupid with no degree isn't much help, either). Success also has nothing to do with an ability to master the economic and business news that bombards us each day. And success can't be found by following the hundreds of expert opinions offered on television, in newspapers, and in investment books. The secret to beating the market, as unlikely as it sounds, is in learning just a few simple concepts that almost anyone can master. These simple concepts serve as a road map, a road map that provides a way through all the noise, confusion, and bad directions. A road map that most smart MBAs, investment professionals, and amateur investors simply don't have.

And that makes sense. If being smart or having a business degree were all it took, there would be many thousands of individual and professional investors with great long-term investment records. There aren't. The answer, it seems clear, must lie elsewhere.

But that leaves us with another problem. If the answer is really as simple as I appear to be saying, in effect

JOEL GREENBLATT

pretty much anyone can sign up to beat the market. How can that be? Why, if it's so simple, aren't there thousands of successful investors out there? This whole thing is starting not to make sense.

Well, the truth is it does make sense. The concepts needed to be a successful stock market investor *are* simple. Most people *can* do it. It's just that most people won't. Understanding why they won't (or don't) is the crucial first step to becoming a successful investor. Once we understand why most others fail, we can fully appreciate the simple solution.

But this understanding comes with a price. We need to start from the beginning and build our case step by step. Understanding where the value of a business comes from, how markets work, and what really happens on Wall Street will lead us to some important conclusions. It will also lead small investors (and even not-so-small investors) to some very good investment choices.

What I tell my students on the first day of class is still true. Most individuals, MBAs, and professionals who try to beat the market—won't. But you can. Let's see why.