The Advanced Teachings of Mrs. Langerhorn: 24
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Note to the Reader … These are not the notes of our conversations that were published earlier under the title "Mitochondria Learns to Invest". These are the papers Mrs. Langerhorn left me after she passed away. They are her advanced teachings, and as such they overlap and reinforce her earlier principles. I hope you gain from them as much as I did. The earlier lessons are incorporated in the book "Stairway to Wealth" available at LuLu.com

Money Under the Mattress

Dear Mitochondria:
You've hinted many times that you wanted to know, but I've never told you. I didn't start from zero. My wealth started with my grandmother, on my mother's side.

I was a girl in the 1930's, when folks didn't use banks any more than they had to.

My family and our friends had money in the stock market when it collapsed in 1929, eventually dropping from 381 to 41. It was an 89% decline, made worse by the fact that an awful lot of stocks were purchased on margin, meaning that you only had to put maybe 50% of the price down and you could borrow the rest of the purchase price.

One way that hurt investors is that if they bought $1,000 worth of stock and the issue dropped 50%, they would still have $500 worth of stock in their account. But if they chose to do it on margin, they could buy $2,000 of stock … and if it then declined 50% their total $1,000 investment would be wiped out. The investor would have started with $1,000 and concluded with zipgus. It was an unhappy time.

Neither was it pleasant time for banks. First of all, people who are wiped out have no money to deposit, so banks had no depositor money to lend. Furthermore, many banks were heavily exposed to the brokerage community and when the stock brokers went tummy-up the backspray hit the banks. From 1929 to 1932 over 5,000 banks closed. People who still had money on deposit when the bank closed the blinds and turned out the lights lost it all.

That's why my people didn't trust banks. So they simply hid their money. My grandfather put it under his mattress. My grandmother on the other side put it in an empty sugar jar. Everybody hid their money in the same place and pretended nobody else know where it was. It was a minor small town courtesy, of course.

The problem was that money doesn't grow in sugar jars or beneath the mattress. Eventually that became clear even to Grandpa and he began, slowly at first, buying neighboring farms. Someone would work them for shares, and everybody was happy.

Grandpa died, still living in that little house, with an almost-full flour sack of money under his bed.

My mother's mother, on the other hand, bought her first stock well after Black Tuesday, October 29, 1929. Grandma didn't buy anything until early 1930, and then she only purchased those with high dividends. Her thinking was that even if stocks were risky, so were banks, and she had to do something because she had kids to raise. Her husband was taken in the Great War. He was testing a 1908 Curtiss "Silver Dart" biplane and it came apart in mid-air.

So Grandma started buying, slowly at first, and watched her shares climb in value as the economic recovery set in. When prices rose so high that their dividend yield dropped too low, she'd sell and recycle the proceeds into a company that still had a high dividend yield. That was her only investment "guideline", and she did real well over time. By the end of WW II she had enough to pay cash for a couple of apartment buildings.

Grandma bought apartment buildings just like she bought stocks. Cash flow ruled.

Towards the end of her life she started leveraging her apartments. She'd borrow a conservative figure on her current buildings to be able to put a large down payment on her next purchases.

Grandma never much liked her own children, for which I was most grateful, and her will reflected that fact. All her properties went to the grandkids. We worked out who-got-what between ourselves. Cousin Bernard wanted the Hudson automobile my father promised me when I graduated from college, so he was motivated to collude with me against the others. With him on my side I only needed one or two others to vote my way and I'd get the apartments I wanted most. The other two co-conspirators were my cousins Amanda and Rosie. I had to trade them things for their shares. For example, Amanda just wanted to be liked, so I took her out for ice cream and girl talk every day before the vote. Rosie wanted my boyfriend, and that was ok because I was tired of him anyway. I liked that swap better, because it didn't cost me any money. So I got the votes I needed to get the buildings I wanted, then we all worked together to get Bernard the apartments he "wanted" (they were the ones I told him he'd have to offer before I could survive swaping the Hudson that I'd fallen in love with). So I got two more buildings and he got the Hudson. Back in those days, I'd do anything to make Cousin Bernard happy.

Each of the grandkids would wind up with two buildings apiece. Including Bernard's share, I wound up with the four biggest properties. They were also the most run-down ones, but I didn't mind that. I knew that somehow I could make them pretty and then I'd have a lot more cash flow than any of the others. Maybe sometime in the future they would have money problems, and I could buy their units with the cash flow from mine. Of course, they'd have to make me a really good deal or it wouldn't make sense to bail them out. I'm not running a charity, here.

Well, I was right about the other heirs losing interest, but wrong about my cashflow being enough to buy their building. I learned really quickly that I had to refinance my units to buy theirs.

That turned out to be one of the best lessons I ever learned. Ever since then, no matter what the economic climate, I always kept my buildings fully mortgaged. There were a couple of reasons for that.

Just as a quick example, if I had a $100,000 building fully paid off and it went up 10% during the next year, I'd make 10% on my investment. But if I had a $70,000 loan against it, and it still went up 10% ($10,000), I'd make 33% ($10,000 divided by my $30,000 equity). So the more my buildings were leveraged, the more return I'd make on my investments. Of course, I'd always make sure that I'd still have a nice cash flow, even after mortgage payments. And, of course, with money in the bank I could buy more apartments … if the price was really, really fair.

And that, Mitochondria, was the original source of my wealth. No, not inheriting buildings from grandma. I may have gotten my start with four of grandma's buildings, but if I'd never refinanced to buy others, I'd not be where I am today.

So, Mitochondria, while I got my start with four of grandma's buildings, the real source of my wealth was conservative leverage … repeated over a lifetime.