Notes from the 2003 Wesco Annual Meeting, 5/7/03

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Note: This is not a transcript. No recording devices were allowed at the meeting, so this is based on 2 1/2 hours of rapid typing, combined with my memory (egads!). Other than the opening statement, I have reorganized the content of the meeting by subject area. Words in [brackets] are my comments or edits.

For more on this meeting, see my 5/9/03 column, Charlie Munger's Worldly Wisdom. For my columns and notes on previous Berkshire and Wesco meetings, click here.

To learn more about Munger, I recommend the book Damn Right: Behind the Scenes with Berkshire Hathaway Billionaire Charlie Munger. I also recommend reading my column and transcript of Munger's speech, "24 Standard Causes of Human Misjudgment," which has powerful implications for investors.

OPENING COMMENTS

This group is the hard core cultists. Most have actually been to the Berkshire meeting [last Saturday], sat through hours and hours of questions, and now here they are again. Some are doing it with other people's money, but many are doing it with their own money. If you've traveled this far, you're hard core.

Why do people come? Partly, I'm sure out of respect for the long-term record of compounding money at high rates. But also there's the cast of mind that helped create the record. I'm very sympathetic to people who share our twists of mind. If you're Warren Buffett and Charlie Munger, you're lonely. The whole of academia, business and economics believe a lot of things we don't believe at all, and conversely don't believe a lot of things we do believe.

Critique of the Efficient Market Theory and Institutional Money Managers

They used to criticize us bitterly, but stopped doing that when criticized by their heirs[?]. There's a world in academia where markets are perfectly efficient, where nobody knows if one company is better than another at any time, where value is dictated based on price. Then, it can never make any sense for a company to buy back its own stock. But if you say, "I can point to you many situations in which a stock was selling for 1/5th of its value, so why shouldn't a company buy it back?", some purists still won't change their minds. A corollary of this says that you can never find a price that is rational to buy a stock that you know a lot about.

It makes it hard for Warren and I to go on every year. We don't really care actually. [Laughter] In what other profession do the leading practitioners differ so much from the leading theorists? [Laughter] Hopefully this is not true in surgery, engineering and so forth.

Institutional money managers hire consultants who hire other consultants. They put money in venture capital, little companies, big ones, growth, value, etc. One thing that's sure is that at the end of the year, you've spent a lot on the consultants and frictional costs. Berkshire and Wesco never have and never will [behave this way].

20 Punches
Warren said at the Berkshire meeting (or maybe it was to the press afterward?), that he often tells business school students that if he gave them a card that only had 20 punches for a lifetime, and each time they made an investment they would use up one punch, and that after 20 punches there would be no more, then on average, with those rules, you'll die a lot richer. But people can't grasp this; they don't know what to make of it. But I believe it's true -- you'll do better over a lifetime [following the 20-punch way of thinking], assuming you're a smart, disciplined person. This room is filled with people who followed that advice. But that is absolute apostasy in academia.

How many different things has Wesco done since Blue Chip Stamps? [A major acquisition that Wesco made under Munger and Buffett's leadership in the 1970s.] We've only bought two or three companies and made a few big stock purchases. We've probably made a significant decision every two years. But nobody manages money this way. For one thing, clients won't want to pay you. [Laughter]

But our theory is that getting a real chance to invest at rates way better than average is not all that easy. I'm not saying it's not moderately easy to beat the indices by half a percentage point every year, but the moment you seek higher returns, is a very rarified achievement. The only way we know how to do this is to make relatively few investments of size.

What you can know if that if you spread your capital over a large number of securities, this will lead to average returns. Why anyone would pay a lot of money to learn what is so obvious is beyond me. [Laughter] I'm serious, people get paid to teach this! [Laughter]

It's not so bad to have one's money scattered over three wonderful investments. Suppose you were a real estate investor with a 1/3 interest in the best apartment complex in town, the best mall, and the best [I missed what he said -- another type of real estate investment]. Would you feel like a poor, undiversified investor? No! But as soon as you get into stocks, people feel this way. Partly, people need to justify their fees.

Envy is a Really Stupid Sin
Then there's the chasing of the investment return rabbit. What if you had an investment that you were confident would return 12% per annum. A lot of you wouldn't like that -- especially if you've done better -- but many would say, "I don't care if someone else makes money faster." The idea of caring that someone is making money faster [than you are] is one of the deadly sins. Envy is a really stupid sin because it's the only one you could never possibly have any fun at. [Laughter] There's a lot of pain and no fun. Why would you want to get on that trolley? [Laughter]

Options and Circle of Competency
We have a theory that you go through life in an orderly way. It gives us extra options. There's an obvious doctrine in life that all individuals and companies have to make decisions based on opportunity costs -- that's how all people make decisions. If you're married, you can keep [your spouse] but you always have the option to say, "I can do better elsewhere." Now you don't say this… [Laughter]

Most people have options: what job to take, school to go to, and so forth. One should measure investment opportunities this way. The more attractive things are, the higher the bar is. Berkshire has raised the opportunity bar by looking at stocks, bonds, private companies, public companies, etc. We have more opportunities by operating in a wider range.

