

Slater, Jim – The Zulu Principle

Orion, 1992, [Equity Investing] Grade ★★★★★

During the summer InvestingByTheBooks will review some older books that we never got around to writing about although we think they are important. First out is Jim Slater's *The Zulu Principle* written to his son who had shown an interest in investing. The book is seen as growth investing classic but it's rather more than this – it's an argumentation for focus investing. Jim Slater, today aged 86, is the British chartered accountant, Sunday Telegraph columnist and Leyland Motors employee who turned corporate raider before the term even existed and was during a period the dominating figure of the City of London. In his investment company Slater focused on companies with underutilized assets – be they physical or human – and then after a take-over stripped the companies of the excesses. Not a practice seen with much approval in pre-Thatcher Britain.

In the book Slater instead takes the viewpoint of his son, the minority investor. The main point that has given book its name is that to have an edge over competition an investor needs to focus on a niche that suits his temperament and then perfect his execution within this his circle of competence. By devoting a "*disproportionate amount of time and effort [to] a clearly defined and narrow area*" you become the expert in the field. "*Investment is essentially the arbitrage of ignorance.*"

Large well-known companies are thoroughly analyzed making it hard to have an edge. In general a smaller portfolio investing in smaller companies will then have an advantage. To help the reader choose among niches that have potential to be profitable, Slater lists and discusses five options: 1) small dynamic growth companies, 2) turnaround situations and cyclical, 3) shells, 4) asset situations and 5) leading stocks. "*You will achieve your objective, like Montgomery and Napoleon before him, by concentrating your attack.*" After choosing a strategy an investor should hold a portfolio of 10 to 12 stocks and never have less than 50 percent of his investment assets in stocks.

The first niche is clearly the author's own favorite choice and the description of investing in small dynamic growth companies covers almost half the book. To choose among prospective investments Slater lists a number of investment criteria that a modern day quant would describe as a combination of value, growth, size, momentum and quality factors. Chief of the factors is the PE-ratio in relation to the growth rate and the PEG-ratio should ideally be below 0,66. According to the author the best bargains can be found among under-analyzed small companies with growth rates of 15 to 25 percent. The quantitative system is relatively similar to William O'Neil's more well known CAN-SLIM-system, but were O'Neil add technical analysis to the quantitative screening to aid investment timing, Slater add fundamental analysis of companies competitive advantage.

The other niches are described in much less detail. With turnarounds timing is paramount and triggers like a change in management could imply a rebound. In investing in "shells" the investor buys a basket of companies with "*nondescript businesses of little account and occasionally some cash*" and wait for them to be taken over by someone who wants a back-door quotation for his company. Asset situations refers to the Ben Graham type of asset based value investing and Slater requires the Price-to-Book and the Debt-to-Equity ratios to be max 0,5 and the company must show some profit and it should be in an industry with okay prospects. Finally, "leading stocks" is basically applying the same type of quantitative checklists to large cap companies trying to improve the investment track record in this area.

As you would expect of a book written to the author's son the writing is simple and easy – and fun - to read. This doesn't mean that Slater has backed away from writing a book that is meant to beat the investment professionals at their own game. Few books are equally well suited in helping a prospective young investor raise his game.

Mats Larsson, July 9, 2015