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Warren Buffett:

Achievements and Advice to Investors

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Agenda

- **Berkshire Hathaway: Investments, companies and market cap**
- **Buffett's "intellectual framework" : Value investment philosophy that goes back to Benjamin Graham**
- **Buffett's investment advice**

The World’s No. 1 investor

Berkshire Hathaway

- **Holding company with a strong position in insurance** (Geico, Berkshire Re, General Re) **but now also into lots of businesses** (BNSF, Iscar, Lubrizol, Marmon Group, MidAmerican Energy); the ”5” delivered $10.8 bn in pre-tax profits in 2013; in 2013 B-H acquired 50% of Heinz
- **Large portfolio of stocks** worth $117bn including large stakes in Wells Fargo (21.9), Coca Cola (16.5), American Express (13.8), Wal-Mart (4.5), BoA, G-S, …
- **Acquired BH in 1965; Medium sized textile business**

Shareholder value driven

- **Goal is to beat the S&P 500 over the long-term** ("if we are unable over time to reach that goal, we have done nothing for our investors, who by themselves could have realized an equal or better result by owning an index fund")
- **Increasingly difficult** because BH is so big and employs so much capital due to its impressive investment record….return to this later

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Berkshire is a Giant

Company	Market Cap (USD bn) 11 March 2014
Apple	478
Exxon Mobil	406
Microsoft	316
Berkshire Hathaway	308
Bank of America	183
Novo Nordisk	128
Statoil	87
Goldman Sachs	79
Hennes & Mauritz	75
Nordea	59
A.P. Møller Mærsk	52
Nokia	29

A few additional numbers from AR 2013

- Net earnings in 2013: $ 19.5 bn
- Employment: 330000 (25 in HQ)
- Assets: $ 485 bn
- Rating: AAA

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How does Buffett run this company?

- **Operating decisions: Decentralized**
- **Investment and capital allocations: Centralized (and made by Buffett in consultation with Munger)**
- **Both highly experienced**

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Buffett seems to have got something right: The 2013 outcome of having invested $100,000 in 1965 in Berkshire Hathaway

	Annual return	Millions in 2013
BH book value	19.7	$671
S&P 500	9.8	$9.8

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Intellectual framework:

- Buffett traces his success back to Graham's value investing principles
- Graham taught at Columbia, NY and also had a company on Wall St.
- So what did Buffett learn from Graham and many years of investment experiences?:

"In my opinion, investment success will not be produced by arcane formulae, computer programs or signals flashed by the price behavior of stocks…..Rather an investor will succeed by coupling good business judgment with an ability to insulate his thoughts and behavior from the super-contagious emotions that swirl about the marketplace. In my own efforts to stay insulated, I have found it highly useful to keep Ben's Mr. Market concept firmly in mind."

Graham/Buffett's Mr. Market parable should help investors to stay cool

" Ben Graham, my friend and teacher said that you should imagine market prices as Coming from a ….fellow named Mr. Market".. But sad to say "the poor fellow has incurable emotional problems. At times he feels euphoric and can see only the favorable factors affecting the business. When in that mood, he names a very high price….."

Mr. Market: Manic depressive

"At other times he is depressed and can see nothing but trouble ahead for both the business and the world. On these occasions he will name a very low price"…."Mr. Market has another characteristic: He doesn't mind being ignored. If his quotation is uninteresting to you today, he will be back with a new one tomorrow….Under these conditions, the more manic-depressive his behavior, the better for you."

“ If he shows up some day in a particularly foolish mood, you are free….to take advantage of him, but it will be disastrous if you fall under his influence. Indeed, if you aren't certain that you understand and can value your business far better than Mr. Market; you don't belong in the game.”

“The Mr. Market perspective may seem out-of-date in today's investment world, in which most professionals and academicians talk of efficient markets, dynamic hedging and betas”

“Their interest in such matters is understandable, since techniques shrouded in mystery clearly have value to the purveyor of investment advice. After all, what witch doctor has ever achieved fame and fortune by simply advising "Take two aspirins"?”

Berkshire’s impressive performance: Three success factors

1) Strong talent for spotting good investments

- Started as a Graham value investor with strong focus on price multiples and good businesses
- Initial investments at very low P/E’s
- As the capital snowballed Buffett had to invest increasingly in large caps with strong brands: **Moats**

Buffett's development over time

- The recent Heinz deal is an example of this trend towards investing in large caps with strong brands; not cheap but safe
- He needs to go for the big elephants because Berkshire is loaded with cash
- Downside of this is that Berkshire's excess return is trending down

2) Cheap funding (leverage)

- **Insurance premium is coming in before expenses: Free float** (borrow at a zero interest rate assuming the insurance business is well managed)
- **Do not exaggerate the importance of the leverage factor**
- **Bufffett Partnership 1957-69: Did not have insurance but annual returns at 29.5%**

3) Only a small number of big mistakes

- Buffett makes mistakes like others, but they are small
- He avoided e.g. the tech bubble
- Did not panic during the financial crisis
- Read his ARs: Buffett discusses his mistakes openly

Buffett’s advice: How we should invest

Only time for a small sample of the value investment principles

Advice #1: Business investment, not ticker

Think about your stock as a business investment

Only invest if you are prepared to hold the stock for a long time

Don't try to outsmart the market in the short term

Try to ignore the super contagious market sentiment: "In my own efforts to stay insulated, I have found it highly useful to keep Ben's Mr. Market concept firmly in mind."

