

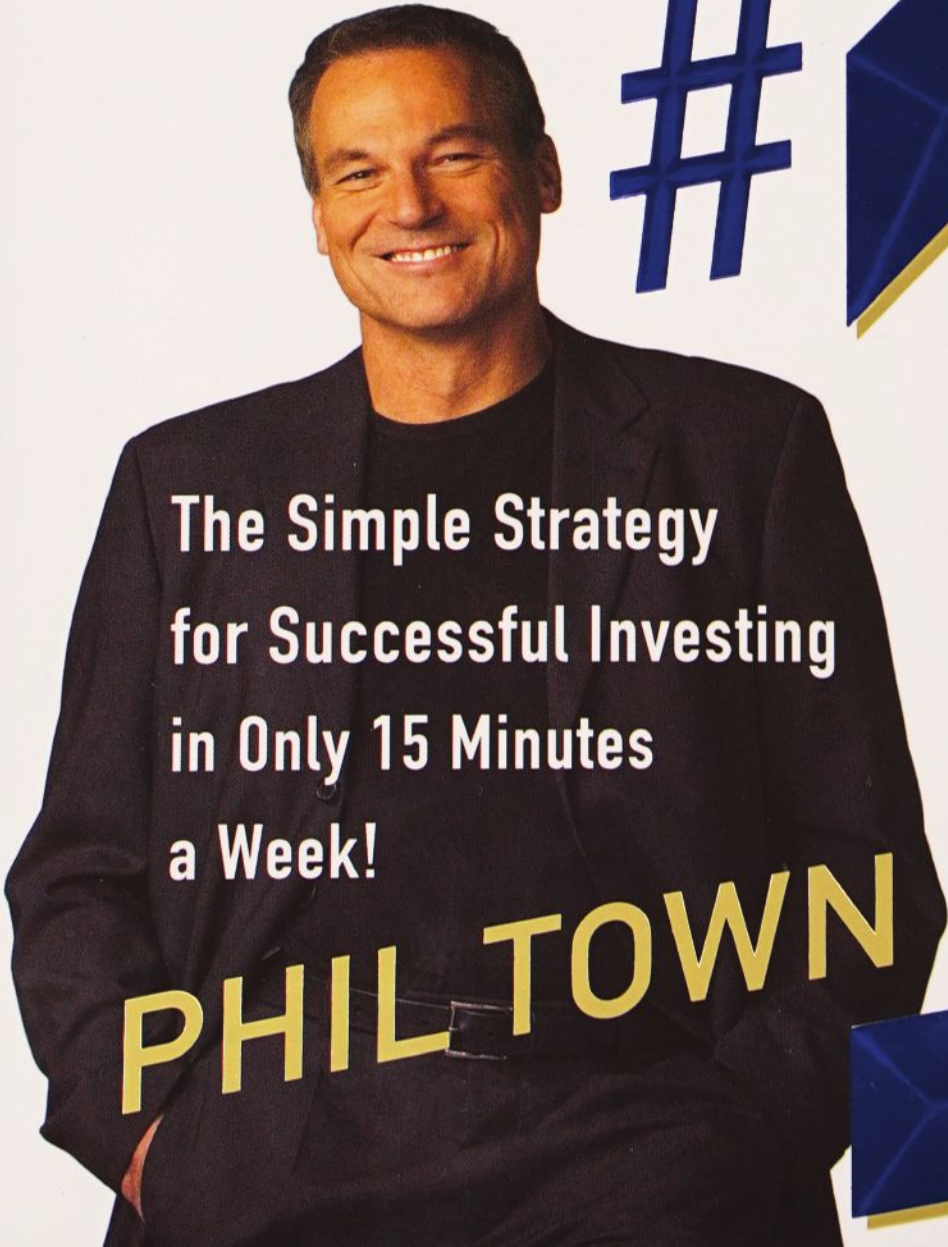
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to get you on the path to riches. This one's special!"

—James J. Cramer, host of CNBC's *Mad Money*

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The Simple Strategy  
for Successful Investing  
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PHIL TOWN

# Margin of Safety, Sticker Price & Meeting Mr. Market

*A cynic is someone who knows the price of everything and the value of nothing.*  
– OSCAR WILDE (1854–1900)

## Demand a Margin of Safety

Margin of Safety (MOS) is what defines our “attractive price,” and it begins by first getting a correct Sticker Price on a given business.

We’ll be calculating Sticker Prices later. First, I want you to focus solely on the concept of a Margin of Safety, which is critical to Rule #1 and all too often forgotten.

The practical application of Rule #1 investing is this: Buy \$1 of value for 50 cents. This is possible, because sometimes the value of a business we want to buy is not equal to the price it’s selling for. It is critical to our job of buying businesses that we understand this. Price is what the market is getting for the business today. Value is what it’s worth.

Recall what I said earlier:

Sometimes the price of a thing is not always equal to its value.

