John Templeton Interview (Our Final Interview with Sir John Templeton)

Alan and Sir John Templeton, something must have caught the eye, and imagination, of Sir John Marks Templeton over 30 years ago. Because, following our first visit to him way back then as part of a larger group of money managers, he has continued to invite us back for one-on-one visits to both his home and his offices in Lyford Cay ever since. He seemed to show a special interest in a fledgling ABL, Inc., even though we were managing barely $10 million at the time, and Sir John was responsible for well over $10 billion.

He has welcomed ABL clients, business associates, even our family members, into his tropical confines. Guests have included John Hatsopoulos, Sir John's neighbor in Lyford Cay, who with his brother was the architect behind the Thermo Electron group of companies; and Dr. Bill Hightower, well-known Alabama surgeon, whose roots, like Sir John's, are Tennessean. During our last visit, we were joined by Garo Armen, Chairman of the Irish pharmaceutical firm, Elan Corp. In all our visits, Sir John has been nothing but gracious, exceedingly generous with his time and exceptionally inspirational with his wisdom and principles. In fact, on the eve of his 92nd birthday, he cautioned us about occasional lapses in his short-term memory.

However, for the next several hours, this man did nothing but amaze us with his spark, his ideas and his financial strategies. He didn't miss a beat. Most importantly, over the years, two of his driving principles have helped build the foundation of our financial organization. The first, that managing other people's money should be considered a sacred trust, something many money managers seemed to have forgotten over the past two decades. Secondly, and this has been integral to our success, always take profits when expectations and valuations are high, no matter what the "herd" may be saying or doing at the time. This, especially, guided us to start selling many of our technology holdings in the late 90's, as well as the reason we are currently locking in profits on some of our major energy issues. Sir John has not only been one of the world's most distinguished financial advisors, he is easily one of the world's most distinguished gentlemen. We owe him a special debt of gratitude, and we feel especially honored with our continued close association with an exceptional man like Sir John.

Lyford Cay, Bahamas
ABL (Alan B. Lancz)
When we last met you were covering how busy you are with your foundations and we were joined by the Chairman of Elan Corp whom you were kind enough to welcome… by the way that stock did very well for us. At the time you were discussing how religion has not really advanced like so many other areas over the years and that the spiritual aspect seems to be a matter of looking into the past instead of ahead – in England 1 in 10 go to church, Russia and China 1 in 100. Why is this the case and what can be done about it?

Sir John (Sir John Templeton)
"I spend seven days a week on my foundations, as we are trying to persuade the leaders, the top 1% of the intellectuals in the world, to devote at least 10% of their money to try to increase their spiritual wealth. You do this by applying scientific research methods to the information of a spiritual nature not yet known. I have to clarify that with an example – unlimited love. Every religion throughout all human history has always advocated unlimited love but there has been almost zero scientific research done on what is the cause of unlimited love, what are the benefits of unlimited love, what are the varieties of unlimited love, and how do you help people feel unlimited love. So we are approaching scientists to come to us with a proposal of applying the new methods of science in making discoveries of spiritual realities (i.e. unlimited love). So far we are financing 383 groups of scientists for such research. One that I will use as an example is that there has never been a university that has taught a course on how to develop your purpose in life. A person who lives his life with purpose accomplishes 10x as much as one that drifts along. So all universities should teach courses on how to develop a purpose that is going to make your life most beneficial."

ABL
Another area we covered was your thoughts two years ago that now more than any other time in your life there is no great difference between markets and industries.

Sir John (Sir John Templeton)
"This is still true today . . . there are no great bargains in terms of countries or industries today, like there have been the majority of time during the past. More so than any other time in my life, I continue to find this to be the case."

ABL
The key investment strategy in this type of environment is to take a market-neutral approach. You suggested going long on 10 well managed solid stocks and then shorting 10 that are in similar industries that do not possess the qualities of your favorite 10. And if an investor is not comfortable picking stocks to short, then going short in the S&P 500 would suffice. This has worked well with active managers far outperforming the indices of late. Do you see this continuing?

Sir John (Sir John Templeton)
"You don't want to tell your clients to go out and buy a lot of common stocks because the prices are too high. You don't want them to own bonds because the bonds are stated in Dollars and the U.S. Dollar keeps on going down. So what should they do? The key is still an equally long and short (net neutral) portfolio. I am not predicting this will be true a year or ten years from now but it is the best alternative right now."

