1999 Wesco Shareholder Meeting, Pasadena CA 1999

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FREE INVESTMENT SEMINAR

The last time I visited Pasadena in 1977, Michigan lost the Rose Bowl to USC. My team got a football lesson then and when I returned last week a lucky few got a world class investment lesson.

The Wesco annual meeting in Pasadena, California is more of a free investment seminar held in a classroom for 200 students. The Omaha meeting is more of a spectacle of financial advice staged in an arena of 15,000 participants. In the future plan to attend both but my preference is Pasadena. In Omaha you meet fellow shareholders in an arena. In Pasadena you learn in a classroom (University Club).

Charlie Munger was a different advisor. Never once did he say, "I have nothing further to add." He spoke like a college professor with candor and experience. With such a small audience it was easy to ask questions. Some even had the opportunity to ask more than once. It's an open meeting. No ticket required.

Lou Simpson was in attendance (his first) and answered some GEICO questions. The tables were turned and Mr. Munger asked Alice Schroeder from PaineWebber some questions.

The entire meeting lasted 3 hours and I was able to take as many notes as the Omaha meeting. The most significant thing that I learned was a better comprehension of technology and the Internet. And an unexpected surprise tour the next day.

When you turn off the noise coming at you from all angles in the investment world, you need to know when to turn your senses back on. In Pasadena you could open your eyes and ears and listen to every question and remember every answer.

Here's a summary of my notes and observations.

1. GOOD IDEAS CAN HURT YOU. For as much as Mr. Munger and Mr. Buffett claim to not consider technology in their circle of competence, I learned a new way of looking at tech. When you come across a bad idea you and everyone else know it's bad, so it can't hurt you. On the other hand when you come across a good idea it's easy to over do it. Mr. Munger liken the Internet to railroads, refrigeration, radio, television and air conditioning. Great technological advances for mankind but not necessarily great investments. Ben Graham said it's not the bad ideas that do you in. It's the good ideas that get you. You can't ignore it and it's easy to over do it. Mr. Munger stressed that technology has opportunities but it's potentially way over done.

2. THERE'S ALWAYS SOMETHING THAT PEOPLE GO CRAZY OVER. In the 1920's it was the over-leveraged stock market and the Florida land speculation. In the 60's it was junk stocks, overvaluations and efficient market theorists. EMT reached insanity levels. Buffett closed his partnership in the 60's because of too much speculation. Which led to junk bonds of the 80's. Today it's the Internet stocks. Mr. Munger's prediction: immense losses will be realized with Internet investments. This is a major reason to have experienced money managers making decisions for you.

3. LESSONS FROM JAPAN. Looked what happened to Japan. A clannish people, smart, hard working and prosperous society. They were led into excessive land speculation, bank fictional accounting, and stock market excesses. The so called 'wealth effect' became a narcotic that eventually crashed. Mr. Munger told the story of Bank of America selling their modest Tokyo executive house for $55 million cash during the height of Japans over-exuberance. Japan attempted to fix their economy with classic Keyesian economic theory; interest rates to zero and high debt but still suffers from a long lasting depression.

4. TELEVISION COMPARED TO THE INTERNET. Mr. Munger considers the invention of the television more impactful than the Internet. Instant color pictures brought into the home could be captured by a few broadcasting networks, which led to good investment returns. Any single provider will soon wire the Internet into the home with unlimited bandwidth but no monopoly.

5. HOT STOCK TIPS VERSUS INVESTMENT LESSONS. One former stockbroker in attendance walked away from the annual meeting (free investment seminar) with a hot stock tip. Lou Simpson and Mr. Munger talked about Mercury Insurance and their respect for the fellow running it. Some took that as a stock tip. I interpreted it as something that I didn't understand and was glad to have experts in charge of making investment decisions for me. If Charlie or Lou thought Mercury was a great investment I am confident they would buy it on my behalf. We're partners in business not competitors.

6. CONCENTRATED PORTFOLIO. Mr. Munger, Mr. Simpson and Mr. Buffett's investments all have one thing in common. They believe in concentrating their portfolios. If you are confident enough to select 3 to 10 common stocks for the long term you too can compete against this distinguished group. If you need to diversify out of ignorance its best to own a low cost and tax efficient index fund. Mr. Munger took a poll of the audience and 90 percent owned fewer than 12 common stocks. Berkshire has 60 percent of its common stock holdings in 3 stocks. Wesco has 95 percent of its common stock holdings in just 3 stocks.

7. DON'T BELIEVE THE BERKSHIRE RUMORS. Mr. Munger said that Berkshire Hathaway is not buying REITS but Mr. Buffett was personally buying some. REITs are more suitable for personal investment because of the dividends. Munger teased Buffett saying that buying REITs was resorting to cigar butt investing and a need to support the lifestyle of his globetrotting wife.

8. GEN RE. Very happy with the way things are going with General Re. Cologne Re charge against earnings was a surprise and not an intentional deception by management.

