

Notes from Buffett Meeting 2/15/2008

Note: Students from Emory's Goizueta Business School and McCombs School of Business at UT Austin were invited to come visit Mr. Buffett for a Q&A session. These notes were reproduced to the best of my ability as I heard and as I could recall them from a collection of mine and other students' notes. There is no guarantee that this was exactly what was said, but the intent was to preserve the spirit of the message. Enjoy.

Emory:

With the popularity of "Fortune's Formula" and the Kelly Criterion, there seems to be a lot of debate in the value community regarding diversification vs. concentration. I know where you side in that discussion, but was curious if you could tell us more about your process for position sizing or averaging down.

Buffett:

I have 2 views on diversification. If you are a professional and have confidence, then I would advocate lots of concentration. For everyone else, if it's not your game, participate in total diversification. The economy will do fine over time. Make sure you don't buy at the wrong price or the wrong time. That's what most people should do, buy a cheap index fund and slowly dollar cost average into it. If you try to be just a little bit smart, spending an hour a week investing, you're liable to be really dumb.

If it's your game, diversification doesn't make sense. It's crazy to put money into your 20th choice rather than your 1st choice. "Lebron James" analogy. If you have Lebron James on your team, don't take him out of the game just to make room for someone else. If you have a harem of 40 women, you never really get to know any of them well.

Charlie and I operated mostly with 5 positions. If I were running 50, 100, 200 million, I would have 80% in 5 positions, with 25% for the largest. In 1964 I found a position I was willing to go heavier into, up to 40%. I told investors they could pull their money out. None did. The position was American Express after the Salad Oil Scandal. In 1951 I put the bulk of my net worth into GEICO. Later in 1998, LTCM was in trouble. With the spread between the on-the-run versus off-the-run 30 year Treasury bonds, I would have been willing to put 75% of my portfolio

into it. There were various times I would have gone up to 75%, even in the past few years. If it's your game and you really know your business, you can load up.

Over the past 50-60 years, Charlie and I have never permanently lost more than 2% of our personal worth on a position. We've suffered quotational loss, 50% movements. That's why you should never borrow money. We don't want to get into situations where anyone can pull the rug out from under our feet.

In stocks, it's the only place where when things go on sale, people get unhappy. If I like a business, then it makes sense to buy more at 20 than at 30. If McDonalds reduces the price of hamburgers, I think it's great.

Austin:

What industry will be the next growth driver in the 21st century and what do you see that supports that?

Buffett:

We don't worry too much about that. If you'd look at the 1930s, nobody could have predicted how much the automobile and airplane would transform the world. There were 2000 car companies, but now only 3 left in the US and they are hanging on barely. It was tremendous for society, but horrible for investors. Investors would have had to not only identify the right companies, but also identify the right time. The net wealth creation in airlines since Orville Wright has been next to zero. If a capitalist had been at Kitty Hawk and shot him down, would have done us a huge favor. Or look at TV manufacturers. There are hundreds of millions of TV's, RCA & GE used to produce them, but now there are no American manufacturers left.

If you want a great business, take Coca-Cola. The product is unchanged, they sell 1.5 billion 8 ounce servings per day 122 years later. They have a moat; if you have a castle, someone's going to come after you.

Gillette accounts for 70% of razor sales at 80% gross margins and it is the same over time. Men don't change much. Shaving might be the only creative thing they do, like painting the Sistine Chapel.

Snickers has been the #1 candy bar for the past 40 years. If you gave me \$1 billion to knock off Snickers, I can't do it. That's the test of a good business. You don't knock off Coke or

Gillette. Richard Branson is a marketing genius. He came in with Virgin Cola, we're not sure what the name means, perhaps it turns you back into one, but he couldn't knock off Coke. We look for wide moats around great economic castles. Growth is good too, but we prefer strong economics. In the upcoming annual report I have a section titled "The Great, the Good, and the Gruesome" where I talk about these.

Emory:

How do you define happiness and what about your life makes you most happy? When you make good on an investment, do you allow yourself to enjoy that success by getting excited - and on the flip-side, when an investment turns down, do you find yourself equally disappointed - or do you try to remove emotion from your work, as much as possible?