The danger is that you have more risk of operating outside of your circle of competency. I don't think we're ever gone outside our circle of competency. We find things across a fairly wide range that we think is within our circle of competency. If you can widen your range and broaden your circle of competency, then you'll be a better investor.

Focus Investing
I remember when Warren was buying American Express when the company was suffering from a scandal [the 1963 Salad Oil Scandal]. Warren said to me, "I can't find anything else that's nearly as attractive." So, he asked his partners [this was before Berkshire, when he was managing the Buffett Partnership] to change the partnership agreement [which, I assume, prevented him from putting too much of the partnership into one position] and put 40% of his capital into American Express. When was the last time you saw a mutual fund do this [I'm not sure if he meant investing so heavily in one stock, or changing the contract with investors to take advantage of an opportunity]? It happens, but it's rare. To me, it's the most ordinary common sense, but it's not the most conventional wisdom of the time.

I know value investors who [I missed this]. There's a graduate of Stanford Business School who can compound money at 25% per annum so why does he need to invest other people's money, and he's now a very rich man. Warren operated out of a sun porch [in his house] for years.

Unattractive Investment Environment
At Wesco, we're in a state of arrest. We have way more capital than we're using. We have some investments in bonds that went up $20 or $30 million [over the past year], but this is not fun, watching and waiting, for people who have an action bias. Too much action bias is dangerous [however], especially if you're already rich.

In terms of the general climate, I think it's pretty miserable for anyone who likes easy, sure money. Common stocks may be reasonably fairly valued, but they are not overwhelming bargains. Interest rates are really low. When you get five-year rates under 3%, it starts getting really unpleasant for people who are used to better results. But I don't think this is a tragedy. If things get really bad, like Japan, then things will be very unpleasant. Think of how you'd like to run a big university under those circumstances. I don't think that will happen here -- I think we're a better place in terms of investing.

But the world can throw you a lot of surprises. Who would have predicted the World Trade Center, interest rates where they are, life insurers in Japan insolvent because they agreed to pay 3% interest per annum.

A New Way to Measure Returns
Think of professional money management. A typical fund might do well, the money comes in, and then there's a big collapse. If you took into account the negative results at the end, with the big money in the fund, the overall result would be negative. If I were running the world, I'd require all people running mutual funds and investment funds to report results in two ways: the

current way and per dollar year. The big funds would really look terrible because they took in really a lot of money and then collapsed. If you took venture capital, which did well with a small amount of capital, and then took in a huge amount of capital [and lost most of it], they'd have trouble shaving in the morning.

[To understand what Munger is talking about, consider a fund with $100 that has a spectacular year and doubles to $200, a 100% return. Money of course pours in (let's say $800), chasing this performance, such that the fund grows from $200 to $1,000. Then, the fund falls by 50% the next year to $500. The fund's IRR (internal rate of return) is 0% (a +100% year followed by a -50% year), yet investors have lost a massive amount of capital: a $100 gain in the first year, followed by a $500 loss in the second year.]

COMMENTS ON BERKSHIRE HATHAWAY

Berkshire Without Buffett

I said to my fellow directors of Berkshire quite recently, when we were discussing Berkshire in his [Buffett's] absence, "It's hard to believe that he's getting better with each passing year." It won't go on forever, but Warren is actually improving. It's remarkable: most almost-72-year-old men are not improving, but Warren is.

If he were gone, we couldn't invest the money as well as Warren, but the place is drowning in money -- we have great business pounding out money. If the stock went down, Berkshire could buy it back. There's no reason to think it will go to hell in a bucket, and I think there's reason to believe it could go on quite well. The people at MidAmerican Energy are quite formidable. I'd be horrified if it isn't bigger and better over time, even after Warren dies. And I can't imagine Ajit not being one of the jewels of the insurance business in the world as far as the eye can see.

If your problem is that eventually all things crest, then you're right. The loss of dominance rate is 100%. Every great civilization that was dominant eventually passed the baton. Similarly, the greatest companies of yore are not the great companies of hence. I like looking back and seeing who would have predicted what happened to [formerly great companies like] Kodak, Sears and General Motors.

Sure, vicissitudes come to all places, but I think Berkshire is structured so that it's unlikely to fall back the way GM has. GM basically transferred the enterprise value to the employees instead of the shareholders. That is not the Berkshire culture. We want employees to be esteemed, get rich and enjoy life, but we're not in business of deliberately transferring the company from shareholders to employees.

