

Charlie Munger Speaks

Notes from the Wesco Annual Meeting

By Whitney Tilson

May 15, 2000

As an admirer of Warren Buffett and a **Berkshire Hathaway** ([NYSE: BRK.A](#)) shareholder, I make a point of attending the company's annual meetings so I can learn from the answers to dozens of questions from his shareholders. Sharing the stage with him is Charlie Munger, Berkshire Hathaway's Vice Chairman and Buffett's long-time partner.

The dynamic is pretty funny to watch: Buffett generally takes the first stab at answering a question, but after giving his answer turns and says, "Charlie?" Munger, immobile and expressionless throughout the day (they could easily substitute a mannequin for quite a while and no-one would notice), typically replies, "I have nothing to add."

But as you can see from my notes from this year's meeting (summarized in my [previous column](#)), Munger often does have something to add, and it is invariably sharp and insightful. In many ways, he's more entertaining than Buffett because he doesn't pull any punches (I think his "mixing raisins and turds" line will go down in Berkshire history).

Over time, I have come to realize that Munger is a genius in his own right, and has had a profound effect on Buffett's thinking (which Buffett freely acknowledges). So who is this "cranky, old fashioned" man (to use his words)? I think many of the answers will be revealed in Janet Lowe's upcoming book, *Damn Right*, which she tells me will be available in October. But I wanted to find out for myself, so I recently attended **Wesco Financial's** ([AMEX: WSC](#)) annual meeting, where Munger, the company's long-time Chairman, took questions from shareholders for two hours. (Since 1973, Berkshire Hathaway has owned 80.1% of Wesco. I am a Wesco shareholder and plan to write a future column about the company and why I believe it's attractively priced.)

As I did in my last column, I will try to distill my notes down to the most important things I heard. Note that in some cases I am paraphrasing because I couldn't write quickly enough.

Opening Statement

"This only masquerades as a shareholder's meeting. It's really a gathering to hear the thoughts of the assistant headmaster of a cult."

Comments on Berkshire Hathaway and Wesco

Making the Right Personnel Decisions

"It's amazing how few times over the decades we've have to remove a person -- far less than other companies. It's not that we're soft or foolish, it's that we're wiser and luckier. Most people would look back and say their worst mistake was not firing someone soon enough. [We don't say that.] Our record is fabulous. We're old-fashioned. For example, in the case of CORT Business Services [a furniture rental business that Wesco acquired this year], Warren said to me, 'You're going to love Paul Arnold [CORT's CEO].' And he was right. Paul's been running the business since he was in law school and loves it."

Berkshire Hathaway's Culture

"There are certain virtues that are common in all of Berkshire's subsidiaries. We don't create them -- we select companies that have them already. We just don't screw it up."

Writing More Insurance

"Both Berkshire Hathaway and Wesco write amazingly low amounts of insurance relative to our surplus. It gives us investment flexibility. We just don't find enough insurance to write -- we'd do more if we could. Writing insurance equal to 10% of surplus for Berkshire Hathaway would be hog heaven -- we don't come close to that. Wesco didn't either, but we took on one big policy this year."

Lumpy Results

"That is one of our advantages as an insurer -- we don't give a damn about lumpy results. Everyone else is trying to please Wall Street. This is not a small advantage."

Risks to Berkshire Hathaway from Large Super Cat Losses

"We don't write big super cat contracts where there's no upper limit [cat means catastrophe; for example, insuring against a large earthquake in California]. It's inconceivable that we'd lose more than 6-7% of the company's assets after tax in one event. The real risk is borne by insurers who write, for example, basic homeowner's policies against a storm or earthquake and don't lay off some of that risk. That's roughly what happened to 20th Century, where they lost 100% of their capital in the Northridge (CA) Earthquake due to writing lots of little policies concentrated in an earthquake area."

Buffett's Successors

A shareholder noted that Berkshire Hathaway's succession plan calls for two people to replace Buffett: one to make the investments and one to oversee the operating companies. Lou Simpson of GEICO has been designated (at least unofficially) for the former position, so the shareholder asked, "Could you share with us who has been designated for the latter role?" Munger's succinct reply, "I could but I won't." [In the past, Buffett has defended his decision not to reveal this person because he might change his mind and wants to avoid the media circus that would invariably occur were this to happen.]

Why Not Use Wesco to Make Smaller Investments?

A shareholder noted that Buffett and Munger have long maintained that Berkshire Hathaway's size makes finding attractive investments difficult. Why then, he asked, don't they use Wesco to make smaller investments? Munger replied, "Lou Simpson will occasionally do smaller investments. But we're not set up to do small investments. Also, Warren and I are idiosyncratic and are unlikely to change our spots."