Buffett:

I enjoy what I do, I tap dance to work every day. I work with people I love, doing what I love. The only thing I would pay to get rid of is firing people. I spend my time thinking about the future, not the past. The future is exciting. As Bertrand Russell says, "Success is getting what you want, happiness is wanting what you get." I won the ovarian lottery the day I was born and so did all of you. We're all successful, intelligent, educated. To focus on what you don't have is a terrible mistake. With the gifts all of us have, if you are unhappy, it's your own fault.

I know a woman in her 80's, a Polish Jew woman forced into a concentration camp with her family but not all of them came out. She says, "I am slow to make friends because when I look at people, I have one question in mind; would they hide me?" If you get to be my age, or younger for that matter, and have a lot of people that would hide you, then you can feel pretty good about how you've lived your life. I know people on the Forbes 400 list whose children would not hide them. "He's in the attic, he's in the attic." Some of them keep compensating by joining board seats or getting honorary degrees, but it doesn't change the fact that no one will give a damn when they are gone. The most powerful force in the world is unconditional love. To horde it is a terrible mistake in life. The more you try to give it away, the more you get it back. At an individual level, it's important to make sure that for the people that count to you, you count to them.

What if you could buy 10% of one of your classmates and their future earnings? You wouldn't buy the ones with the highest IQ, the best grades, etc, but the most effective. You like people

who are generous, go out of their way, straight shooters. Now imagine that you could short 10% of one of your classmates. This part is usually more fun as you start looking around the room. You wouldn't choose the ones with the poorest grades. Look for people nobody wants to be around, that are obnoxious or like to take all the credit. If you have a 500 HP engine and only get 50 HP out of it, you'll be beat by someone else that has a 300 HP engine but gets 250 HP output. The difference between potential and output comes from human qualities. You can make a list of the qualities you admire and those you despise. To turn the tables, think if this is the way I react to the qualities on the list, which is the way the world will react to me. You can learn to turn on those qualities you want and turn off those qualities you wish to avoid. The chains of habit are too light to be felt until they are too heavy to be broken. You can't change at 60; the time to look at that list is now.

Austin:

Why do you think that despite making your methods publicly available, that relatively few people have been able to emulate your success?

Buffett:

I asked Graham the same question. Everyone took his class at Columbia Business School. He used current examples, and by the end of the semester you would have a portfolio that would've made you money. Graham lived a life of sharing. He may have had more money hoarding, but lived happier because of it. The money's just a figure in the paper, perhaps he would've died with 86 million instead of 42 million, but it doesn't really matter. 90% of the people that took his class ended up doing something else.

At age 11 I started investing, purchasing three shares of Cities Service Preferred. I had read every book on investing in the Omaha library. I was really into charting and technical analysis. I loved it, but didn't make any money from it. At 19 I read Graham's "The Intelligent Investor" and it changed my world. Did Ben lose because I read his book? Maybe we competed and he made less money, but it didn't matter to Graham.

The philosophy either takes immediately or it doesn't at all. The reason gets down to temperament. People want to make money fast, but it doesn't happen that way. Graham's philosophy doesn't promise enough for many people. You don't know when it will happen, but you just wait for the fat pitches within your circle of competence. It's not as exciting as guessing

whether the stock price will go up the next day. Most investors in internet companies didn't know the market cap. They were buying because they thought the stock would move, but if you asked them to write "I would buy XYZ company for \$6 billion because", they wouldn't get halfway through the sentence. It's the classic tortoise versus hare, bound to work over time. Charlie and I have educated competitors. Most don't compete with us, though. It's fine, we have more than enough money.

Emory:

What qualities in managers set them apart as great leaders, in essence, where do you find the right balance between "hard" and "soft" skills?

