

## **Conversation with Charlie Munger**

**July 1<sup>st</sup>, 2011**

**Pasadena Convention Center**

### Opening Remarks:

The question after Wesco was bought by Berkshire Hathaway (BRK) was who was going to pay for the event today. Charlie decided to pay for it to continue the tradition.

### Wesco Merger:

Said he feels like a captain who finally got to the port he had always dreamed of. He believes BRK is the right port for Wesco. About one half of the Wesco shareholders became shareholders of BRK. The contract was disadvantageous for BRK because of the losses recognized in Swiss Re. BRK's stock subsequently went to a price that was so low that Wesco shareholders got more shares than Warren and he had ever intended. He thinks there was a favorable wind at the end though.

Warren and Charlie developed a reputation for doing the right thing. It has worked well to be known for doing the right thing, even when BRK has the power and their partners or counterparties do not.

Quote: How nice it is to have a tyrant's strength and how wrong it is to use it like a tyrant.

### Academic Discussion

Charlie didn't think the audience would bear listening to this at the end of the conversation so he put it in the beginning. When you have a complex system, what he calls lollapaloozas can be very impactful. These almost always come from a confluence of factors operating in the same direction, but coming from different academic disciplines—economics, finance, and psychology. He has never cared what disciplines they come from though. It is that they come together to have a large impact that is important.

With lollapaloozas in mind, he wanted to let us know how he approaches things. There is a problem that has bedeviled the economic departments of universities. When economists went to the movie theater, they noticed that Coke and popcorn were priced way too high relative to the prices of these goods elsewhere. There have been millions of man hours devoted to understanding this phenomenon. They understand why first class airplane seats sell for more than coach seats but can't understand—using marginal utility—why candy bars sell for so much at theaters.

Similarly, it is well known that car manufacturers sell a car for \$40,000 and then sell you an extra gizmo that costs \$20 for \$400. When you are paying \$40,000 for a car, a \$400 charge is so small that people barely even notice it and the seller can extract more money out of customers this way. Nothing can be simpler than what he told us but he can't believe how many academics don't understand this. He then suggested that if you can adopt his tricks and his approach, you can do better than most other people.

He then applied the same approach to something that is far more complex. It became orthodoxy from a Keynesian point of view that you can borrow and print money to ameliorate recessions. The Keynesians believed that recessions would be short and depressions less likely as a result of borrowing and printing money. People became so enamored with this idea that they thought these economics laws were like those of physics.

The Japanese got in trouble because of an idiot boom in real estate. They now have tried everything in the Keynesian book to try to fix that. They have had to deal with 20 years of stasis, which they are uniquely able to handle. They are a nice and polite people. However, Americans and people from most other countries would likely not be able to go through 20 years of stasis. If the “new” laws of economics do not work as well as the professors think they will, Americans will be in trouble.

Of course Keynesian and monetary tricks do not work as well when everyone knows you are playing them. For example, things that worked in the 1930s might not work now. Back then the US had better credit and people did not use the polls to make themselves rich. Meaning, people did not get voted into power and then use their power just to become rich. This is a lollapalooza system.

Next, Charlie provided an explanation of Japan’s economic malaise that is not commonly cited. Japan is an export dependent economy. In the late 1980s and 1990s, Japan got huge and credible new competition from China and Korea. They got this because the traditional laws of economics were working well in China and Korea when they adopted something like free market capitalism. The main competitors got more competitive and this impacted Japan substantially. This is an explanation that you never hear. This is why you need to try multiple approaches to solving problems—using checklists.

Additionally, Charlie recently re-read Matt Ridley’s *The Rational Optimist* again. This is a great book. Ridley is absolutely charmed with the way that free market capitalism changed the world. Specifically, he has fallen in love with the idea that the division of labor was the main contributor to this success. He only looks at this explanation though and it is wholly inadequate. There are multiple factors that have made free market capitalism so successful. Even if Stalin were running a pin factory (made famous by Adam Smith in *Wealth of Nations*) he would get efficiencies out of it. The process of competition between different operations and companies causes the power to be allocated to people who are good and can perform a great service. But, if you just stop there you miss other things. For instance, what happens is that the owner of a business gets “reinforcement” very often. Each time the cash register rings he or she gets an “aha” feeling. There are lots of rewards and punishment in free market capitalism that do not necessarily apply to someone who works for the Department of Agriculture (and can’t be fired) or who is a communist in Eastern Europe.

The takeaway is that there are all kinds of problems that are better solved by going through a checklist. This works well in primary medicine too. Only a terrible internist jumps to the first conclusion and sticks to it. (Sadly, this represents about 75% of internists.)

