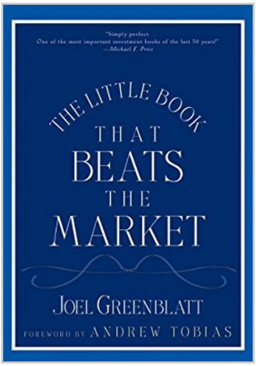

The Little Book That Beats the Market (Little Books. Big Profits)

By Joel Greenblatt

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Two years in MBA school won't teach you how to double the market's return. Two hours with *The Little Book That Beats the Market* will.

In *The Little Book*, Joel Greenblatt, Founder and Managing Partner at Gotham Capital (with average annualized returns of 40% for over 20 years), does more than simply set out the basic principles for successful stock market investing. He provides a "magic formula" that is easy to use and makes buying good companies at bargain prices automatic. Though the formula has been extensively tested and is a breakthrough in the academic and professional world, Greenblatt explains it using 6th grade math, plain language and humor. You'll learn how to use this low risk method to beat the market and professional managers by a wide margin. You'll also learn how to view the stock market, why success eludes almost all individual and professional investors, and why the formula will continue to work even after everyone "knows" it.

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The Little Book That Beats the Market (Little Books. Big Profits) By Joel Greenblatt Bibliography

- Sales Rank: #57309 in eBooks
- Published on: 2008-04-21
- Released on: 2008-04-21
- Format: Kindle eBook

Editorial Review

Amazon.com Review

An Exclusive Q&A with Author Joel Greenblatt

It's been five years since you first published *The Little Book That Beats the Market*. Have your thoughts changed at all about the effectiveness of value investing?

In my mind, the principles of value investing have not changed. As we've learned yet again, markets can be volatile and emotional. They often go to extremes of pessimism and optimism, and prices can and often do fluctuate wildly and significantly over short periods of time. As a result, Mr. Market can provide some excellent opportunities to purchase bargain priced stocks when people are unduly pessimistic. This is where value investing comes in. Buying companies below their true value is the road to being a successful investor. The magic formula found in the Little Book seeks to buy a group of above average companies but only when they are available at below average prices. Because it is a formula, it seeks to do this in an unemotional way that can take advantage of the market's mood swings. Ben Graham taught us these lessons in the 1930s and the principles still hold as well today as when he first wrote them down more than 70 years ago.

Do you think individual investors should re-think their investment strategy as a result of the recent market crash and recession?

I think the best lesson that can be learned from the recent price drop and partial recovery is that stocks are volatile. For most people, stocks should represent a portion of their investment portfolio because I still believe that over the long term they will provide superior returns relative to most alternative investments. However, whether that portion of an investment portfolio devoted to stock investments should be 40% of an investor's portfolio or 80% is a very individual decision. How much are you willing (or able) to lose before you panic out? There's no sense investing such a large portion of your assets in a long-term strategy if you can't take the pain when your chosen strategy doesn't work out for a period of years. The "magic formula" found in the book can underperform the market for years. It can also lose money if the market goes down. But it is also a strategy that makes a lot of sense and that should work well for investors over the long term.

Can you explain the Magic Formula's basic strategy in one sentence?

The Magic Formula strategy is a long-term investment strategy designed to help investors buy a group of above-average companies but only when they are available at below-average prices.

You make reference in the new afterword to receiving a number of emails from readers after the *The Little Book That Beats the Market* was published. Could you share with us some of the comments you received?

I received many emails after the first edition of the book was published. Some suggested that the strategy was working great for them while others reported that they had waited over a year and the strategy was underperforming. These results and emails are consistent with the message of the book. Over the five years since the book was published, the strategy earned very nice returns for investors, but the ride was bumpy. Not only did the formula underperform for a period of time, in 2008 it lost money along with the market. Overall, the formula performed quite well but only for those who maintained a true long-term perspective. This is easier said than done. In the new afterword, I try to give more facts, color and information about the strategy that I hope will help investors be successful in taking full advantage of the magic formula over the long term. Of course, I also got plenty of emails where investors just asked us to do it all for them. Other emails asked us to apply the formula internationally. As a result, we have worked on both of these projects over the last several years.

In the new afterword, you write "Beating the market isn't the same thing as making money." Can you elaborate on this and why it's a difficult concept to swallow at times?