Buffett:

We have 45 managers. Some of them we communicate with once a year, some once a month, some everyday. I usually have dinner with the Blumkins every month, and we go on vacation, because we're friends. What we look for in managers is a passion for the business. They usually come to us. I've never bought from a financial seller. We can't run the business so I am counting on them to behave well; we have very little in the form of contracts. The business needs to continue just the same after I hand them the check as before. My big question is whether he will still get up at 6 AM just the same with \$500 million, and continue to send money to Omaha. I have to look them in the eye and decide whether they love the business or they love the money. It's fine if they love the money, but they have to love the business more. Why do I come in at 7 every morning, can't wait to get to work. It's because I get to paint my own painting and I like applause.

We bought a jeweler, Ben Bridge. It was a 4th generation company, with over 100 stores. They were only interested in selling to us. The family didn't want to sell to others, the employees didn't want it. I never met him. He didn't want to sell either, but the family needed it.

At Borsheims we have a woman from Zimbabwe. She didn't even have the benefit of an MBA. We didn't look at a resume, or grades, or HR recommendations, but were looking for passion and we'll pay fairly because we don't want the resent that comes with unfairness. We want people that will work regardless.

I got a fax from Pete at Forest River saying this is the type of business you would like to own. He didn't want to worry about if he died tomorrow, and left his wife and daughter behind. After we made the deal, we had dinner and I brought up the topic of salary. I told him to name whatever number he wanted and I would sign the check. He asked me what I made. I told him \$100,000 and he said he didn't want to make more than me, so we settled on \$100,000. Pete called yesterday, and said he wanted to make an offer for another business. We talked for five minutes, I gave him some advice, but I really give them a lot of freedom. I've spent \$1.7 billion and I've never even been to the company, at least I hope it's there.

I can't look at this group and tell you which 3 are going to be great managers. I can see it after they've been doing it for a while. Look at Mrs. B. She had one son involved in the business and 3 daughters not involved. She wanted a way to fairly distribute the proceeds of the business and this solved her problem. She worked until she was 103, and died at 104. She lived two blocks from the store. She left price tags on the furniture at her home because it made her feel more comfortable, like she was in the store. She left Russia and landed in Fort Dodge, Iowa. She saved \$500 for 16 years to start this business that has the top 2 furniture stores in the nation. You can't hire those kinds of people, no matter what you pay them. We've been lucky that we've never lost a manager to competitors since 1965. Some retire, some were fired, but we give them the opportunity to paint their own canvas.

Austin:

If you could have lunch with one person you have never met, who would it be and why?

Buffett:

I would have to say Isaac Newton or Benjamin Franklin. I've met a lot of interesting people and some uninteresting ones, too. The two men had a bigger grasp of the world they lived in. But I don't think I would pass up an opportunity with Sophia Loren.

Emory:

Mr. Buffett, do you believe that the Federal Reserve is fostering moral hazard thereby leading to the misallocation of capital and subsequent asset bubbles? If so, what are the long term risks?

Buffett:

There is always some introduction of moral hazard when government decides to act in favor of the common good versus letting someone fail. There was moral hazard with the bailout of LTCM and there is some aspect of that with the current situation. But it's hard to measure because the consequences are 15-20 years out. During the 1987 market crash, Greenspan was new to the job and unsure of what would happen. The specialist system got hit, most of them operated on very little capital and were broke. The Fed provided them with more capital. Will that change future behavior? Maybe, but at the time it was the right call. It's also resulted in the "Too Big to Fail" doctrine. The big banks, Freddie Mac, and Fannie Mae figured the US Government wouldn't allow them to fail and the managements of those companies knew that. I would be disinclined to second guess the Fed, they have more information and are trying to do what's right.

Austin:

Given your business success, your immense fortune, and your celebrity status, how do you stay so down to earth and humble? Are there specific people or lessons you have learned throughout your life that enable you to maintain this outlook?

Buffett:

I was lucky to have the right heroes. Tell me who your heroes are and I'll tell you how you'll turn out to be. One of your most important jobs in life will be raising your children. They will learn more from you than they will in graduate school. My father was a huge influence, and later on Graham came along. I was also never let down by my heroes.