Because Rule #1 investing is essentially just a shopping trip for something on sale, critical to Rule #1 investors are to understand that we must know what an item—or business—is worth.

And that friends, is called **sticker price**.

### Here’s what Warren Buffett has to say,

“The basic ideas of investing are to look at stocks as businesses, use market fluctuations to your advantage and seek a Margin of Safety.”

## Sticker Price

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Let's look at a car buying example, like we did earlier.

While on Park Avenue in New York City, I saw a brand-new Maserati Quattroporte in the dealer's window. That's a beautiful car. Seriously. So I went in and asked one of the sales reps what the sticker price was on the car. She told me \$101,000 to \$115,000, depending on the options.

By then I was sitting in the driver's seat, playing with the buttons on the dash. I asked her, "How much for this one?" She told me it was a six-month wait, that they were fetching somewhere between \$120,000 and \$145,000. I excused myself and escaped. Still curious, I went to eBay and found one on sale for (only) \$145,000. The New York dealer I'd spoken to hadn't been kidding... but, the sticker price was \$106,000.

That first dealer and another on eBay wanted \$145,000. Why?

Because there was a big demand.

Hey, welcome to America.

Some buyers are willing to pay that price because they have more money than they know what to do with. The money is there. They want the car. They'd pay the \$145,000 even if the price is above the sticker by 40%. I don't pay sticker price for anything, so I'm not buying that car. I might even be in love with that Maserati, but I've got to take care of my money so my money will take care of me. That means not blowing it just because I can't wait awhile. You and I both know that the over-sticker price isn't going to last long.

Soon enough, that Maserati will be available to me at sticker and then, at some point, below sticker. We're going to buy businesses in a similar fashion.

The single most important determinant of the money we get in the future is the price we pay today. Is the price at the Sticker, above the Sticker, or below the Sticker? We can figure out what the Sticker Price is, but we can't control the price being charged for the business. That's up to our partner, Mr. Market. And now, I'd like you to meet him.

## Meet Mr. Market

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The idea that the market is our partner came from Ben Graham. And like many of Graham's insights about investing, this concept is immediately obvious and profound (at least it should be). Mr. Market is an incredibly agreeable partner. At any time, he's willing to make a deal happen.

If we want to buy a business, he'll sell it to us. If we want to sell a business, he'll buy it from us. Awesome!

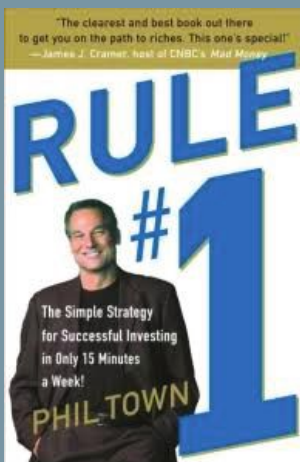
The catch: Mr. Market gets to name the price. This catch would give us no particular advantage in making great investments if it weren't for the fact that Mr. Market is bipolar. Our partner goes through gigantic mood swings from the highest euphoria to the lowest depression. Most of the time Mr. Market is taking his meds, and on most days he's pretty lucid and rational about the prices he sells and buys at.

That means most of the time the price of a business is pretty close to its value. But sometimes he can get so insanely optimistic that he prices everything insanely high. On other days Mr. Market can get so depressed that, unlike Annie, he's convinced the sun will not come up tomorrow.

On those days he feels there's never going to be a good day again for any of these businesses. And he prices them so low that it's as if he's giving them no value at all. Crazy or not, his mood that day sets the prices.

Obviously, even if it's not very fair to take advantage of this massive emotional handicap, we prefer to buy from Mr. Market when he's severely depressed and we want to sell to Mr. Market when he's irrationally exuberant. It's kind of a shame to take advantage of someone who's emotionally unbalanced, but then again, he doesn't seem to mind. He's been bipolar for so long that he just thinks it's normal. He honestly doesn't think he's mispricing anything, even if one day the price is \$100 per share and just a few months later it's \$10 per share. And if you ask the professors who study Mr. Market, they'll tell you the guy is fine—they'll tell you that his behavior is completely rational and give you all kinds of reasons why the price of that company was rationally \$100 and then rationally \$10! I guess when the keepers of the loony bin are loony, everybody is "normal."

By knowing that (1) price is not value; and (2) Mr. Market is going to price stocks crazy from time to time, we know that if we can properly value every business we are interested in buying, all we have to do is be patient and wait for Mr. Market to bring it to us at the right price—the price where making money is certain. Some investors think that great companies don't go on sale, and they're usually right. But usually right isn't the same as always right.



If you've enjoyed reading about my good friend, Mr. Market and want to know more about picking up great businesses when he gets off his meds, then I encourage you to pick up my first New York Times Best-Selling book, Rule #1. You can get it here!

[Click Here To Purchase My Book, Rule #1!](#)