CNBC

Opinion: Ron Baron explains his investing philosophy with goal of doubling his money every 5 to 6 years

By Ron Baron
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KEY POINTS

- Ron Baron said he began investing during the 1970s, which was a tumultuous time.
- As a stockbroker, he recommended small-cap companies, such as Disney and McDonald's, and told clients to sell when the stocks doubled or tripled. But many of these stocks continued to climb.
- Now, having learned from this lesson, Baron says, he invests in companies that will grow over full market cycles, at a faster-than-average rate.
- "Our goal is to double our money about every five or six years," Baron writes.

Ron Baron, founder of Baron Capital

Anjali Sundaram | CNBC

I began my career as a securities analyst in 1970. It was a tumultuous time.

The Vietnam War, Watergate, the resignation of President Richard Nixon, the Iranian hostage crisis, a recession, inflation, interest rates in the double-digits, gas prices that had tripled. The only crisis with which we did not have to contend during that decade was a pandemic. Further, in the midst of chaos, the stock market crashed, resulting in a global bear market that lasted from 1973 to 1974. It was one of the worst downturns since the Great Depression. The only one comparable was the financial crisis of 2007–2008.

My experience during the 1970s was foundational. The stocks I had recommended were small-cap companies. They included Disney, McDonald's, Federal Express, Nike, and Hyatt.

After these stocks doubled or tripled, I recommended selling. That was because I earned brokerage commissions — not a salary. Several years later, when I looked back, virtually all those stocks continued to grow dramatically.

I concluded that, instead of trading stocks or trying to predict market fluctuations, the better strategy was to discover and invest in great companies at attractive prices and stay invested for the long term.

I believed then, and believe now, that you do not make money trying to forecast short-term market moves.

In my 52 years of investing, I have never seen anyone consistently and accurately predict what the economy or the stock market was going to do. So whenever extraneous events happened and stocks uniformly declined, I believed that represented long-term opportunity.

Investing in 'pro-entropic' businesses

I also learned to invest in "pro-entropic" businesses. In times of entropy – disorganized chaos – I found many of the best companies did not just survive but thrived. They took advantage of opportunities that tough times presented. They acquired weaker competitors at bargain prices or gained market share as their rivals faltered. They accommodated customers, creating loyalty and goodwill and enhancing lifetime value. While continuing to invest in key areas such as R&D and sales, they rooted out extra fat elsewhere in their budgets, creating long-term efficiencies. When conditions normalized, they were better positioned than ever to take advantage of their resiliency.

After the 1973-1974 bear market, I saw this pattern play out again and again. The stock market crash of 1987, the dot-com bubble burst of 2000-2001, the 2007-2008 financial crisis, and now. That is why I like to say we invest in companies, not in stocks.

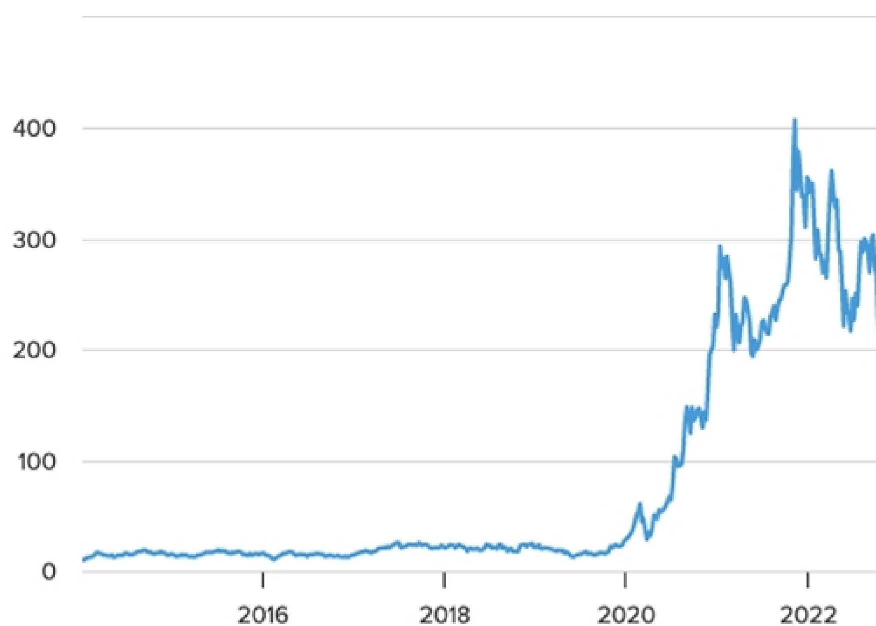
We look for companies that will grow over full market cycles, at a faster-than-average rate. We invest based on what we think a business will be worth in five or 10 years, not what it is worth right now.

Our goal is to double our money about every five or six years. We seek to accomplish that by investing for the long term in companies we believe are competitively advantaged and managed by exceptional people.

The Tesla example

Tesla is probably the most well-known company we currently own. But I would point out that it is no outlier. In fact, Tesla is the perfect example of how our long-term investment process works.

We first invested in 2014. I thought Elon Musk was one of the most visionary people I had ever met. What he was proposing was so revolutionary, so disruptive, yet made such sense.



We have owned its stock for years while Tesla built its business. Sales grew, but its share price, although extremely volatile, was mostly flat. We remained invested throughout that time, and when the market finally caught on in 2019, Tesla's share price increased 20 times. That's why we try to invest in companies early – because you never know when the market will finally perceive the value we perceived, and it drives the share price up.

We only invest in one kind of asset – growth equities. Why? Because we think growth stocks are the best way to make money over time.

> **"While the simple answer to combat inflation is to invest over the long term, the concept of compounding tells us why. ... Over time, this effect snowballs...**
>
> — **Ron Baron** CEO

Historically, our economy has grown on average 6% to 7% nominally per year, or doubling every 10 or 12 years, and the stock markets have closely reflected that growth. U.S. GDP in 1967 was $865 billion, 55 years later it is $25.7 trillion — or over 28 times greater than it was in 1967.

The S&P 500 Index was 91 in 1967. It is now at about 3,700.

We seek to invest in companies that grow at twice that rate at a time when we believe their share prices do not reflect their favorable prospects.

Stocks are also a terrific hedge against inflation. Inflation is once again back in the headlines, but it has always been present. The purchasing power of the dollar has fallen about 50% every 18 years, on average, over the past 50 years.

While inflation causes currencies to lose value over time, it has a positive impact on tangible assets, businesses and economic growth. This means stocks are the best way

to counter the devaluation of your money.

While the simple answer to combat inflation is to invest over the long term, the concept of compounding tells us why. When your savings earn returns, compounding allows these returns to earn even more returns. Over time, this effect snowballs, and earnings grow at an increasingly fast rate.

So, if you earn 7.2% on an investment, which is the historic annual growth rate of the stock market (excluding dividends) for the past 60 years, the growth of your investment will be exponential. You will have nearly seven times your initial amount in 30 years, 12 times in 40 years, and more than 23 times in 50 years!

I'd also like to point out that the stock market is one of the most democratic investment vehicles — available to everyone, unlike real estate, private equity, hedge funds, etc. I founded Baron Capital in 1982 to give middle-class people like my parents a chance to grow their savings. Even today, 40 years later, that is why I do what I do.

Ron Baron is chairman and CEO of Baron Capital, a firm he founded in 1982. Baron has 52 years of research experience.

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