I had nothing to do with my own success. My father was a securities broker and after the Great Crash, he had no one to call. Consequently, I was born in 1930 in the United States during the time of one of the greatest capital markets. I was born with the wiring for capital asset allocation. I had the right wiring at the right time. Temperament is a large part of my wiring. I was naturally good at it, and I used some feedback to develop it better. There is nothing to be arrogant about. Gates says if I had been born earlier, I would've been some animal's lunch. I can't run, I can't climb. I'd be talking about allocating capital and the animal would think,

“Those are the kind that taste the best.” You have all won the ovarian lottery. There is no reason to feel guilty about it.

I have never given away a dime that has any meaning on how I live. There are people that go to church and they put money in the offering plate that truly makes a difference in how they will live their lives, what they will eat, what presents they will buy for their children. There’s no reason to get puffed up over things you didn’t control.

Emory:

Due to the credit crisis and consequently large write-downs, banks have made it more difficult to lend healthy businesses capital for increasing efficiency, expansion, new projects, etc., thereby potentially becoming the primary agents restricting growth. What are your thoughts on liquidity in the marketplace and the possibility of it contributing to a recession? Also, do you see a potential for financial institutions not currently in the lending business stepping in to take advantage of the reduced supply of capital?

Buffett:

What we are seeing is a huge repricing and evaluation of risk, correcting for problems of the past. I don’t know of good credit propositions that are going unfulfilled. There’s lots of cheap credit for sensible deals, which I don’t define as anything that happened over the last 12, 18 months. A lot of things that didn’t make sense are being washed out of the system. It is painful for bad decisions. Comparatively, this is not a credit crunch. In 1982 the prime rate was 22% and money was very expensive. In the late 60’s, we made a sound deal there wasn’t any money to be had. That’s not the case now. The Fed has opened the window, and rates are down. It doesn’t mean there won’t be a major recession.

Austin:

What are some of your biggest mistakes or regrets?

Buffett:

We’ve made lots of mistakes, but they don’t bother me. We’ve had no regrets. We are in the business of making many decisions and there are bound to be mistakes. There are \$10 billion mistakes of omission that no one knows about; they don’t show up in the accounting. In 1994 we

paid \$400 worth of Berkshire stock for a shoe company. The company is now worth 0, but the stock is worth \$3.5 billion. So now, I'm happy to see Berkshire go down since it reduces the size of my mistake. In 1973 Tom Murphy offered us NBC for \$35 million, but we turned it down. That was a huge mistake of omission.

In my personal life, there are always things I could've done differently. But so many good things have happened. It just doesn't pay to dwell on the bad things. Finding the right spouse is 90% of it. If you are lucky on health and lucky on your spouse, you are a long way home. Getting turned down by HBS was one of the best things that could have happened to me, bad luck can turn out to be good.

Emory:

Could you comment on the current rise of sovereign wealth funds from the Middle East and Asia and how they are playing an increasing role in how corporations raise capital. Is competition from these sources for the cash flows of corporations affecting your investment strategies or opportunities?

Buffett:

Any competition is competition. The situation of sovereign wealth funds is interesting. A lot of it is China bashing, OPEC bashing and plays right into politician's hands. Today, the US will buy \$2 billion more from the world than they buy from us. In exchange we give them little pieces of paper and they have to buy assets. As long as we consume more than we produce we have to let the rest of the world invest in us. We created sovereign wealth funds and that \$2 billion gains interest. US funds feel they can get the best terms from these foreign investors and lately, enticed them into buying equity. China wanted to buy Unocal, a 3rd rate oil producer with production overseas in places like India. US Congress went ape and 395 representatives signed an anti-Chinese resolution to block the deal. For 100 years the US companies went around buying the world's assets and bribing officials, but told China they couldn't buy Unocal. The Chinese took it, but they didn't like it. It doesn't make sense that we are buying foreign assets, and giving them pieces of paper and then telling them what they can't do with that money. We have created them and I have no objection to them. I recommend an index fund for these sovereign wealth funds. It gives them exposure to the US market, but they won't get taken by salespeople with bad deals. In economics you always want to say "And then what?"