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Business approach: Ignore Mr. Market

“ Both individuals and institutions are constantly urged to be active by those who profit from giving advice…Ignore the chatter, keep your costs minimal, and invest in stocks as you would in a farm”

“ If you can enjoy Saturdays and Sundays without looking at stock prices, give it a try on weekdays” (AR (2013))

Advice #2: We should be able to est 5-year earnings with some precision

“ We first have to decide whether we can sensibly estimate an earnings range for five years out, or more. If the answer is yes we will buy the stock (or business) if it sells at a reasonable price in relation to the bottom boundary of our estimate. If we lack the ability to estimate future earnings – which is usually the case – we simply move on to other prospects” (AR (2013))

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High growth does not ensure high returns

" Just because Charlie and I can see dramatic high growth for an industry does not mean we can judge what its return will be as a host of competitors battle for supremacy. **At Berkshire we stick with businesses whose profit pictures for decades to come seems reasonably predictable" AR(2010)**

Only invest in companies you understand

- Buffett never invests in tech simply because he does not understand it
- His advice: Work hard on studying annual reports, brand durability, etc.
- When you have done the hard work and feel convinced that this is a good investment you also feel that the investment is less risky
- You will then ignore Mr. Market

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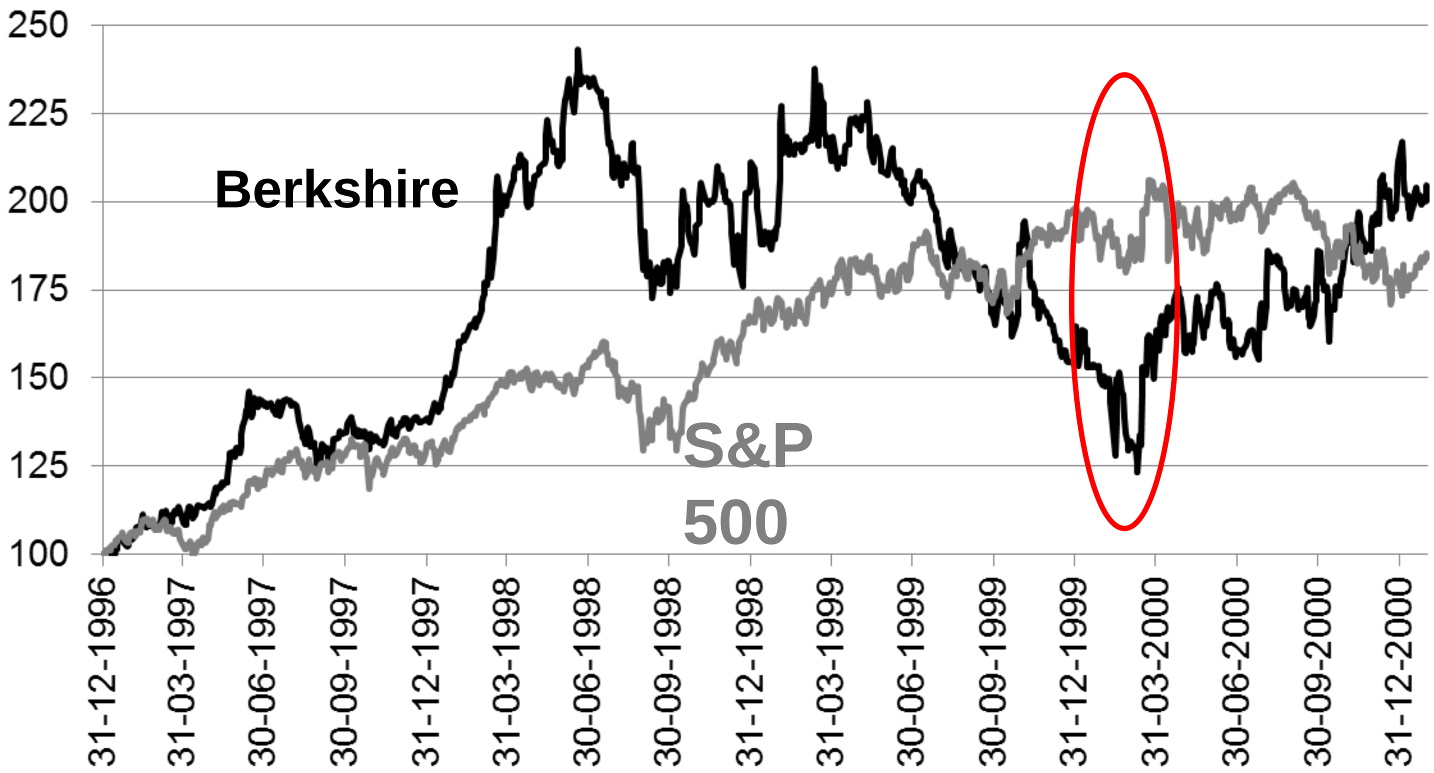
Buffett underperformed by more than 50% at the peak of the tech bubble



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Advice #3: “ Be greedy when others are fearful and fearful when others are greedy”

Buffett is putting his money where his mouth is:

- **In Sept 2008, at the peak of the financial crisis, Berkshire invested $15.5 bn**

Investments in September 2008

- $5 bn in Goldman Sachs (desperate for cash; preference shares with a yield at 10%)
- Symbolizing the victory of long-term value investing vis a vis short-term Wall St. speculation
- In sept 2008, also $6.5 bn into Wrigley

Advice #4: If you don’t have time to do the work let others do it for you

Invest in a low cost index fund

60/40: Combine an index fund with a bond fund

Invest in a good value fund

A fair critique of Buffett: He has not created new firms

- But he has managed to let the capital grow in a remarkable way
- That has helped healthy companies to expand

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Thank you for your attention!