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## Highlights From Buffett's Letter

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*Wall Street tunes in to Buffett's musings not only for business details and investing strategy, but for his plainspoken demeanor. Here are some highlights on hedge funds, acquisitions, succession and more.*

### On two measures of growth:

In this ambition, we hope – metaphorically – to avoid the fate of the elderly couple who had been romantically challenged for some time. As they finished dinner on their 50th anniversary, however, the wife -- stimulated by soft music, wine and candlelight -- felt a long-absent tickle and demurely suggested to her husband that they go upstairs and make love. He agonized for a moment and then replied, "I can do one or the other, but not both."

• [Berkshire's Earnings Surge 54%<sup>1</sup>](#)

### On acquisitions:

Over the years, our current businesses, in aggregate, should deliver modest growth in operating earnings. But they will not in themselves produce truly satisfactory gains. We will need major acquisitions to get that job done. In this quest, 2005 was encouraging. We agreed to five purchases: two that were completed last year, one that closed after yearend and two others that we expect to close soon. None of the deals involve the issuance of Berkshire shares.

### On acquiring strategy:


Unlike many business buyers, Berkshire has no "exit strategy." We buy to keep. We do, though, have an entrance strategy, looking for businesses in this country or abroad that meet our six criteria and are available at a price that will produce a reasonable return. If you have a business that fits, give me a call. Like a hopeful teenage girl, I'll be waiting by the phone.

### On climate change and hurricanes:

It's an open question whether atmospheric, oceanic or other causal factors have dramatically changed the frequency or intensity of hurricanes. Recent experience is worrisome. ... What we do know is that our ignorance means we must follow the course prescribed by Pascal in his famous wager about the existence of God. As you may recall, he concluded that since he didn't know the answer, his personal gain/loss ratio dictated an affirmative conclusion.

### On medical insurance losses:

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One thing, though, we have learned -- the hard way -- after many years in the business: Surprises in insurance are far from symmetrical. You are lucky if you get one that is pleasant for every ten that go the other way. Too often, however, insurers react to looming loss problems with optimism. They behave like the fellow in a switchblade fight who, after his opponent has taken a mighty swipe at his throat, exclaimed, "You never touched me." His adversary's reply: "Just wait until you try to shake your head."

**On lessons learned from derivatives:**

Long ago, Mark Twain said: "A man who tries to carry a cat home by its tail will learn a lesson that can be learned in no other way." If Twain were around now, he might try winding up a derivatives business. After a few days, he would opt for cats.

**On exiting the derivatives business:**

When we finally wind up Gen Re Securities, my feelings about its departure will be akin to those expressed in a country song, "My wife ran away with my best friend, and I sure miss him a lot."

**On selecting managers:**

The attitude of our managers vividly contrasts with that of the young man who married a tycoon's only child, a decidedly homely and dull lass. Relieved, the father called in his new son-in-law after the wedding and began to discuss the future:

"Son, you're the boy I always wanted and never had. Here's a stock certificate for 50% of the company. You're my equal partner from now on."

"Thanks, dad."

"Now, what would you like to run? How about sales?"

"I'm afraid I couldn't sell water to a man crawling in the Sahara."

"Well then, how about heading human relations?"

"I really don't care for people."

"No problem, we have lots of other spots in the business. What would you like to do?"

"Actually, nothing appeals to me. Why don't you just buy me out?"

**On executive compensation:**

Getting fired can produce a particularly bountiful payday for a CEO. Indeed, he can "earn" more in that single day, while cleaning out his desk, than an American worker earns in a lifetime of cleaning toilets. Forget the old maxim about nothing succeeding like success: Today, in the executive suite, the all-too-prevalent rule is that nothing succeeds like failure.

**On executive perks:**

In this manner, outlandish "goodies" are showered upon CEOs simply because of a corporate version of the argument we all used when children: "But, Mom, all the other kids have one." When comp committees follow this "logic," yesterday's most egregious excess becomes today's baseline.

### **On compensation committees:**

Comp committees should adopt the attitude of Hank Greenberg, the Detroit slugger and a boyhood hero of mine. Hank's son, Steve, at one time was a player's agent. Representing an outfielder in negotiations with a major league club, Steve sounded out his dad about the size of the signing bonus he should ask for. Hank, a true pay-for-performance guy, got straight to the point, "What did he hit last year?" When Steve answered ".246," Hank's comeback was immediate: "Ask for a uniform."

### **On his role on compensation committees:**

Let me pause for a brief confession: In criticizing comp committee behavior, I don't speak as a true insider. Though I have served as a director of twenty public companies, only one CEO has put me on his comp committee. Hmmmm ...

### **On the U.S. current account:**

The U.S., it should be emphasized, is extraordinarily rich and will get richer. As a result, the huge imbalances in its current account may continue for a long time without their having noticeable deleterious effects on the U.S. economy or on markets. I doubt, however, that the situation will forever remain benign. Either Americans address the problem soon in a way we select, or at some point the problem will likely address us in an unpleasant way of its own.

### **On trading too often:**

Long ago, Sir Isaac Newton gave us three laws of motion, which were the work of genius. But Sir Isaac's talents didn't extend to investing: He lost a bundle in the South Sea Bubble, explaining later, "I can calculate the movement of the stars, but not the madness of men." If he had not been traumatized by this loss, Sir Isaac might well have gone on to discover the Fourth Law of Motion: *For investors as a whole, returns decrease as motion increases.*

### **On hedge funds and other managers:**

The new arrivals offer a breathtakingly simple solution: *Pay more money.* Brimming with self-confidence, the hyper-Helpers assert that huge contingent payments -- in addition to stiff fixed fees -- are what each family member must fork over in order to *really* outmaneuver his relatives. The more observant members of the family see that some of the hyper-Helpers are really just manager-Helpers wearing new uniforms, bearing sewn-on sexy names like HEDGE FUND or PRIVATE EQUITY.

### **On succession:**

As owners, you are naturally concerned about whether I will insist on continuing as CEO after I begin to fade and, if so, how the board will handle that problem. You also want to know what happens if I should die tonight. That second question is easy to answer. Most of our many

businesses have strong market positions, significant momentum, and terrific managers. The special Berkshire culture is deeply ingrained throughout our subsidiaries, and these operations won't miss a beat when I die. ... The other question that must be addressed is whether the Board will be prepared to make a change if that need should arise not from my death but rather from my decay, particularly if this decay is accompanied by my delusionally thinking that I am reaching new peaks of managerial brilliance. That problem would not be unique to me.

**His thoughts on the matter:**

When that time comes for me, our board will have to step up to the job. ... And while we are on the subject, I feel terrific.

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