Austin:

Is the individual investor even capable of assessing the riskiness of securities given the large number of institutions/hedge funds in the market?

Buffett:

I don't think there is much being overlooked now, but I'm forced to look at big things. That's the advantage you have over me. A few years ago a friend of mine mentioned that I should look at Korea. We bought Posco for 3-4 times post-tax earnings. I found 20 other companies selling at 2-3 times earnings and strong balance sheets. I diversified because I didn't know the Korean market as well. We are looking for the very unusual. Occasionally things will happen in a securities market that are extraordinary. I like shooting fish in a barrel, but I like to make sure the water's drained out.

We had that situation a few years ago with the 30 year versus 29 ½ year Treasury bonds. Because of less liquidity, the off-the-run bonds were selling for 30 basis points less, which translates into 3% of principal value. LTCM entered the trade at 10 basis points originally, but they overleveraged and were forced to unwind the position. If you went long/short you could make money really quickly.

Markets are efficient most of the time about most things. But for these opportunities, nobody will tell you about them. They won't be on CNBC and they won't be in brokerage reports. You have to go find them yourself. In 1951, after I graduated from school, I used Moody's and S&P manuals as my sources of information. I went through them page by page. I was like a basketball coach looking for 7-footers. I still have to find out if he's coordinated, and can stay in school. But if someone comes up to me that's 5'6" and says, "Wait 'til you see me handle the ball", I say "No thanks". On page 1443 of Moody's, I found Western Insurance Securities. It had earned \$21.66 per share 2 years ago, and earned \$29.09 last year. Over the past year the stock was selling for between \$3 and \$13 per share. I still had to do the work to make sure the earnings were valid. The markets will get it right eventually. But they are there. You don't have to find too many. Finding 10 of these opportunities in your lifetime will make you so rich. But you can't be wrong. You can't have any zeroes. A list of big numbers multiplied by zero will equal zero. You can't go back to "Go".

Emory:

What do you think of aggregate infrastructure investment to stimulate the economy?

Buffett:

I think the best way to stimulate the economy is to give money to the poor. They will spend it. Don't give it to guys like me. Infrastructure investment makes sense, but we haven't done it in a while and it won't do anything for the next 6-12 months. Infrastructure is not big relative to GDP. We are a consumer-driven society, spending 106% of production.

Austin:

Who do you think will be one of the next greatest investors and are you partial to favoring someone with a similar investment style as yours?

Buffett:

We just finished looking for someone. The Board has 3 candidates to replace me as CEO and 4 candidates to replace me as investor. They are all doing fine where they are, but they would be willing to come over to Berkshire for less pay.

In 1969, I wound up my partnership and I had to help people find someone to manage their money. I recommended Bill Ruane of Sequoia Fund, Sandy Gottesman, who is currently on the board at Berkshire, and Walter Schloss, who I wrote about in "The Superinvestors of Graham and Dodds-ville". There's no way they could miss.

But I don't know many of the newer investors, they're not my contemporaries. It's not enough to just look at track records. They aren't predictive and there will always be a few people that do well. I know guys who can make 50% a year with \$5 million, but not with \$1 billion. The problem with guys that do well is they attract so much money that it neutralizes their advantage. It's hard to identify them, and even harder to make a deal to keep them from attracting other capital. It's like betting on a 12 year old horse that won at 3 years old. It's also important to avoid managers who use leverage. It's the reason that investors with 160 IQs flame out.

Emory:

At the Wesco annual meeting last year, Charlie said, "The best way to get success is to deserve success". Do you recall anything from your experience which best demonstrates how you were able to position yourself to deserve success, and do you have any advice for students on how they can position themselves to deserve success as well?