At GM, they tried to get by each year without a calamity [e.g., a strike] by giving [whichever union whose contract was due for renegotiation] a lot, which they then had to give to the other unions. Do this over 40 years and at the end there's nothing left for shareholders. That's not the culture at Berkshire.

Will it ever fail? I suppose it will. [I believe he was referring to Berkshire, not GM, in the context of his earlier comment, "Every great civilization that was dominant eventually passed the baton."]

Berkshire and Wesco's Stock Prices Relative to Intrinsic Value
We like the stocks of both Berkshire and Wesco to trade within hailing distance of what we think of as intrinsic value. When it runs up, we try to talk it down. That's not at all common in Corporate America, but that's the way we act.

At Berkshire, there's been a deafening silence [on what we think of the stock price]. Berkshire is trading in a reasonable way given our environment and opportunities, which is why we've been silent. We are in no distress at all about the current value of the stock, and we're the type who feel uncomfortable if the stock gets too high or too low.

I have yet to see a shareholder who needs to get out not be able to sell it. So far, we haven't had any crisis of liquidity. If there were a crisis of liquidity, there's someone around who has plenty of liquidity. [E.g., Buffett/Berkshire] [Laughter]

There have been two times that my Berkshire stock holdings have fallen by more than 50%. So what? Warren has always said that if you're not prepared to experience a 50% quotational loss, you shouldn't be in stocks.

Intrinsic Value of Berkshire vs. Wesco
[He gave two explanations -- I missed them -- and concluded:] Either way you calculate it, Berkshire has way more value per dollar of book value [than Wesco].

Berkshire's Advantages in Super Cat Insurance Underwriting
If it could easily be done, just by manipulating rules of statistics, like life insurance, then everyone would have done it and there wouldn't be much profit in it. But what you point out -- what everyone doesn't like about it -- is what we like about it. For example, there have been lots of earthquakes but the average actuary says that after 50 years without an earthquake, it means that one is now less likely. But we think that maybe pressure is building up, making it more likely not less. We try to take into account all of these factors.

There is a close collaboration between Warren and Ajit Jain. I've known both a long long time and if there are two better people on this earth to do this [super cat underwriting], I don't know who they are. We can't guarantee results, but they've done fine -- in fact, more than fine.

Sometimes they will do things where it's a straight Pascalian calculation -- the odds are x and we get paid at a rate that give us better odds than Las Vegas. The reason other people won't do it is because if they're wrong, it'll be a big money loss, but Berkshire can handle a big number loss. I'm quite comfortable watching those two people do it. I wish I could do it, but I can't. It's reasonable heuristics by two tough, sharp-minded men.

Event Arbitrage Investing and Berkshire's Junk Bond Investments in 2002
We haven't been doing much event arbitrage in recent years. In earlier years we did a fair amount, but now it's rare. The equivalent is we bought something around $10 billion of junk bonds last year, and $7 billion are left around. It's sort of similar to event arbitrage that Warren used to do in his earlier days. I don't think you'd find the recent records in event arbitrage are very good compared to the results we've had.

Warren calculated that over the past 60 years, if you combined Ben Graham's record and his, they generated returns of 20% per annum on event arbitrage. Ben Graham called them "Jewish Treasury Bills."

[Graham was Jewish. Here's the full story: When Buffett graduated from Columbia Business School, he offered to work for Graham at his investment firm, Graham-Newman, for free. Graham turned him down, even though Buffett was his only student to ever receive an A+ grade, because he only hired Jews. (This was not unusual at the time, as Wall Street had a number of all-Jewish firms to balance the many all-white, male, Christian firms.) Buffett returned to Omaha and worked as a stock broker (and occasionally wrote research reports on companies like GEICO) until Graham contacted him years later in 1954, after he had decided to open up the firm to non-Jews. Buffett took the job for two years, until Graham shuttered the firm in 1956, and then went back home to Omaha to open his own partnership. Incidentally, it was at Graham-Newman that Buffett met another legendary investor, Walter Schloss, who was also a junior analyst there.]

Now, that way of investing [event arbitrage] has gotten fashionable [today] because some money will be coming in even if world goes to hell in a hand basket. You can amuse yourself with that calculation as much as you want, but we tend not to do that. I suppose we could if the right opportunity came along. For one thing, its hard to do with a lot of capital.

The junk bonds are an interesting case. When we were buying [last year], the mutual [bond] funds were getting net redemptions and had to sell. Even under those conditions, we only got $8 or $10 billion invested. Now, the mutual funds have net inflows and you can't buy anything.

[I share Munger's bearish on bonds, as I argued in Don't Chase Performance.]

More on Bonds
Warren's doing most of the work on Berkshire's bond portfolio. I scarcely look at them.

We normally don't talk about what we are or aren't investing in, but I can't help saying that we don't own tobacco bonds. As for the WPPSS bonds, we bought every bond that traded, but we could only buy $300 million. It's hard to invest large sums of money.