Berkshire Hathaway Repurchasing Shares

"In the past, when Berkshire has gotten cheap, we've found other even cheaper stocks to buy. I'd always prefer this. It's no fun to have the company so lacking in repute that we can make money for some shareholders by buying out others."

Why Don't More Companies and Investors Copy Berkshire Hathaway?

"It's a good question. Our approach has worked for us. Look at the fun we, our managers, and our shareholders are having. More people *should* copy us. It's not difficult, but it looks difficult because it's unconventional -- it isn't the way things are normally done. We have low overhead, don't have quarterly goals and budgets or a standard personnel system, and our investing is much more concentrated than average. It's simple and common sense.

"Our investment style has been given a name -- focus investing -- which implies 10 holdings, not 100 or 400. Focus investing is growing somewhat, but what's really growing is the unlimited use of consultants to advise on asset allocation, to analyze other consultants, etc.

"I was recently speaking with Jack McDonald, who teaches a course on investing rooted in our principles at Stanford Business School. He said it's lonely -- like he's the Maytag repairman.

"I was in the ROTC for six years and saw a very limited culture [in the military] with few new ideas. It's the same elsewhere"

Future Outlook for Berkshire Hathaway

"The future will be harder for Berkshire Hathaway for two reasons:

- 1) We're so big. It limits our investment options to more competitive areas that are examined by very smart people like Alice Schroeder [Paine Webber's insurance analyst, who was sitting in the audience].
- 2) The current climate offers prospects in common stocks over the next 15-20 years that are *way* less than we've experienced over the past 15-20 years. Read Warren's *Fortune* [article](#) -- I totally agree with it.

"But this is not a tragedy. We're content. Berkshire Hathaway and Wesco will accumulate cash every year, and we have a structure that gives us enormous flexibility. While we're too big to buy the stock of a small company, we have the advantage of having entire companies offered to us. Something has always turned up for us. I'm not discouraged, but I don't think your money here is going to do anything like what you're used to."

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Comments on Businesses

Coca Cola

"Over the next 20-30 years, Coke will be selling more soda and other drinks. They will also be able to raise prices moderately and increase margins. Therefore, if you own Coke, you'll do all right. [Regarding the stock's high valuation,] if you project growth long enough into the future, you can get high current valuations. So what you're seeing in Coke's stock price is the residual prediction that despite its recent stumbles, they'll be coloring a lot more water 20 years from now."

The Furniture Business

"Berkshire Hathaway now owns the leading furniture retailer in six states and, through CORT, has a substantial position in the rent-to-rent [as opposed to rent-to-own] furniture business. This all came about by accident. The furniture business is generally not a good one, but if you own the best companies, it's a fine business for us. It seems like CORT's business wouldn't be a good one, but it is."

MidAmerican Energy

"Who would have thought we'd buy an electric company in Iowa? But this is a perfectly decent investment. It also gives us a window into a field where a lot of crazy things are going on, which may give us other opportunities [see the discussion of the real options that MidAmerican has in my recent [column](#)]."

Net Jets' Expansion into Europe

"Europe is a bitch of a place to get into, with all its countries and rules. We are losing money and expect that this will continue for a while. But look at the situation faced by the 2nd mover: all the same troubles and we're already there. Coke has done this all over the world and look how it's paid off."

The Newspaper Business

"It is way less certain to be a wonderful business in the future. The threat is alternative mediums of information. Every newspaper is scrambling to parlay their existing advantage into dominance on the Internet. But it is way less sure [that this will occur] than the certainty 20 years ago that the basic business would grow steadily, so there's more downside risk. The perfectly fabulous economics of this business could become grievously impaired."

General Comments

Earnings Manipulation and Accounting Shenanigans

"With so much money riding on reported numbers, human nature is to manipulate them. And with so many doing it, you get Serpico effects, where everyone rationalizes that it's okay because everyone else is doing it. It is always thus.

"Now, it's chain letter mechanics. Because it's mixed with legitimate activities like venture capital, it looks respectable. But we're mixing respectable activity with disrespectable activity -- hence my comment at the Berkshire Hathaway annual meeting about if you mix raisins with turds, you've still got turds. There is nothing in accounting that can prevent unscrupulous managers from engaging in a chain-letter-type fraud.

"I hate with a passion GAAP [Generally Accepted Accounting Principles] as applied to derivatives and swaps. JP Morgan sold out to this type of accounting to front-end revenues. I think it's a disgrace."

