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A Weekend with Warren

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For the past 12 years, I've traveled to Omaha every spring for the annual meeting of Berkshire Hathaway, the multi-billion dollar conglomerate managed by Warren Buffett. It's a meeting place for Berkshire shareholders and like-minded investors from all over the world, all whom come to Omaha once each year to hear Buffett's thoughts.

The annual meeting is an unusual event, often called "The Woodstock for Capitalists." Over 40,000 people come to Omaha's Qwest Center, ranging from young students with a few shares, to money managers with Berkshire stock in their portfolio, to long-time Berkshire shareholders worth many hundreds of millions of dollars. The format of the meeting is simple: Anyone can ask a question, and Buffett – assisted by his business partner Charlie Munger -- simply answers as many as possible from 9am to 3pm, with an hour break for lunch.

Imagine getting a free full-day lesson from Roger Federer to improve your tennis game, or several hours in the kitchen with Anthony Bourdain to sharpen your cooking skills – that's what the Berkshire meeting is like for investors. For the cost of a plane ticket to Omaha, we get to hear one of the world's sharpest investment minds sharing his thoughts.

This year's annual meeting occurred recently (May 1st), and I wanted to pass along to you some of the highlights. Devoted Berkshire-watchers can download my [detailed notes](#) from the Sanibel/Captiva website, where we have also posted a [presentation](#) that I delivered at the [Value Investor Conference](#) held in Omaha just prior to the meeting, as well as [a presentation](#) delivered by my colleague Tim Vick to a group of international CEOs about Buffett-style management practices.

Meeting Highlights

Buffett has been very much the optimist during the time that I have been attending meetings, but I was struck this year at the pessimistic tenor of so many of the audience's questions – one shareholder asked, "How can such a lousy long-term economy make you so happy?" While Buffett acknowledges the risks of higher inflation, a falling dollar, and large federal debt levels, he's generally of the opinion that these negatives are outweighed by America's enormous positives – its capitalist system, entrepreneurial culture, and willingness to take risks, for example. This continued to be the case this year.

It's interesting to note that the questions were, if anything, even more negative and worried at last year's meeting, yet the S&P 500 is up about 20% since then. Perhaps markets really do have to "climb a wall of worry," as the old nostrum goes.

Continuing two longstanding themes, Buffett was pessimistic on the dollar, and expressed worries about the potential for inflation. However, he noted that to make a profitable direct currency bet, you have to get not just the direction right, but the rate of decline relative to another currency. That's much harder, which is why he prefers to hedge Berkshire's dollar exposure by owning companies with lots of sales

denominated in other currencies. We've been focusing on the same area of the market – well-capitalized multinationals with pricing power – in our portfolios at the Trust Company.

Buffett also prefers to use companies with pricing power to protect against inflation, rather than precious metals, largely because companies produce a stream of cash flows than can be valued, while gold (for example) is only worth what another investor will pay for it. He's admitted that gold has done well recently, but also pointed out at the meeting that Berkshire was worth $\frac{3}{4}$ of an ounce of gold when he took over the company (\$15 per BRK share vs. \$20/oz for gold), and Berkshire is now worth 83 ounces of gold (\$120k per A share vs. \$1430/oz for gold.)

While reasonable people can differ on the value of gold as a hedge against various economic uncertainties, I'm personally in the Buffett camp. (And lest you think Uncle Warren is a Pollyanna about inflation, I'd note that one of his earliest public articles was a 1977 piece in Fortune called, "[How inflation swindles the equity investor.](#)") He hates inflation, but just feels that owning businesses with pricing power is the better long-run hedge.

Turning away from the macro world, Buffett made some interesting hints that he may think Berkshire shares are underpriced at the moment. For one, he mentioned a "very very large international company" that was interested in doing a deal with Berkshire, but that it was too big to handle without issuing stock, and he wouldn't do that. Also, he stated flatly that if Lubrizol (a recent acquisition) had wanted to use stock, they would not have done the deal. "We would have been giving away parts of the business that we already own... You can draw your own conclusions about our calculation of intrinsic value from that statement." Buffet is at his most Delphic when talking about the valuation of Berkshire shares, and this was the clearest statement I've heard in years that he may think the shares are undervalued.

The same was true for shares of Johnson and Johnson, which is a large equity holding for Berkshire. J&J recently purchased a wonderful Swiss medical device company called Synthes, and when asked about the deal, Buffett said, "I would like the deal a whole lot better if it was all for cash... By using a lot of stock, you could draw the inference that JNJ is not valuing its own businesses as attractively as you might think they should be evaluated." I think the translation here is that he thinks J&J shares are cheap, and so trading them away for shares of another business trading at a higher valuation is essentially trading away an undervalued currency.

I could go on for pages and pages about the meeting, but I think it's perhaps best to let Buffett and Munger speak for themselves, so I'll end this commentary with a selection of the quotes that I found most pithy, insightful, or just plain funny. Again, you can read my detailed notes [here](#).

In Their Own Words:

Initial reaction to David Sokol's Lubrizol ownership shares

Munger: "...I would argue that you don't want to make important decisions in anger. You want to display as much ruthlessness as your duty requires, and you do not want to add one single iota because you're angry. So Tom Murphy, one of our best directors -- always told the people at Cap Cities, you can always tell a man to go to hell tomorrow if it's such a good idea. ... I don't think it was wrong to remember the man's virtues as well as his error."