[According to Of Permanent Value: The Story of Warren Buffett (a wonderful 1,490 page tome for true Berkshire junkies), "Buffett quietly bought $139 million worth of Projects 1, 2, and 3 of Washington Public Power Supply System bonds in 1983 and 1984…Buffett explained how WPPSS had defaulted on $2.2 billion worth of bonds issued to help finance Projects 4 and 5. That stigma stained other projects and Buffett was able to buy the bonds at a steep discount."]

Berkshire's SQUARZ deal in 2002
Warren has a big motor and there isn't enough going on at Berkshire with a tiny pile of assets and an insufficient number of large businesses [laughter] so when he sees a mispriced security, so he's willing to issue it. Personally, I wouldn't issue it. But it's one of Warren quirks. Remember the LIONS [a security Berkshire issued long ago]? We only have to put up with this every 20 years. To Warren, the appeal is that it could be done. I think the mere fact of borrowing money at a negative interest rate turned him on [because] not many people are able to do that. Just call it an intellectual quirk.

[For more on the SQAURZ deal, see my column, Berkshire's Unusual Security.]

Berkshire's Acquisition Strategy
We've bought business after business because we admire the founders and what they've done with their lives. In almost all cases, they've stayed on and our expectations have not been disappointed.

Buying Stock vs. Entire Companies
We do both, but we get tax advantages by buying whole companies rather than stocks -- very significant ones. Also, if we buy a company, we can change management, dividend policy, etc. if we need to.

We'll pay more per share for 100% of a company than 3%, but practically everyone else will too.

Why Did Berkshire Bid for Burlington Industries?
That's very easy: Burlington has a segment that relates to Shaw. Shaw does flooring and carpets [so there's a part of Burlington that] would fit in nicely with Shaw. What wouldn't fit in, we were will to buy for the price we offered. It was a peculiar add-on thing. We haven't suddenly decided that textiles are the thing.

The judge was willing to have us give the company a put [for an inadequate fee]. In our world, puts are worth a lot of money. There was a perfectly reasonable judge, but we're perfectly reasonable too, so we walked.

A Change in Dividend Tax Policy Wouldn't Change Us
[At the Berkshire meeting, Warren did talk about dividends. It [making dividends tax-free] wouldn't change us. Our long-stated policy is that as long as we think that, over an extended period of time, we think we can create more than $1 of value for every $1 retained, then we'll retain it. If that changes, we'll shell it out.

Would Corporate America change if dividends could be distributed tax free? Sure. For one thing, people would think the law might change [and therefore rush to pay out dividends before they became taxable again].

Failing to Buy Wal-Mart Stock
Wal-Mart was an $8 billion sin. What happened is that we started to buy it and the price started to go up and we're naturally so cheap that we stopped buying. It's not $8 billion we lost, but $8 billion we didn't gain. We keep doing this. We haven't done this hundreds of times, but our sins of omission have cost us a lot in terms of opportunity. I wish I could tell you we won't do this again. We do find things to actually do and they tend to work out well. If we only could have been 5% smarter, our shareholders would be a lot better off.

Costco and Wal-Mart
Costco [Munger is on the Board] and Wal-Mart are two of the most admirable retailing operations in the history of the world. In fact, Wal-Mart has the best retailing record in the history of the world. It was started by a guy in his 40s and he hasn't been dead that long. There's a similar story at Costco. Costco would be worth a lot more money if there weren't any

Wal-Mart [Laughter]. Sam Walton talked to Sol Price about buying what is now Costco, but those two titans never got together. We screwed up by not buying Wal-Mart stock, and Wal-Mart screwed up by not paying whatever price Sol Price wanted.

Future Relationship With Wal-Mart
Obviously based on past history, with Garan and McLane, we trust Wal-Mart. [Wal-Mart accounts for more than 85% of Garan's sales.] We admire Wal-Mart. How could you have a good value system and not admire Wal-Mart?

[When asked about Berkshire expanding its relationship with Wal-Mart to put Dairy Queens in Wal-Mart, sell GEICO insurance, knives, etc. through Wal-Mart, Munger replied:] I wouldn't get carried away with two transactions. Wal-Mart has perhaps the best buying systems on earth. They won't be buying from us because they like us. We wouldn't want it any other way. I wouldn't expect any fast flood of products into Wal-Mart.

COMMENTS ON BERKSHIRE HATHAWAY AND WESCO HOLDINGS

McLane
Obviously we like the manager [of McLane, Grady Rosier] a great deal, and obviously we trust Wal-Mart to stay with us as a major customer. Obviously we think it's a good buy at the price we paid. What more can I say? It's not some business that's going to grow at fantastic rates forever and ever, partly because one of its main products is tobacco. But we didn't pay for a business that's going to grow forever and ever. We like buying decent businesses at fair prices.

