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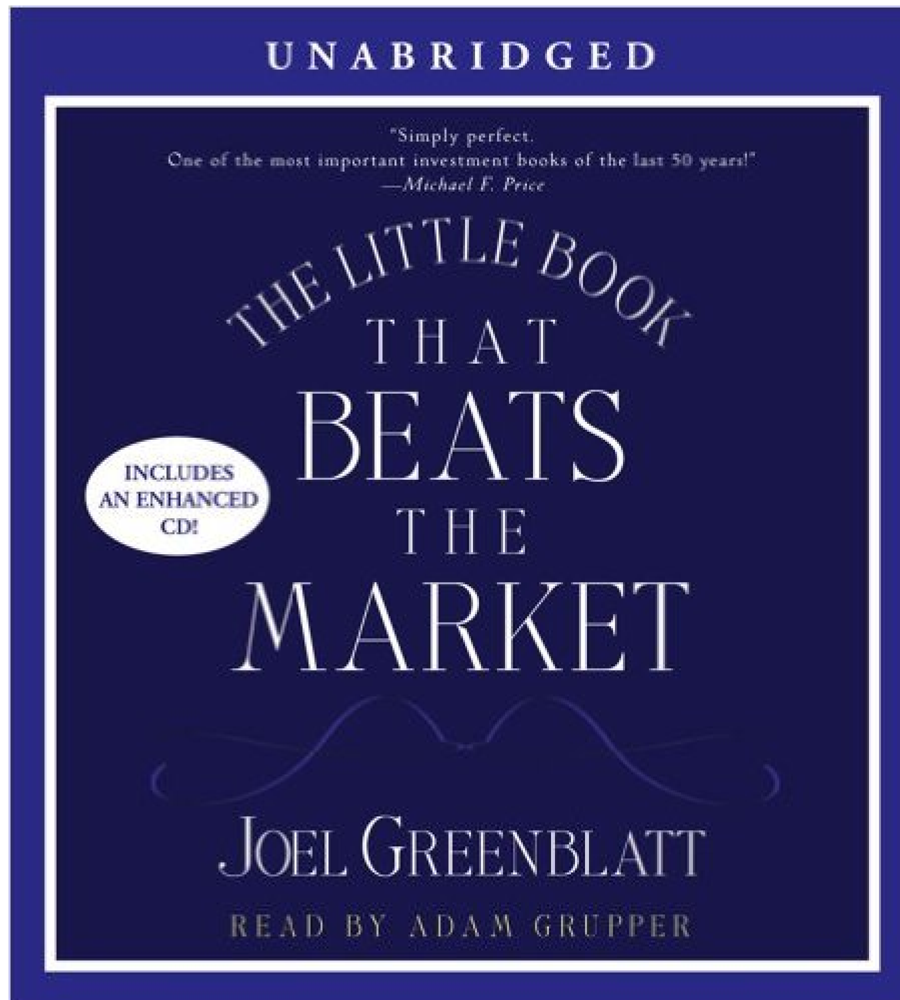
The Little Book That Beats The Market



Synopsis

Can you spare three hours to learn how to beat the market? As unlikely as it may seem, hedge fund manager and professor Joel Greenblatt, whose investment firm has averaged 40% annual returns for over twenty years, can teach you how. You can achieve investment returns that beat the pants off even the best investment professionals and the top academics. In fact, you can learn how it's possible to more than double the annual returns of the stock market averages.   But there's more. You can do it all by yourself. You can do it with low risk. You can do it without making any predictions, and you can do it by following, step by step, a time-tested, proven "magic formula" that uses only common sense and two simple concepts. Best of all, once you are convinced that it really works you can choose to do it for the rest of your life.   A runaway bestseller even before it was published, The Little Book That Beats the Market shows how successful investing can be made easy for investors of any age. It's never too early or too late to start investing, and with Greenblatt as your guide you'll know exactly where to go and what to do. By following the clearly outlined simple steps and magic formula, you can achieve extraordinary long-term investment results with a very low level of risk.