ABL
In an adaptation of your suggestion we have focused on high quality, dividend paying companies for 2004, especially after the huge gains in 2003. This combined with a risk hedged strategy of buying select chemicals that should do particularly well if the price of energy declines in combination with the cheapest energy company we could find at this time last year Anadarko. Both areas did well as the basic material cyclical plays did well with the demand from China and energy stocks exploded with record high oil prices. Do you see this as an alternative strategy to those investors fearful of shorting stocks?

Sir John (Sir John Templeton)
"Yes that seems like an excellent strategy for the current environment . . . it makes a lot of sense, particularly when investors do not limit themselves to one nation or even only one area of the world. More so than any time in my long life, there are only minor differences in valuations, as prices are pretty much the same throughout the world. But if you are trying to find the right stocks to be long while others to be short, you will find more of them if you do not limit yourself to one nation . . . you'll find many more by just looking at ten nations. I was just looking at a study from last week on the banking industry in South Korea and it was fascinating as you can buy the best banks in South Korea for only 6x earnings, whereas, American stocks are currently selling at 19x earnings."

ABL
As a follow-up, why is the current environment particularly poor for passive index investing?

Sir John (Sir John Templeton)
"Index investing basically will just go up and down like the market. So if the market is too high then the index is too high. Secondly if an investor wants to index invest as opposed to utilize active management, they must consider two key factors. First, what index would you choose? Would you choose an index of just one nation or would you choose an index of all nations? And secondly, if you choose an index – it will be all long as there are no indices that are short, so in effect you are risking your money (all long) at a time when almost all stocks are too high."

ABL
According to a Barron's article last week, nearly one third of newly retired seniors have unpaid balances averaging $4K on their credit cards. This is up nearly 90% from ten years ago. The fact is households are spending more than they earned in recent years (third quarter alone $342B more spent than earned), which is the most since the third quarter of 1950 after the pent-up demand from

WWII. Some blame Alan Greenspan for holding interest rates so low, saying he has made saving unattractive. What are your thoughts?

Sir John (Sir John Templeton)
"What you have said explains largely why prices are too high. It is true that people have spent too much, it is true that people buy stock and homes on borrowed money, all of which are dangerous. Now I can't say when it is going to end, it may go on another month, or year or longer, but it's dangerous."

ABL
On November 10th, 2004, The Wall Street Journal wrote that today's real estate investor must have an extremely long-term outlook because prices have risen so dramatically. In the past five years prices in California and Washington DC real estate have doubled on average, while much of the northeast is up between 70-90%. What are your current thoughts on real estate prices in general?

Sir John (Sir John Templeton)
"Real estate prices are currently the most dangerous I have ever seen. This is a much easier question than stocks because it is more difficult to say what a stock is worth but real estate is worth no more than the cost to reproduce it. You should not pay for that house (pointing toward Lyford Cay) more than it would cost to build that house directly across the street. So you have something to guide you. And residential real estate prices in most cities are too high – as it is easy to build. This forces more and more people to build and that creates a surplus of houses and the prices will go down. Obviously, we are talking in general terms because if you can pick out the right location in real estate your real estate values will still go up even in this current inflated price environment. But so many people are trying to do this that it is extremely difficult to find a place where real estate isn't already up."

ABL
How is the investment world different under a second term of President Bush within the current geopolitical climate?

Sir John (Sir John Templeton)
"Prosperity is marvelous. We have never seen a time of such great prosperity and such great peace. The conditions are just the best I have ever seen as these are probably the best that conditions have ever been. But I doubt that the Republicans will get elected four years from now. Because the big problems will be worrying people much more. Such problems like foreign trade – American foreign trade is the worst any nation ever had and that can't go on – it has to end. And so before the next election four years from now that is going to be a big political problem. Same thing with federal deficits – the U.S. federal deficit is the largest any nation had in history. You can't have nations go on and on with bigger and bigger debt. So before the next election that is going to end as well. The great increase in individuals using borrowed money, which we discussed earlier, will lead to many

more bankruptcies than we have ever had before. Many individuals should enjoy it while it is here but your clients should be aware of this and play it safe."

ABL
Is the world a safer place now?