You should think of a business like McLane not as a normal merchandising business -- it's a logistics business like FedEx or UPS. It's a super-slick, super-efficient system for carrying out a logistics function. I think Wal-Mart sold it because they're the best in the world at retailing and they want to concentrate at what they're best at. I would too.

Clayton Homes
We wouldn't have bought Clayton Homes if the family members weren't there and weren't planning to remain. With reference to the price, the entire industry worked itself into a disastrous collapse with vast oversupply of used units, big financial losses, etc. Even Clayton has felt the effects of this calamity. We think Berkshire will help make Clayton stronger. We agree that Clayton is the jewel of the industry. We're buying at period of maximum distress. We think it's okay for Berkshire and okay for Clayton shareholders.

A lot of people wouldn't be interested because they can't stand taint. There's nothing wrong with Clayton, but the whole industry is tainted. We're willing to do things like that all of the time. Our triple A credit rating won't hurt Clayton [Laughter]. Everything you like about Clayton's culture -- does it seem that inconsistent with Berkshire's culture?

I've always felt that manufactured housing should have a bigger place in our society. It might morph into something different. Houses are built in many places in a very inefficient way.

CORT Business Services
CORT [which Wesco acquired in January 2000] has been clobbered by the big dot-com decline. The whole temporary office business in the country had a huge boom. Law firms, accounting

firms, venture capital firms, etc. all expanded. When they went bust, rental firms went bust. In that business, we caught a big recession.

We're having a similar recession in NetJets in that used jets have gone down in price. CORT and NetJets are losing a lot of money. Do I think CORT is going to fail? No. Net Jets? No. There are vicissitudes in life. In fact, we're buying other furniture rental companies. Some people vote with their feet; we vote with our wallets. Was our timing great in buying CORT? No, it was terrible.

Asbestos and Berkshire's Investment in USG
Obviously, so far at least, USG has not been one of our happiest moments. Everyone in American has underestimated how much asbestos could cost. One reason is that an awful lot of money goes to people who haven't been hurt -- way more than half goes to lawyers and experts and those who haven't been hurt. They [the country] did it a lot better when they had [a settlement] for black lung [disease] for coal miners. They simply put a tax on coal and all the money didn't go to lawyers and people who weren't sick.

In my judgment, the common stock of USG won't go to zero, but how well it will work out on the plus side, from zero to infinity, I'll leave you to figure out.

Won't Talk About Investments
[When asked to comment on Berkshire's investment in Mueller Industries (NYSE: MLI; a manufacturer of brass, copper, plastic and aluminum products; Mueller also owns a short-line railroad and various natural resource properties in the western United States), Munger replied:] We ordinarily don't talk about the reasons for making particular investments. We don't want people following us into particular stocks. It's sort of like asking, "What are you buying tomorrow?" We tend not to answer those questions.

INVESTMENT ADVICE

Attractive Investment Opportunities Tend to Be Ephemeral
A lot of opportunities in life tend to last a short while, due to some temporary inefficiency. If you're Berkshire, you can get a few billion dollars out, but most institutions would miss it -- they would have to meet with trustees, lawyers, etc. By the time they were done, they'd have missed it. In this environment, you have to be present and ready to act. Look at some of our recent acquisitions. They faced default and needed money by Monday, and it was Friday afternoon. It was an ephemeral opportunity. For each of us, really good investment opportunities aren't going to come along too often and won't last too long, so you've got to be ready to act and have a prepared mind.

Cigar-Butt Investing and the Value of Meeting With Management
I don't think Warren would think it [cigar-butt investing] was useless -- he just doesn't want to do it. [Laughter] And he trained under Ben Graham, who said, "Just look at the facts. You might lose an occasional valuable insight, but you won't get misled." If you sit down and talk to the key manager for an hour and you're a smart person, I think that could be a significant plus. But a smart person might be right 60% of the time and, for the balance, be misled. If you have some specific questions that the management is going to answer, obviously that would be helpful.

Warren reads a lot of what people have written. He just doesn't want to do it [spend a lot of time talking to managements]. There's a good argument that at a certain level of skill, you're better off without it, especially if you're Warren Buffett. But even he finds it helpful.

I remember a few years ago, Warren met with a CEO and afterward said he thought the CEO wasn't very shareholder friendly and was the biggest horse's ass. So we didn't invest and the stock compounded at 15% per annum for 20 years.

Views on Ben Graham's Ideas
The idea of a margin of safety, a Graham precept, will never be obsolete. The idea of making the market your servant will never be obsolete. The idea of being objective and dispassionate will never be obsolete. So Graham had a lot of wonderful ideas. Warren worshipped Graham. He got rich, starting essentially from zero, following in the footsteps of Graham.

I liked Graham, and he always interested and amused me. But I never had the worship for buying the stocks he did. So I don't have the worship for that Warren does. I picked up the ideas, but discarded the practices that didn't suit me. I don't want to own bad businesses run by people I don't like and say, "no matter how horrible this is to watch, it [the stock] will bounce by 25%." I'm not temperamentally attracted to it.