Since the strategy involves buying a portfolio that is 100% long the stock market, if the stock market goes down, our portfolio may well go down, too. If the market drops 40% and we beat the market by losing only 38%, this is small consolation. As I say in the afterword, while I firmly believe that for most people an investment in the stock market should represent a substantial portion of your investment portfolio, how big that portion should be can vary widely. For some it can be well over half of assets, for others well less than half might be appropriate. The magic formula strategy is a wonderful strategy for that portion of your portfolio that you choose to invest in the stock market. In fact, I truly believe that the magic formula remains one of your best options. How much to invest in the stock market, however, is a very personal decision that should be partially based on your ability to withstand short-term negative price movements. One encouraging fact, though, discussed in the afterword is the performance of our large cap portfolio over the last decade. Over that period, the market as measured by the S&P 500 was actually down, yet our backtests showed that following the formula over those same ten years would have resulted in a more than tripling of your money. Unfortunately, those great long-term returns came with plenty of bumps, including some not so short periods of losses and underperformance. But once again, if the formula worked every day, every month and every year, everyone would follow it and it would be ruined. Fortunately, it's not so great, and as a result I strongly believe that long-term investors should continue to benefit from the magic formula for many years to come.

From Publishers Weekly

Contrary to efficient-market naysayers, this engaging investment primer contends that ordinary stock-market investors can indeed get better-than-market returns over the long haul. Greenblatt (*You Can Be a Stock Market Genius*), a Columbia Business School adjunct professor, touts a "value-oriented" approach that looks for bargain stocks whose share price is cheap relative to the company's profitability. His version is a "magic formula" that ranks stocks on the basis of two variables—the earnings yield and the business's return on capital. His Web site, magicformulainvesting.com, virtually automates the procedure for novices. Greenblatt offers lots of statistical proof of the formula's success, but emphasizes the importance of faith in seeing the investor through inevitable short-term downturns: "It will be your belief in the overwhelming logic of the magic formula that will make the formula work for you in the long run." He conveys his ideas through a lucid if rudimentary and rather corny explanation of basic investment concepts about risk, return, interest and business valuation. Although the fabulous returns he touts seem too good to be true, Greenblatt's formula is a reasonable variant of mainstream value-investing methods. Investors seeking a little more hands-on excitement than the average mutual fund offers won't go too far wrong following his advice. *(Jan.)*

Review

"...a sharply written, anecdote-rich, easy to understand investing strategy". (*Wall Street Journal*, August 7, 2006)

"...a rare worthy edition to humanity's investing know-how". (*SmartMoney*, May 5, 2006)

There's certainly no dearth of advice on investment. The best-seller lists are full of books on how to be a successful investor "in only 15 minutes a week", on how to become an "automatic" millionaire, and about how to invest if you're "young, fabulous and broke".

The best book on the subject in years is value investor Joel Greenblatt's **The Little Book That Beats the Market**, which is still a top seller months after its release. Beyond the credibility that comes from someone whose private investment partnership, Gotham Capital, has produced 40 per cent a year returns over the past 20 years, Mr Greenblatt brings an elegant and simple writing style to what can be a complicated subject.

He outlines a "magic formula", based on how he invests, that anyone can use. The formula has only two inputs, a company's earnings yield and its return on capital. The rationale is straightforward: buy shares in good businesses, measured by returns on capital, only when they're available at bargain prices, defined as a high earnings yield.

The magic formula looks for companies that have the best combination of earnings yield and return on capital, with each input weighed equally. An outstanding company with an expensive stock ranked, say, first for return on capital but 1,999th on earnings yield, would have the same combined ranking of 2,000 as a low return on capital company within expensively priced shares, ranking 1,999th in return on capital but first on earnings yield.

Using this approach to create a regularly updated portfolio of about 30 stocks with the highest combined rankings, Mr Greenblatt tested his formula between 1988 and 2004. The results were remarkable: with only one down year, the magic portfolio would have returned 30.8 per cent a year, against a 12.4 percent annual return for the S&P 500.

Rather than using the latest 12 months' earnings to calculate earnings yield and return on capital, Mr Greenblatt and his analysts try to improve on the rote application of this formula by using earnings estimates in a "normal" year, one in which nothing unusual is happening within the company, its industry or the overall economy.