Sir John (Sir John Templeton)
"Oh yes, now you are on the happy side of this equation. If you collect all the statistics, you will find that despite all the negative headlines there is a smaller fraction of the world population killed in battle in the last fifty years than any 50 year period in world history. It makes for good media sales and ratings so you hear about the negatives all the time but you look at the number of people involved and it is tiny. In health a century ago, people died at an average age of 47 and now they die at 72 on average. Look at communication when President Lincoln was assassinated, nobody in Europe knew about or heard about it for 5 days, now information is instantaneous all over the world. We should be grateful that we are living in the most prosperous, peaceful, most wonderful time in history. I wish people were more joyful as there has been no better time period to live. The problem is there is a common flaw in human nature to be attracted to the negative rather than the positive."

ABL
When we met 20 years ago, you had mentioned an information overload that was on the horizon – did you have in mind the internet and its influence on worldwide communication?

Sir John (Sir John Templeton)
"Yes, but I did not know what it would be. I am not smart enough to tell you what exactly the change would be (the internet) but I think things will continue to speed up – the information overload we discussed 15-20 years ago will even be greater 10 years from now."

ABL
I am going to visit Russia in approximately two weeks. What question or strategic comment would you share with President Vladimir Putin if you were going to see him?

Sir John (Sir John Templeton)
"Oh I only wish I was young enough to join you. But the two key points I would convey . . . One is humility, the other diversification. It is very easy once you are the leader of a huge nation to think you are very wise, but everyone makes lots of mistakes and remember that half of what you decide is going to turn out to be a mistake – so humility is critical. And secondly, don't think that monopolies where you give one corporation or industry control of things is a good idea. Because anybody that has such control has no incentive to do better. So you want competition and diversification."

ABL
Even though the headlines are totally focused on the declining dollar from an historical perspective the U.S. Dollar is nowhere near record lows. What are your current thoughts on the U.S. dollar?

Sir John (Sir John Templeton)
"When I was a student in England the Pound Sterling was regarded as the strongest thing, in the world a century ago gold was the most sought after and the last 50 years it has been the American Dollar. This will never be the same as it will always change. So you must invest in relation to everything, not just in relation to the U.S. Dollar."

ABL
What are your personal thoughts on Modern Portfolio Theory which theorizes that holding an extremely diversified group of assets eliminates the risk in any particular security?

Sir John (Sir John Templeton)
"All such systematic ways to invest in stock do not seem wise to me. I think investors should have an open mind, utilizing wide-ranging methodology rather than categorizing oneself in a box and limiting one's outlook."

ABL
Warren Buffett has hit a bit of a snag with Eliot Spitzer's insurance investigation. Is this the start of a bigger phenomenon that you pictured when you anticipated that his star may be shining too brightly (everyone following the herd).

Sir John (Sir John Templeton)
"I have tremendous admiration for Warren Buffett. The way he's able to run his vast amounts of organizations with a personal staff of only 17 people – that's the right way and that will never go out of style or collapse because it is the right way. But he has gotten so big now that you can't expect him to get ahead of other people. When he was smaller it was much easier for him to have superior results, but now the result of his company would only be slightly better than other companies. Also the price of his stock is above what it could liquidate for, conversely in open ended mutual funds you can always liquidate for the net asset value (NAV). In Berkshire Hathaway you would lose 40% from its current price to its current net asset value. So I don't own any of his stock even though I admire him."

ABL
We have talked quite a bit over the years on how the investment business has changed from the days you started in 1939 or even since you started the Templeton Growth Fund over 50 years ago. Can you give us another way things have changed over and above what we have already discussed over the past two decades.

Sir John (Sir John Templeton)
"In the days I started, investment counselors were never supposed to have any marketing or sales people and were never supposed to advertise. They were to act like a medical doctor and just get clients one at a time – a very slow process."

ABL
I can relate to those days as we are very selective with each new client and custom design portfolios to match each client's specific goals and objectives. Did you like those days better?

Sir John (Sir John Templeton)
"No, Alan, I can't say I did. I felt I was doing a lot of good but at that time I was only helping about 200 families. But when it became more respectable to advertise and have salespeople, I eventually served 300,000 investors when I sold to Franklin."

ABL
With that Sir John I want to thank you for your time as I know that in this stage of your life you rarely offer these special visits. It definitely has been a pleasure and, as always, your time is much appreciated.