[For more on Graham, read his classics: The Intelligent Investor [the single greatest book on investing, in my opinion] and Security Analysis. Another book I recommend on Graham is The Rediscovered Benjamin Graham. Finally, my friend Rich Rockwood wrote a nice piece on Graham's thinking recently, Invest the Buffett Way.]

Diversification and Circle of Competence
95% of American managements, the minute they get out of their chosen activities, why shouldn't they just slaughter themselves? I think most managements are nice people, but their general powers of capital allocation are inadequate. And the people advising them, the investment bankers, etc., they will mislead you 95% of the time. The consequences for the utilities that tried to diversity were lethal.

Why are we different? We're working harder at trying to be rational. If you don't work hard at it, and just float along, you will fall victim to the folly of the crowd -- and there will always be folly of the crowd. I wish people would learn more from this than I think they will.

A Shareholder Case Study
[A shareholder stood up and said he first discovered Buffett and Munger and bought Wesco stock in 1984, and kept buying more -- and also added Berkshire stock -- despite Munger talking down Wesco all the time. Munger replied:] If I was steering you toward Berkshire rather than Wesco, then I hope I didn't hurt you. [Laughter]

The man who just spoke is teaching by providing an example of what I was talking about earlier. Here's a guy who is acting like he has 20 punches in life. He likes these guys [Buffett and Munger], gets to know them better, doesn't ask a consultant if he should buy a burlap bag manufacturer in India -- he just kept buying what he knows and has confidence in.

[Munger then asked the shareholder:] How many investments have you made in which you had as much confidence as you had in us?

Shareholder: "Maybe 10."

Munger: "A typical rich shareholder, which means he probably doesn't have a chauffer."

Shareholder: "I drive a '94 Buick."

Munger: "They won't teach this in all of the finance departments. Maybe you should give all of the money back." [Laughter]

Investing Taught at Business Schools
There are a handful of business school professors who teach investing properly. Jack McDonald of Stanford Business School, for one. He comes to the Berkshire meetings. I've taught in his class and Warren has come to his class. There are others.

Reforming academia, except accidentally by having a view that catches on, isn't something I try. It's amazing how difficult it is to change ideas, no matter how wrong they are.

Neither Warren nor I has ever thought for two seconds about beta. But every business school teaches this [concept]. Maybe if we had a few more hundreds of billions of dollars, people would pay attention to us. [Laughter]

Competitive Threat from China
If you're in any business of a manufacturing nature that China can do well, after you consider transport, then you're in the crosshairs of a very formidable opponent.

Why didn't we recognize this with the shoe business? Well, as a German philosopher once said, "Too soon old and too late smart."

Comments on Philip Fisher
Phil Fisher believed in concentrated investing and knowing a lot about your companies -- it's in our playbook, which is partly because we learned from him.

[For more on Fisher, I recommend his books: Common Stocks and Uncommon Profits [one of the all-time great books on investing, in my opinion], Conservative Investors Sleep Well, and Developing an Investment Philosophy.]

Recommended Reading for Investors
I think the business publications, because they digest so much so well, are a good resource. There's a lot of brainpower on the staffs of Fortune, Forbes and The Wall Street Journal.

RISKS IN THE FINANCIAL SYSTEM

Derivatives
It's easy to see [the dangers] when you talk about [what happened with] the energy derivatives -- they were kerflooey. When they [the companies] reached for the assets that were on their books,

the money wasn't there. When it comes to financial assets, we haven't had any such denouement and the accounting hasn't changed, so the denouement is ahead of us.

We tried to sell Gen Re's derivatives operation and couldn't, so we started liquidating it. We had to take big markdowns. I would confidently predict that most of the derivative books of [this country's] major banks cannot be liquidated for anything like what they're carried on the books at. When the denouement will happen and how severe it will be, I don't know. But I fear the consequences could be fearsome. I think there are *major* problems, worse than in the energy field, and look at the destruction there.

Consumer Credit
Consumer credit has been a gold mine -- it's like selling heroin to addicts. There are a lot of fiscalaholics [a new Mungerism] who will probably find some way to pay their bills. Some banks understood this and made a great deal of money.

What I said last year was that it made me nervous, that constant pushing of consumer credit. I didn't say when [a blow-up might occur], but it still makes me nervous.

COMMENTS ON OTHER ECONOMIC MATTERS

The Banking Industry, Past and Future
The banking industry has been a gold mine. I think Warren and I blew it -- we should have invested a lot of money in banks. While we did well in it, we should have been heavier in it. The amount of money made in banking has been awesome. And [this despite the fact that] the people who made the money -- how shall I say it -- have been moderately skillful. [Laughter] [I think he said something here about one being able to make a lot of money in banking even if one is "a perfect ass."] [Bankers have been like] a duck sitting on a pond and they raised the pond. By borrowing short and lending long, one can make a lot of money. It's so easy that people are tempted to do more and more.

