



Steve Galbraith, Morgan Stanley Chief Investment Officer

Searching for financial walks & stolen bases.

Michael Lewis' latest book, *Moneyball*, is all about finding value where the consensus does not. The book revolves around the unlikely success of the Oakland A's, who, in finance terms, consistently outperform the market with players (stocks) that other teams (investors) deem rejects. The A's managers found that convention tended to overrate such sexy achievements as stolen bases and batting averages while underestimating the importance of on-base percentages and walks. Which led us to wonder: What are the financial equivalents of a stolen base and a walk?



Growth rates — the financial equivalents of a .280 hitter with a .290 on-base percentage. The A's found that "bad" body types can still be terrific players, and vice versa. Too often scouts predetermine that the 6'3" beefcake boy will outperform the dumpy 5'8" guy. The financial equivalents of the 6'3" stud who can't hit a curve ball are "growth" factors like historical and forecast growth rates. If one were systematically to buy the quintile of stocks offering the fastest historical or projected growth while shorting those providing the least, an investor would systematically underperform the market by some 500 basis points per annum.

Say No to Mo'. What's an even more obvious way of underperforming? How about buying a stock that has just gone up a lot. Buying yesterday's winners is akin to being caught stealing a base. If one were to systematically go long the quintile of stocks with the best performance over the prior month while going short the quintile with the worst, one would systematically lose a lot of money.

The walk equivalent. The most prominent characteristic the A's look for in players is the ability to draw walks. Walks are highly valued both for what they are not (i.e., outs), and what they are (an active use of the opposing pitcher's arm, and a place on the bases). Walks = success. But walks are boring. Walks do not elicit oohs. As such, walks are grossly undervalued. In the stock market, we have endured an era where investors chased the oohs and aahs, overlooking boring old valuation. Over the long haul, the most important factors in adding alpha to portfolios are valuation oriented. Price to earnings, price to sales and even price to book are the financial equivalents of walks. If one were to buy systematically the cheapest quintile of stocks on these metrics while selling short the dearest, one might enjoy an early retirement.



Sizzle is vastly overrated. Just as being a Red Sox fan prepares one much better for the realities of life than being a Yankees fan, understanding the nuances of baseball can help you understand investing. In an era characterized by corked bats and corked financial statements, give us the steak, not the sizzle, give us walks, give us cheap stocks.

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This is an edited excerpt from "Searching for the Financial Equivalent of a Walk," by Steve Galbraith, dated 8/5/03. For a copy of the full article, including important information and disclosures regarding Morgan Stanley, please see www.morganstanley.com/ourviews or contact 1-800-962-1343. This article does not provide individually tailored investment advice and has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. It was based on public information, and Morgan Stanley makes no representation that it is accurate or complete. Estimates of future performance are based on assumptions that may not be realized. Investments and services offered through Morgan Stanley & Co. Incorporated and Morgan Stanley DW Inc., members SIPC. Morgan Stanley and One Client At A Time are service marks of Morgan Stanley. © 2003 Morgan Stanley.