

Polaroid traded at 95 times earnings in 1972.

Great companies can be bad buys

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Maxim: *Think one level deeper than the market.* — Howard Marks, in substance

Knowing that a company is good is the start of an investment decision, not the end of it. The harder question is what everyone else already believes, and what the price assumes.

A good company and a good investment are not the same thing, and the gap between them is the price.

In the early 1970s, American investors fell in love with a group of about fifty blue-chip growth companies: Coca-Cola, IBM, McDonald's, Xerox, Polaroid and their peers. They were called the Nifty Fifty, and they were said to be "one-decision stocks": buy them, and never think about selling. By December 1972 the group traded at an average of 41.9 times earnings, against 18.9 for the S&P 500, according to Jeremy Siegel's study of the episode in the [AAll Journal](#). Polaroid traded at nearly 95 times earnings; Xerox at about 46.

The companies were genuinely excellent. That was the point everyone agreed on, and it was already in the price. In the vicious 1973–74 bear market, the Nifty Fifty came "crashing to earth", in Siegel's words.

Siegel's later analysis, published in 1998, added a twist that makes the story more useful than the usual morality tale. Taken as a group, the fifty bought at their 1972 peak would have nearly matched the S&P 500 over the following 26 years. Some were bargains even at those prices: Coca-Cola, he calculated, would have been worth paying more than 80 times earnings for, and Philip Morris returned 18.8% a year. Others were wildly overvalued. Polaroid's price was almost eight times what its future returns justified, and it was among several that lost money outright.

So the lesson is not "never pay a high price". It is that the high price forced a much harder question than "is this a good company?" The question was: which of these companies could live up to what everyone already expected?

First-level and second-level thinking

Howard Marks of Oaktree Capital has spent decades describing exactly this gap. In his 2015 memo [It's Not Easy](#) he put it in two sentences. "First-level thinking says, 'It's a good company; let's buy the stock.'" And: "Second-level thinking says, 'It's a good company, but everyone thinks it's a great company, and it's not. So the stock's overrated and overpriced; let's sell.'"

First-level thinking is not wrong; it is incomplete. Every investor can see that a famous company is well run. Because everyone can see it, that knowledge rarely creates an advantage. The return comes from being right about something the price has not yet reflected: that a company will do better than expected, or that a widely loved one will do worse.

Indian investors have lived a version of the Nifty Fifty story too. On 18 October 2021, Avenue Supermarts, the owner of the DMart chain and one of the country's most admired retailers, touched ₹5,899, a level [Business Today](#) later recorded as its high. That day, [Business Standard reported](#), it was valued at 124 times the following year's estimated earnings, against a sector average of about 65, and one brokerage said the price was "pricing in perfect execution and limited competition". Five years later, in October 2026, the shares traded at about ₹3,250, [according to Business Standard's market data](#). Whatever one thinks of the business itself, buyers at the peak paid for perfection, and the price stopped assuming it.

The questions that take you one level deeper

Marks lists the questions a second-level thinker asks. A few of them, applied to any stock or fund you are considering, will change how you look at it:

1. **What is the range of likely outcomes?** Not just the story you believe, but the good, middling and bad versions of the next five years.
2. **What does the consensus think?** Read what analysts, the media and other investors are saying. If everyone agrees, the agreement is probably in the price.
3. **How does my view differ?** If it does not differ, you have no edge, only company.
4. **What does today's price assume?** Work out roughly what growth the valuation implies, and ask whether it is plausible.
5. **What happens to the price if the consensus is right, and if I am right?** If the stock only does well when an already optimistic consensus turns out to be too pessimistic, the odds are not on your side.

A simple decision rule. Before buying anything, write one sentence on what the market believes about it and one on where you disagree. If you cannot write the second sentence, you are relying on first-level thinking, and you should either pay a price that leaves room for disappointment or own the market through an index fund instead. When you do hold a widely admired company, revisit the question whenever its valuation runs far ahead of its own history.

Marks's idea is often summarised as "be contrarian", but that misses it. Disagreeing with the crowd is easy; being right when you disagree is the hard part, and sometimes the crowd is right. Coca-Cola deserved its 1972 price. Polaroid did not. Telling them apart required asking not just whether a company is good, but how good everyone already thinks it is. That extra level of thought is where the returns hide.

Sources

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