Can it go on forever? A wise economist once said, "If a thing can't go on forever, it will eventually stop." My guess is that the extremes are over. Banking has been a marvelous business, but I wouldn't think it would continue to get better and better and it might even get a lot worse.

Pension Fund Consultants
I'm glad you asked, as it gives me a chance to talk about a deeper reality. [Laughter] Let's compare pension fund consulting with bass fishing. You can go on the bass fish tour and catch bass and get prizes. Or you can go into the business of selling tackle and giving advice to bass fisherman. They are two different businesses. The people who choose the latter wouldn't be very good at catching bass. That's how Warren and I view things. We want to win the bass fishing tour, whereas pension fund consultants sell tackle. We're not interested in selling tackle, we're interested in catching bass.

Housing Boom
We've had a boom in housing that has been almost unprecedented in the country, and it keeps going on despite setbacks in certain places. It's partly due to interest rates being so low, and partly because everyone who previously bought [houses] did so well. But in some places, like

Silicon Valley, prices got so high that they've come down. I don't know a lot about the housing price market. I wouldn't have predicted that a little house in Palo Alto would be worth $3.5 million. It took a good educational system and being amidst the Silicon Valley boom.

Having failed to predict accurately [what would happen in the housing industry] in the past, I don't know why, based on a clear lack of competency, why I should predict anything now. Ordinarily, [my advice is to] buy housing when you need it, and don't try to time the market.

ADVICE ON LIFE AND OTHER (MUNGER'S WORLDLY WISDOM)

Approach to Life

We've tried to do that [convey our philosophy] in everything we've ever done and said. But you can't say: "Please dispense all wisdom in one sentence." We're just not up to it. Other people have tried. If you want it short, try Buddha, who said: "I only teach one thing: I teach the cause of human sorrow and how to avoid some of it." (This isn't word for word, but some of it.)

That's my approach: Go around figuring out what doesn't work and then avoid it -- and when you get the sorrow, how to handle it. I think this is a very rational approach to the human condition. If you want to avoid sorrow, you gotta know the cause of sorrow. There are certain ways of improving life that have a certain outcome.

If it's trite, it's right. That's not totally true, but mostly true.

How to Get Rich

We get these questions a lot from the enterprising young. It's a very intelligent question: you look at some old guy who's rich and you ask, "how can I become like you, except faster?" [Laugher] My answer is that I did it slowly, inch by inch, taking losses mentally when they occurred. If you want to do it with fast rapidity, then you're talking to the wrong man, but I know my way works.

If you don't just want to play tiddlywinks, I say welcome to the pool. Spend each day trying to be a little wiser than you were when you woke up. Discharge your duties faithfully and well. Step by step you get ahead, but not necessarily in fast spurts. But you build discipline by preparing for fast spurts. You may not need Zsa Zsa Gabor or a Lamborghini or a lot of other things you think you need now. Slug it out one inch at a time, day by day, at the end of the day -- if you live long enough -- most people get what they deserve.

It's so simple. What's the best way to get a good spouse? The best single way is to *deserve* a good spouse because a good spouse is by definition not nuts. [Laughter] It's the same with the responsibilities in life.

Iraq and Afghanistan

As for Iraq and Afghanistan, your guess is as good as mine. But I will say that it's very easy to shrink from something unpleasant and conclude we don't really need it. At least I admire the ability to suffer now in the hopes of making something better. I'm skeptical of the approach that never finds it necessary to suffer now to make it better. There's a lot to be said to seeking ways to suffer now to make things better. That's the way it is in investing -- sacrifice now in the hopes of something better. Now whether it will actually turn out better [in the Middle East], your guess is as good as mine, but I kind of like the fact that we tried.

[For more on this, see my two columns, Iraq and Investing and Weathering Iraq's Storm.]

Don't Change the Dividend Tax Policy
I think in a democracy, you have to kind of work to keep appearances not too unfair. The way to do this is to keep the reality not too unfair. I think that to some cab driver working seven days a week and paying taxes at a 40% rate, that someone at the country club paying zero tax would be unacceptable. Look what happened when American Airlines executives took part of their compensation and made it secure. The resentment among the workers, who were being asked to sacrifice, was overwhelming -- and I think rightly so.

I think if you make it [e.g., become wealthy], then you have a duty not to mess up the system. I think Corporate American has been terrible at setting an example. If you rise in life, you have to behave in certain way. You can go to a strip club if you're a beer-swilling sand shoveler, but if you're the Bishop of Boston, you shouldn't go. [Laughter]

Opinion on a Temporary Wealth Tax
The wealth tax has existed in the past. For example, immediately after WW II, to recover from the war, Germany instituted a temporary wealth tax and people cheerfully paid it. In this country, I think that once people got accustomed to it, it would stay [e.g., politicians would make it permanent].