Mr Greenblatt has created a free website for screening stocks based on his approach (www.magicformulainvesting.com). In a recent screen I carried out on the site of the top 100 magic formula companies with market capitalizations above Dollars 2bn, the top 10companies ranked by market cap were Exxon Mobil (XOM), Microsoft (MSFT), Pfizer (PFE), Johnson & Johnson (JNJ), IBM (IBM), Intel

(INTC), Conoco Phillips (COP), Dell (DELL), 3M (MMM) and Motorola (MOT). Now that's an impressive group of companies.
I own one of them(Microsoft) in my portfolio. Given how sceptical I am about the tech sector, owning this is a real leap for me but this is a fantastic business and the stock is attractively priced. Microsoft has a dominant franchise, some of the most jaw-dropping economic characteristics ever achieved, capable, honest, shareholder-friendly management, and unlike most technology companies, reasonably predictable future prospects.
I am optimistic about Microsoft's future prospects for a number of reasons. The company will be releasing in the next year significant upgrades of its two cash cows, Windows and Office. Historically, these events have been big and highly profitable events for Microsoft.
Yes, Microsoft's days of ultra-high growth are over, inevitable for a company with Dollars 40bn in annual revenues. But it is highly likely the company will grow substantially faster than the S&P 500 for many years to come and that its fabulous economic characteristics will remain largely intact.
At a recent price of Dollars 27, Microsoft, after adjusting for the company's cash hoard, is trading at under 17 times earnings estimates for this calendar year.
I don't claim this is screaming cheap but it is close to the lowest p/e multiple the stock has ever traded at and is, I believe, an attractive price for a company of its quality and bright future.
You might wonder if Mr Greenblatt is concerned that popularising his strategy will mean it will stop working. "Traditional value investing strategies have worked for years and years and everyone's known about them," he says. "They continue to work because it is hard for people to do, for two main reasons. First, the companies that show up on the screens can be scary and not doing so well, so people find them difficult to buy.
Second, there can be one-, two- or three-year periods when a strategy such as this doesn't work. Most people aren't capable of sticking it out through that."—Whitney Tilson is a money manager who co-edits Value Investor Insight and co-founded the Value Investing Congress. (*Financial Times*, April 24, 2006)

"...an entertaining two-hour read" (*Daily Telegraph*, April 2006)

"...the book unquestionably makes good on its promises." (*SmartMoney*, March 2006)

Joel Greenblatt's *The Little Book That Beats the Market* is pitched not to the swells of Wall Street but to the novice individual investor.
Greenblatt, the founder of hedge fund firm Gotham Capital, has taken what he has learned about investing and written this skinny, pocket-size book.
His goal: to explain how to make money in terms that even his five kids could understand. "I figured if I could teach them how to make money for themselves, then I would be giving them a great gift."
Greenblatt, a Columbia Business School professor and an investor for 25 years, says, "I believe I can teach you (and each of my children) to be one of them" — meaning, a successful investor.
The Little Book That Beats the Market is simple and sincere; Andrew Tobias, author of *The Only Investment Guide You'll Ever Need*, writes the introduction.
The formula works if you have faith and are patient enough to follow his guidance — over time, Greenblatt says.
Greenblatt's formula is based on Warren Buffett's investment principles: Invest in good companies when they are cheap.
According to Greenblatt, his formula historically has beaten the market for nearly two decades. Although he does not name the stocks, he claims that from 1988 through 2004, the high-return/low-price stocks of 30 of the largest 2,500 companies had returns of 22.9% annually.
Simple enough. But how do you find these stocks? "The truth is you don't need an MBA to beat the market," he writes.
But there's no fairy godmother on Wall Street. "If your stockbroker is like the vast majority, he or she has no

idea how to help you! They don't get paid to make you money. The plain fact is you are on your own." That said, you have no business investing in individual stocks on your own, he says.
His magic formula promise: "If you just stick to buying good companies (ones that have a high return on capital) and to buying those companies only at bargain prices (at prices that give you a high earnings yield), you can achieve investment returns that beat the pants off even the best investment professionals."
He has a free (for now) website, www.magicformulainvesting.com, which screens companies using his criteria. He advises individual investors to buy a basket of 20 or 30 top stocks over the course of a year and turn them over on a strict schedule, depending on how they perform. He does not mention a minimum amount to invest.
Be forewarned, though. The formula may or may not work over "shorter" periods, which can often mean years, not days or months. Good things come to those who wait and, in this case, Greenblatt means that it takes three, four or even five years to show its stuff. After a year or two of performing worse than the market averages, most people won't stick with it. But you've got to "really believe in it deep down in your bones."
Even if you don't drink the Kool-Aid, you will learn about the technique of value investing from a pro. Greenblatt boils investment jargon down to what you need to know as succinctly and humorously as possible. Along the way — and it won't take you more than two hours tops — you're given a tutorial on bonds, stock shares and prices, earnings yields, return on capital and more. The appendix, which is "not required reading," adds a more detailed, strategic commentary.
It might be hard for less-schooled investors to understand why the "magic" formula makes sense and to stay with it when things get bleak, but the hard part is just getting started, he counsels. That's true for investing, period. (*USA Today*, January 16, 2006)