CEO compensation and agency issues

Buffett: “You know, the -- the Bible says the meek shall inherit the earth, but the question is, will they stay meek.”

Barriers to entry in an industry

Buffett: “I asked myself the question, you know, can I start a soft drink company and take on Coca-Cola if I have a hundred billion dollars. Richard Branson tried it some years ago in something called Virgin Cola. You know, the brand is supposed to be a promise. I'm not sure that's the promise you want to get if you buy a soft drink.”

Share buybacks

Buffett: “Corporate America to some extent buys stock more aggressively when it's high than when it's low. They may have some equation in their minds that escapes my reasoning power.”

America's Potential

Buffett: “How can you be anything but enthused about this country?” The standard of living for an average American has increased six for one since he was born in 1930. “We have a system that works magnificently, though it does get gummed up once in a while...The game isn't over, it's not like the potential of America has been used up. What's happened is that the rest of the world has caught on to some extent”...China turning economies loose that have been dormant for centuries. “They're not growing faster because the people are smarter or work harder, because they have tapped into a system that works marvelously over time”...”Over the next hundred years, we will have 15 or 20 lousy years, but we will be so far ahead of where we are now that it will be unrecognizable.”

Learning

Munger: “...continuous learning is absolutely required to have any significant achievement at all in the world.”

Inflation Hedges

Buffett: “I would bet on a goods-producing business outperforming something that doesn't do anything over any period of time. But there's no question that rising prices create their own excitement, so when people see gold go up a lot...I mean if your neighbor owns gold and it goes up a lot, and you think you're smarter than he is, and your wife says “how come that jerk next door is making so much money and you're just sitting here...” well, it affects your behavior. People like to get in things that have been rising in price. Over time that has not been the way to get rich.”

Legacies

Q: “A hundred years from now, what would you and Charlie like to be remembered for?”

Buffett: “Old age!”

Munger: “I have a saying that came down from one of my great grandfathers, he wanted to be remembered for a fortune fairly won and wisely used. That’s a pretty good goal.”

Buffett: “I’d probably say teacher. ...I’ve benefitted from some great teachers in my life.”

The Dollar

Buffett: “We have not been really active in currency markets lately. No question that purchasing power of dollar will decline over time, question is at what rate...I also think that purchasing power of almost all currencies will decline, and a short position is a conviction that one currency will decline at a faster rate than another. Don’t have a strong conviction, do have some mild views, not enough to bet much money on. Do have some fears of rapid loss of value in dollar. Charlie has pointed out to me that dollar of 1930 when I was born is worth six cents now, yet we’ve done pretty well. I hate inflation, but we’ve adapted pretty well to it over the years...we have not had the real runaway type inflation that can be upsetting to a society, but it’s something you have to guard against.

...I think we’ll see a lot of inflation, but if I had a choice, I would rather be born in the United States today than in any other place at any other time in history.”

Expectations

Buffett: “Charlie’s big on lowering expectations.”

Munger: “Absolutely. That’s the way I got married -- my wife lowered her expectations.”

Buffett: “And he lived up to them!”

Trust

Munger: “...if you look at the greatest institutions in the world, they select very trustworthy people, and they trust them a lot, and it’s so much fun to be trusted, and there’s so much self-respect you get from it when you are trusted and are worthy of the trust that I think your best compliance cultures are the ones which have this attitude of trust and some of the ones with the biggest compliance departments, like Wall Street, have the most scandals.

So it’s not so simple that you can make your behavior better automatically just by making the compliance department bigger and bigger and bigger. This general culture of trust is what works.”

Tell Us How You Really Feel, Charlie

Munger . “...I think the lack of contrition in our financial sector after the disgraceful stuff they got us into is perfectly awesome. It makes David Sokol look like a hero.”

Dementia

Buffett: “How many of you know that if you trade an S&P 500 futures contract, and hold it for ten seconds and have a profit, that sixty percent of profit is long term gain. Essentially, our congress has said that this activity should be more lightly taxed than cleaning washrooms. Extraordinary that we have

decided that this activity should get sixty percent taxed at a fifteen percent max rate even though it may take ten twenty seconds and be just a flicker on a screen.”

Munger: “And the hedge fund guys get a much lower tax rate than the professors of physics or the drivers of taxis. This is demented. “

For the Love of Costco (Munger is a Long Time COST Director)

Buffett: “Charlie and I were once on a plane that was hijacked, the hijackers picked us out as the two dirty capitalists, they said that each of us would be given one request before they shot us. They turned to Charlie and said, “what is your request?”

Charlie said, “I would like to give once more my speech on the virtues of Costco, with illustrations.”

The hijacker said that sounded reasonable, he turned to me and asked me what my request was, and I said, “Shoot me first!”

Buffett’s Salary

Munger: “...I think somebody in America has to be the exemplar for not grabbing all that you can.”

On Berkshire’s Utility Business Proposing a Nuclear Plant in Iowa

Munger: “...if a tsunami gets to Iowa, it’ll be a hell of a tsunami.”

On Investment Bankers Bearing Earnings Projections

Buffett: “Lubrizol had already made projections out to 2015, they asked did I want to see them, and I told them no. I’ve never seen a projection from an investment banker that didn’t show the earnings going up over time. It’s like asking the barber if you need a haircut.”