Estate Taxes
I like the idea of retaining gift and death taxes, but as for the guy who builds up a good business worth $5 million and wants to pass it to his children, I think the death tax should be zero. But for people who really strike it big, I think there should be an intergenerational tax.

Intergenerational Tensions
If the growth rate of the country goes to zero, then of course we'll have intergenerational tensions. If it continues to grow at 2% -- per capita real growth of 2% per annum -- then we won't, and Social Security will be okay.

Don't Invest Part of Social Security in Stocks
People grew accustomed to stocks doing well. A lot of people behind these schemes thought stocks would yield very high returns over a long period of time. I don't have any gospel from god that stocks will yield 8-10% real returns over a long period. But I do have faith that if government gets involved, it will gum it up. I don't want trustees appointed by the government voting shares of the common stocks in America. Leave it well enough alone.

Common stocks are valued in 2 ways: 1) rational estimates based on future use value [e.g., as Buffett has said in the past: future cash flows that the underlying businesses will generate from now until kingdom come, discounted back to the present at an appropriate rate]; 2) in the hopes that they will go up because people want to buy them. Like bonds and Rembrandts. Once you have government buying stocks every year like [they are] Rembrandts, God knows what would happen. This doesn't appeal to me at all. I'm afraid of it, afraid of the politics, and I don't believe the numbers of those projecting them. By the way, the numbers of those proposing this idea three years ago now look silly. What would happen to the morale of this country if [we invested Social Security into stocks and then what's happened over the past 20+ years in Japan happened here? Imagine that the] government of Japan had put [their] Social Security into common stocks. For a while, stock prices went up and everyone felt good, consumers and politicians spent more, etc., and then stocks declined by 80%. I think they'd be in even worse shape. The more anything sounds like easy free money, the less I tend to believe it.

Giving Money Away
I don't like to think of bequests, not because it reminds me that I'm going to die, but because I find it very hard to figure out what to do with money. Some people like to have people come up to them asking for money, but I don't.

I know a lot of people who like to remain anonymous when they give away money, and you may think that this is a becoming modestly, but mostly it's because they're afraid someone else will ask them for more money.

Charities Cooperating More
In terms of getting all charities in the world to act together, I can't get all of my children to act together, and they've been in my house and under my control.

View of Liberal Art Faculties
[Every year, Munger takes a shot at what he believes are clueless, disconnected-from-reality liberal art faculties at major universities. This year was no exception:]
I think liberal art faculties at major universities have views that are not very sound, at least on public policy issues -- they may know a lot of French [however]. [Laughter]

The Importance of Reading
In my whole life, I have known no wise people (over a broad subject matter area) who didn't read all the time -- none, zero. Now I know all kinds of shrewd people who have done well by staying in a narrow area. But investing requires broad knowledge.

You'd be amazed at how much Warren reads -- at how much I read. My children laugh at me. They think I'm a book with a couple of legs sticking out. [Laughter]

Recommended Reading
A Matter of Degrees, by physicist named Segre, is a perfectly marvelous book. Not a book you can go through at 90 mph, but if you parse through it slowly, you'll get a lot out of it. You'll get a lot of hours per dollar if you use it right.

How much GNP per capita there is really matters. It multiplied by seven times in a single century [in the U.S.] -- a lot by previous history of man. I certainly recommend the Carnegie biography by the Grinnell guy -- I forget his name [he was referring to Andrew Carnegie by Joseph Frazier Wall], but it's the definitive biography. It's a very interesting story. Carnegie started in absolute poverty and had only 4 1/2 years of grade school in a one-room schoolhouse with only one teacher for 170 or 180 students. From this beginning came Carnegie Steel and all of his eccentricities. He was married at 51 and was a virgin -- it was a different world. [Laughter]

It's very interesting -- the past is strange. People behave differently there. [Laughter] The way labor was treated was really something. People did dangerous work, had no Workman's Comp, insurance or pensions, companies could arbitrarily slash their pay by 40%, etc. And that was only 100 years ago. It makes you think how different the world will be 100 years from now.

Johnson, Adams and Franklin Biographies

Yes, I've read the whole Johnson biographies [Robert Caro's trilogy: The Path to Power, Means of Ascent, and Master of the Senate] and I've read the Adams biography [John Adams by David McCullough] and the various Franklin biographies.

Sure, Franklin was quite old when he was ambassador to France. This was after he was world famous and rich, and he was more self-indulgent than when he was young and making his way in the world. But he was a very good ambassador and whatever was wrong with him from John Adams's point of view [I'm sure] helped him with the French. [Laughter] I think Franklin was a marvelous steward. I'm willing to take the fellow as he averaged out. And certainly I'm in favor of old people having a little enjoyment. [Laughter]