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Customer Reviews

As a portfolio manager at a large New York based hedge fund I have read more investment books than I care to admit. With that being said, The Little Book That Beat the Market is the first book I have felt compelled to review on (of course, I am not really going out on a limb recommending a book that legendary investor Michael Price describes as "One of the most important investment

books of the last 50 years.")Professor Greenblatt's first book, You Can Be a Stock Market Genius, is widely regarded as the seminal text on special situations investing and the strategies contained in the book are employed by multiple hedge funds and investment professional. While I recommend Stock Market Genius to anyone who has the time and desire to analyze stocks in detail (at least 3 hours a week) I highly recommend The Little Book That Beat the Market to ALL investors of ALL ages and to ANYONE who wants to understand how businesses create value.The beauty of the Little Book is a follows:1) It is simple2) It works3) Most investment professionals cannot follow the Little Book's strategy and that makes this strategy one of the only instances where small investors have a HUGE advantage over professionals.4) The people who have recommended this book are some of the most successful investors in the history of Wall Street (myself excluded, maybe someday!)1) It is SimpleWhile some of the reviews on have argued that the Little Book is too simply, I completely disagree. The reason this book is great is that it takes a very complicated subject matter (investment success) and makes it simple and easy to understand.

Joel Greenblatt's Little Book That Beats the Market (John Wiley, just released; $19.95), offers what the author says is a "magic formula" for success in the stock market. Such a phrase may arouse your skepticism, as it did mine, but let's look into the claim. Joel Greenblatt founded and is a managing partner of Gotham Capital, a hedge fund that, according to reports, achieved a 50% annualized return [before payment of an incentive allocation] during the ten years (1985-1995) that it was open to outside investors. This kind of record certainly merits attention. Greenblatt, it's safe to say, has gotten rich. Greenblatt's formula is based on only two measures: earnings yield and return on capital. These numbers are not hard to obtain. Greenblatt defines earnings yield as EBIT (earnings before interest and taxes) divided by enterprise value. Enterprise value equals a company's stock market capitalization plus debt plus preferred shares minus cash and cash equivalents on the balance sheet. Return on capital he defines as EBIT divided by the sum of net fixed assets (total assets minus depreciation to date) plus net working capital (current assets minus current liabilities). One weakness of Greenblatt's presentation is the use of earnings as a measure. I prefer to look at a company's free cash flow (after subtraction of capital expenditures) rather than EBIT. Earnings are susceptible to a greater degree of manipulation than cash flow. Second, the book does little to elucidate the qualitative measures that go into Greenblatt's investment process. Which businesses have a sustainable advantage? How do you identify growth? On the other hand, Greenblatt lays out a testable hypothesis--a real merit.

I won’t repeat what other reviewers have said. This book is a quick read, with a breezy tone, and in some simple ways helps to explain value investing, but...A few problems that the author dismisses without any discussion.1. Backtesting. Most backtested stock market systems don’t work in the forward direction for very long. A good example is the Motley Fool’s Foolish Four model, based on the Dow Dividend model. Backtested it looked great! But when a large number of people started to follow the model, it’s performance approached mediocre. This makes sense. Wall Street is nothing but efficient. Any strategy that works will quickly be copied by tens of thousands of players, and this can quickly ruin a system. That’s why hedge funds that use "black box" models don’t publish the models.And since Greenblatt tells the reader that the system only works over a three year period, it would be at least three years before one could tell the system wasn’t working.I would predict that the system will produce diminishing returns over the next ten years, proportionate to how many copies of the book that the author sells. Ironic that the richer that Greenblatt gets, the poorer his followers will get.2. Trading costs: Greenblatt completely ignores trading costs and taxes in his analysis. If you follow his advice and buy 30 stocks, you would pay $779 in round-trip commissions at E-trade (or $600 if you had more than $50,000). That’s about 1.5% a year in trading costs on $50,000 invested, or about 3% a year on $25,000. Or almost 8% on $10,000! That’s a big expense drag, especially if the system doesn’t outperform by as much as it claims to.And taxes.

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