“Greenblatt delivers admirably…it contains one of the clearest, most entertaining explanations you’ll ever see of the ideas underlying value investing.” (*International Herald Tribune*, 16th January 2006)

Hedge fund manager and Columbia University business school professor Joel Greenblatt has written a delightful volume called *The Little Book that Beats the Market* (Wiley) that anyone who takes his personal investing seriously should read. Greenblatt starts his slim volume with an uncommonly elegant explanation -- written for his children -- of how to value stocks. He argues that any investor can achieve higher-than-average returns by investing solely in companies with a high earnings yield and high return on equity. The book's biggest flaw is Greenblatt's use of cute, over-hyped language. He calls his approach to stock picking a "magic formula" and acts certain his strategy will continue to beat the market even now that everybody knows about it. (*The Washington Post*, December 25, 2005)

“a marvellously clear explanation of the value investing approach” (*Financial Times* (also on *FinancialNetnews.com*) 10th December 2005)

“The book is certainly written simply and the concepts are conveyed compelling” (*Daily Telegraph*, 29th November 2005)

Contrary to efficient-market naysayers, this engaging investment primer contends that ordinary stock-market investors can indeed get better-than-market returns over the long haul. Greenblatt (*You Can Be a Stock Market Genius*), a Columbia Business School adjunct professor, touts a "value-oriented" approach that looks for bargain stocks whose share price is cheap relative to the company's profitability. His version is a "magic formula" that ranks stocks on the basis of two variables—the earnings yield and the business's return on capital. His Web site, magicformulainvesting.com, virtually automates the procedure for novices. Greenblatt offers lots of statistical proof of the formula's success, but emphasizes the importance of faith in seeing the investor through inevitable short-term downturns: "It will be your belief in the overwhelming logic of the magic formula that will make the formula work for you in the long run." He conveys his ideas through a lucid if rudimentary and rather corny explanation of basic investment concepts about risk, return, interest and business valuation. Although the fabulous returns he touts seem too good to be true, Greenblatt's formula is a reasonable variant of mainstream value-investing methods. Investors seeking a little more hands-on excitement than the average mutual fund offers won't go too far wrong following his advice. *(Jan.)* (*Publishers Weekly*, November 14, 2006)

"*The Little Book* is one of the best, clearest guides to value investing out there." (*The Wall Street Journal*, November 9, 2005)

"...the best book on the subject in years." (*Financial Times*, May 2006)

"Mr Greenblatt's system is elegant, simple and, on the face of it, very successful." (*Investors Chronicle*, May 2006)

"…worth a look." (*The Business Supplement*, September 2006)

Users Review

From reader reviews:

Myra Lopez:

The reason? Because this The Little Book That Beats the Market (Little Books. Big Profits) is an unordinary book that the inside of the e-book waiting for you to snap that but latter it will zap you with the secret that inside. Reading this book beside it was fantastic author who also write the book in such incredible way makes the content inside easier to understand, entertaining approach but still convey the meaning totally. So , it is good for you for not hesitating having this ever again or you going to regret it. This amazing book will give you a lot of gains than the other book possess such as help improving your talent and your critical thinking way. So , still want to delay having that book? If I were being you I will go to the book store hurriedly.

Carl White:

The Little Book That Beats the Market (Little Books. Big Profits) can be one of your beginner books that are good idea. Most of us recommend that straight away because this e-book has good vocabulary that could increase your knowledge in terminology, easy to understand, bit entertaining however delivering the information. The author giving his/her effort to set every word into enjoyment arrangement in writing The Little Book That Beats the Market (Little Books. Big Profits) yet doesn't forget the main stage, giving the reader the hottest as well as based confirm resource information that maybe you can be considered one of it. This great information can easily drawn you into completely new stage of crucial considering.

Barbara Butler:

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