9. STOCK OPTIONS. Berkshire handles executive compensation the honest way by declaring it as an expense on the earnings statement. When Berkshire acquired Gen Re it declared upfront $63 million of compensation expenses to inform shareholders as to the true costs against earnings. Mr. Munger considers himself the sole voice against a widely used practice of deceiving the shareholders with stock options. The typical stock option program is corrupt accounting and is like a Ponzi scheme. An investment farce where high profits are promised from fictitious sources and early investors are paid off with funds raised from later ones. The average stock option program bleeds 12 –14 percent of profits from shareholders. Mr. Munger thinks the accounting profession bends too much and should have higher standards like the engineering profession. Better standards are needed.

10. YEAR-END CASH. Berkshire loves companies that have earnings at the end of the year in cash. Mr. Munger compared this desire with a friend who had a construction equipment firm that had all his annual earnings in accounts receivable and equipment in the yard at the end of the year.

11. FOUNDATION MANAGEMENT. One word for it – preposterous. Mr. Munger likens it to a mad hatter's tea party. Too many layers. Consultants hired to hire more consultants. No value added.

12. ANALYST COVERAGE. Welcomed Alice Schroeder of PaineWebber and took the opportunity to ask her some questions. She reassured shareholders that she wasn't given any special treatment. Information that Alice used in her writings is available to all owners in the annual reports. Berkshire releases all public information on the Internet after market hours for all interested parties so no one has inside information.

13. CASUALTY BUSINESS. It's going to get more competitive. Mr. Munger compared the casualty insurance business to rowing against a strong current but Berkshire has a very large well-equipped boat.

14. GEICO COMPETION. Mr. Munger called on Lou Simpson to explain GEICO's competition. He said in Southern California its 20th Century and Mercury. Elsewhere its Progressive and potentially AIG, and GE (Colonial Penn), State Farm, and Allstate. Business will be tougher in the next 5 years, but Mr. Munger likes what's happening at GEICO. It's the biggest advertiser on cable.

15. ERRORS OF OMISSION. Mr. Munger said they should have bought more Coke. Once you know it's a good idea you don't need to talk about it. Berkshire's success is measured by how successful they were buying Coke but should be measured by how much more successful they would have been if they bought more. No other management team would be so candid to talk about their errors of omission.

16. CONTRIBUTION TO SEE'S. Berkshire's contribution to See's Candies has been to leave it alone. Often Headquarters screws it up by thinking it knows best. Berkshire doesn't like to micro manage.

17. DIFFICULTY OF ACHIEVING 15% RETURNS IN THE FUTURE. Because of its size Berkshire will have a difficult time achieving market-beating returns in the future. But Mr. Munger said that if you understand the difficulty of something you have a better chance.

18. S&P INDEX ADDITION. Just a matter of time before Berkshire is added and figuring out how to add a stock that has little shareholder turnover.

19. INVESTMENT SUCCESS. To win at investing you need to know and understand many main models of the world e.g. Ponzi scheme. Find an investment manager who is concerned about disappointing you, the customer. Evaluating human beings is important in management and investing.

20. BUSINESS SCHOOLS SHOULD TEACH RETAILING FIRST. Mr. Munger thinks a business education should start first with retailing. When Charlie and Warren walk into a retail business, like a car dealership, they immediately begin to analyze it. Its how they're wired.

21. HOW TO MAKE YOUR LIFE BETTER. Mr. Munger believes in his latticework of models. And he believes that the best thing you can do to make your life better is to master life's models.

22. BUFFETT FOUNDATION. Mr. Munger said that the 5% annual payout required after both Mr. and Mrs. Buffett deaths will not affect the normal operations of Berkshire Hathaway and will be insignificant. No need to worry about future family influences of the Buffett's or Munger's.

23. GREAT STORIES. Mr. Munger told many great stories. A few about Wrigley Chewing Gum and an entertaining one about silver mining companies that made money on silver and by shareholder fraud. Another great story of an investment manager who recently made $100 million for himself by selling his firm but had not served his customers well.

All in all it was one of the best free investment seminars that I have ever attended. Honest. Straightforward. Unrehearsed. Unedited. Nothing to sell. Nothing to buy. Just a great way to size up management.

You can read the transcript but you won't be able to see and hear the tap dancing. This is a great mind available to us all. Next year by popular demand, Mr. Munger plans to expand the meeting.

A SIDE NOTE: Okay I have to admit that I did something after the Wesco Financial annual meeting that may rank higher than learning from one of the best minds in the investment business. In fact this may be the most fun of any business/manufacturing tour I have ever taken and hope to take again. I got a tour of See's Candy factory in Los Angeles.

Jesus Soria, production manager, said there were only a few rules on the chocolate factory tour. One, you can taste anything while inside the factory. Two, you can't take anything with you. Wow. Talk about a kid in a candy store. If you see a noticeable dip in next quarters See's candy profits you can attribute the loss to me.

Being the loyal shareholder I am, I taste tested just about everything. What a tour. And Jesus (a.k.a. Chewy) was able to answer just about every question; including competition, distribution, synergies with other subsidiaries, production before Berkshire, expansion plans, employee relations, spoilage, shrinkage, the manufacturing process, shelf life, and seasonal workloads.

An annual tour of this production facility is a must for any shareholder attending the Wesco annual meeting. An extraordinary investment (and life) seminar followed by a gastronomic delight.

Hope to see you next year.
Willy Wonka