Interest Rates

"Neither Warren nor I have any record of making large profits from interest rate bets. That being said, all intelligent citizens of this republic think a bit about this. In my lifetime, I've seen interest rates range from 1% to 20%. We try to operate so that really extreme interest rates in either direction wouldn't be too bad for us. When interest rates are in a middle range, as they are now, we're agnostic."

Japan's Recession

"Anyone has to be flabbergasted by Japan's recession, which has endured for 10 years, despite interest rates below 1%. The government is playing all the monetary games, but it's not working. If you had described this situation to Harvard economists, they would have said it's impossible. Yet at the same time, there's an asset bubble in Hong Kong. Why? Because Japan and China are two vastly different cultures. The Chinese are gamblers.

"This is a classic example of why, to be a successful investor, one must draw from many disciplines. Imagine an economist standing up at a meeting of economists and giving my explanation. It wouldn't be politically correct! But the tools of economics don't explain what's going on."

Advice to Other Investors

Opportunities for Small Investors

"If you have only a little capital and are young today, there are fewer opportunities than when I was young. Back then, we had just come out of a depression. Capitalism was a bad word. There had been abuses in the 1920s. A joke going around then was the guy who said, 'I bought stock for my old age and it worked -- in six months, I feel like an old man!'

"It's tougher for you, but that doesn't mean you won't do well -- it just may take more time. But what the heck, you may live longer."

Practice Evolution

"This is really important. For example, Hertz and Enterprise Rent-a-Car through practice

evolution have developed personnel systems, etc. that work for them. They are like different species in similar ecological niches.

"Common stock investors can make money by predicting the outcomes of practice evolution. You can't derive this by fundamental analysis -- you must think biologically.

"Another example is Tupperware, which developed what I believe to be a corrupt system of psychological manipulation. But the practice evolution worked and had legs. Tupperware parties sold billions of dollars of merchandise for decades.

"We wouldn't have bought CORT if we didn't like the culture, which resulted from long practice evolution."

Mental Models for Investing

"You must know the big ideas in the big disciplines, and use them routinely -- all of them, not just a few. Most people are trained in one model -- economics, for example -- and try to solve all problems in one way. You know the old saying: to the man with a hammer, the world looks like a nail. This is a dumb way of handling problems."

Be Satisfied with What You Have

"Here's one truth that perhaps your typical investment counselor would disagree with: if you're comfortably rich and someone else is getting richer faster than you by, for example, investing in risky stocks, *so what?! Someone will always be getting richer faster than you. This is not a tragedy.*

"Look at Stanley Druckenmiller [who ran one of George Soros' funds, which is essentially being shut down due to large losses in speculative tech and biotech stocks]: he always had to be the best and couldn't stand that others were beating him by investing in these sectors.

"A lot of success in life and business comes from knowing what you want to avoid: early death, a bad marriage, etc."

Recommended Books and Comments on Silicon Valley

Munger was asked to name his favorite books of all time. He replied, "That's hard because I mix ideas from so many books. One fabulous book is [The Selfish Gene](#), which provides basic insights on human conditions. [In the past, Munger has strongly recommended [Influence: The](#)

[Psychology of Persuasion](#), which I just read and liked enough to add it to [my list](#) of all-time favorite books related to investing.]

Later, Alice Schroeder, who covers the insurance industry for Paine Webber, asked if he'd read [The New New Thing](#), [Wall Street On Sale](#) or the new translation of [Beowulf](#). He had only read the former, and commented: "It was interesting enough for me to finish it. In some respects it describes an appalling culture. While Silicon Valley has made great contributions to society, some things come pretty close to 'the unacceptable face of capitalism.'"

EVA

Asked to elaborate on his comments at the Berkshire Hathaway meeting on Stern Stewart and their concept of Economic Value Added, Munger said:

"It's obvious that if a company generates high returns on capital and reinvests at high returns, it will do well. But this wouldn't sell books, so there's a lot of twaddle and fuzzy concepts that have been introduced that don't add much -- like cost of capital. It's accepted because some of it is right, but like psychoanalysis, I don't think it's an admirable system in its totality."

A number of people have asked whether I agree with Munger's dismissal of EVA. Sort of. I agree with his comment about the "twaddle," but fear that he may have deterred people from studying and understanding return on invested capital -- the single most important metric I consider when evaluating a company. Sure, Bennett Stewart's book, [The Quest for Value](#), is unbearably dense, but ROIC is *not* a difficult concept nor is it difficult to calculate. For an understandable (not to mention free) take on ROIC, I recommend the Fool's School, [A Look at ROIC](#), and Paul Johnson's [Introducing ROIC as an Economic Measure](#) (focus on pages 1-9 and 35-37). Johnson is one of the authors of [The Gorilla Game](#), my favorite book on tech investing.

-- Whitney Tilson