Buffett:

Behaving decent is a large part of it. Out of school I offered to work for Graham for free and he said I was overpriced. I tried to be useful and visible to him. I gave him stock tips and kept up with him. Almost always good things come from good behavior. Don't keep score in life. Tom Murphy does not keep score. He keeps doing 20 things for me and I can only hope to return the favor. Keeping score is terrible in marriage and terrible in business. I put myself in the seller's shoes. With most humans there is a great desire to reciprocate. If you do something for them, they will do 2X for you. How rare is it to work during lunch hours and be the first one there in the morning. You'll get noticed if you do something extra. It's good to have a willingness to pitch in when you aren't going to get credit for it. Charlie and I partnered up in 1959. We always both think we're right. We disagree but we've never fought. And we've never held past mistakes over each other's heads. I recommend reading "Poor Charlie's Almanack". It's amazing, has sold 50,000 copies and it's still sold independently.

Austin:

Have there been instances in your career where you have been tempted to deviate from your strategy and if so, how did you handle that?

Buffett:

I'm not that type. I'm not disciplined. I just naturally want to do things that make sense. In my personal life too, I don't care what other rich people are doing. I don't want a 405 foot boat just because someone else has a 400 foot boat. Some of my friends have big boats where 55 people are serving 14. Of those 55, some will be stealing from you, some will be sleeping with each other, and I just don't want to deal with that. My friends have the boats, so I'm the ultimate freeloader. I don't need multiple houses. If I wanted to do something wild & crazy I could do it, but Anna Nicole Smith is gone. Reminds me of the story of the 60 year old man that got a 25 year old to marry him. When his friends asked how he did it, he replied, "I told her I was 90."

Emory:

It seems that the worldwide trend is towards lower corporate tax rates. Do you think that the US risks becoming less competitive if it maintains its current corporate tax rate?

Buffett:

Relative to GDP, government taxation is 18.5% and spending is 20%, so we borrow the balance. The national debt should not be a scary topic and the fact that it's gone up is fine as long as it's proportional to GDP. Where do we get that 18.5%? There's 2.7 trillion in government revenues. 2.2 trillion comes from individuals, and less than 1% of that comes from the estate tax. 1.1 trillion comes from income taxes, with payroll taxes consisting of 900 billion, but it's capped at the first \$100,000 of salary. We want a tax system that encourages greater prosperity, but it needs to take care of the family.

We did an informal office survey by looking at the total tax footprint versus the total income. I earned 46 million and paid a tax rate of 17.5%. My rate was the lowest, the average was 33%, and my cleaning lady paid 40%. The system is tilted towards the rich. The Forbes 400 total net worth has gone from 220 billion to 1.54 trillion, an increase of 7-to-1. You see in legislature that there is lobbying carried on by the powerful over issues such as the estate tax and carried interest for private equity investments. We need to flatten income and payroll taxes, and those making under \$30,000 shouldn't be bothered.

Let's imagine that 24 hours before you are born, a genie comes to you and tells you devise a social and economic system. The only catch is that after you designed the system, you would choose a paper from a barrel which would determine your demographics. What objectives would you want? You need to devise a system that creates prosperity. It needs to be a meritocracy, to put the right people in the right place. It needs to have a strong education system, and throw off lots of goods and services. It also needs to not discriminate against women or minorities. Even though the per capita GDP is \$47,000, 20% of the population makes less than \$20,000. We need to eliminate that fear of sickness or old age. A tax code is the codification of a country's values. But you can't kill the golden goose of prosperity.

Austin:

There is always mention that some of your success could be attributed to not buying in to the Wall Street mania b/c you are in Omaha—what importance do you give to balance as it pertains to work and life and what do you do to maintain your appropriate balance?

Buffett:

I have so much fun that it's not work. I get to do what I want, where I want – on a boat, wherever. My wife was responsible for bringing up the children. Neither of us had problems with that arrangement, and it made sense from an Adam Smith “division of labor” perspective. It will be a much tougher choice for women, and always be somewhat unequal. In my own life I did virtually no social functions or meetings that I didn't want to do. In my adult business life I have never had to make a choice of trading between professional and personal. I have simple pleasures. I play bridge online for 12 hours a week. Bill and I play, he's “chalengr” and I'm “tbone”.

After a talk at Harvard, I told them to work for who they admired the most, so they all become self-employed. It's important to go to work for someone or some organization you admire. I've not seen many males having to make tough choices. But women are the ones who have tough situations.