### Blue Chip Stamps

He then went on to talk about Blue Chip Stamps, a “doomed” trading stamp company. Almost all of these companies are now dead or almost dead in general. However, when this business was more profitable it produced a large float like a casualty insurance company. What was interesting about the task of investing that float was that BRK only found 3 big things to do in decades with the money: it bought Sees, Buffalo News and control of Wesco. The idea that he and Warren only made 3 moves is interesting given how investment bankers are always pushing people to buy things. It is “boring” to run a business and make sure each restaurant is clean, for example. It is much more fun to look for things to buy. However, almost any data suggests that most shareholders lose with all of these mergers—academic studies prove this. But, BRK shareholders did not lose because he and Warren only did 3 things and were patient. They were able to be patient because they had something else to do with the money. They had the option to buy marketable securities. Most companies don’t have this option and the combination of options gave them a respectable repertoire provided that they were patient.

Strangely, the worst thing that could have happened was the purchase of Wesco. The other two businesses they bought were way more profitable. But, even so the Wesco stock went from \$5 to \$385. Even if starting Microsoft was better financially than buying Wesco, he and Warren don’t care. They don’t want to fall prey to envy. Envy is stupid because you can’t have fun with envy—envy always represents a total net loss. There is always someone doing better than you.

Another advantage to BRK’s process was that Warren and Charlie were learning as they went. They didn’t understand the power of a great brand until they bought See’s Candy. They found that they could raise the price 10-15% each year and nobody cared. This understanding then changed BRK and its investment pattern. We are all ignorant—no one knows enough now to cope with the future. His motto is to pay yourself first—protect your own mind and make it better. You always have to learn. Increasing rationality is a moral duty and it is very important to keep improving as much as you can. That’s how he and Warren went at it and it worked well.

They weren’t the smartest guys—they were massively ignorant. In fact, many of the major successes of BRK started off with massive failures. For example, they bought one of the 4 major department stores in Baltimore. This was really stupid! But they recognized the mistake, tried to exit, and did. They were able to sell it for what they bought it for, basically. Out of the contacts they made when they bought the department store they were able to buy a niche retailer that made them a lot of money.

Many people graduate from Wharton now and think they know how to do everything—that is a big mistake. What is needed is a lifelong learning process—this is both helpful and a lot of fun. He said that he has had so much fun learning. In fact, it is amusing to see economics professors spending all these man hours on silly problems that he could solve with his left hand even though he never took a class in economics.

## The Great Recession

The bubble in America was from a combination of megalomania, insanity and evil on the part of a lot of people in banking—both mortgage and investment banking. Greenspan was a smart man but he overdosed on Ayn Rand at a young age. You can't have total freedom to create gambling games. Much of what crept into investment banking was a gambling game in drag—it was not capital raising. Now, the banks have developed an advantage in derivatives and do not want to give it up. A casino would never give up slots to keep roulette and blackjack. Similarly, the banks don't want to give up their best businesses to save the rest of us from risk. It makes sense that banks don't want to give it up.

Betting on a stock index is like betting on a bucket shop. The banks brought back bucket shops with the derivatives markets. With casinos you have to have parking, bars, restaurants and entertainers. But the banks have a casino with no overhead. The government then allows them to operate with leverage through the repo system. Conservative investment banks went to 30-50x leverage, making small returns on each transaction but making a lot of money in aggregate.

Then, the accounting profession allowed banks to show income and assets that weren't really income and assets. Accountants didn't think they had a responsibility to show the actual mess that could bring down the entire system. The medical system wants to prevent epidemics but the accounting profession does not want to deal with difficult and systemically risky issues—they want to charge more by making everything more complex. This is a contemptible approach. What accounting figures have expressed contrition? What major person in the US has been embarrassed by US accounting? Very few. But one such person is Jamie Dimon of JP Morgan who has written scathing criticisms of the accounting rules in his annual reports.

As an example, bad debt reserves go to zero in a boom. What kind of maniac would think that is good accounting? Only a CPA or a professor of accounting. The rest of us are grown-ups and know that is not good accounting. Paraphrase of a quote from Burke: For all of the folly in the world to prosper and become rampant, all the good and wise men have to do nothing.

Bernie Madoff has shown no contrition. In his mind, he was OK. Most people think the 150 years he got were unfair. Charlie would bet that Dick Fuld does not feel any contrition today either. He totally ruined Lehman Brothers with his megalomania. This is very serious situation because people won't show any shame. You need to have a society with the right rules to stop people from going crazy. There ought to be rules that only allow banks to do simple things with the government's credit. Remember what happened in the S&L business? Bankers are clearly not that wise or disciplined. They go crazy with envy. If the guy down the street is making a lot of money, it is hard not to try to do the same. Major accounting firms starting selling fraudulent tax shelters. But, when they finally got the whistle blown on them, they reluctantly threw out the partners who were involved. However, he never hears anyone saying they feel ashamed. Well Charlie feels ashamed to be in the same race as these people. Wise laws that protect against people doing crazy or evil things are important.

In the cases of Korea and Mexico, investment bankers sold them derivatives and caused those countries and decade old firms to go bankrupt. It is OK if financial companies are a little boring. Some of our best

banks gave free checking to get people who couldn't handle credit to sign up, a situation that led to overdrafts and people getting socked with huge fees. The banks also programmed the computers to process the biggest check first and that led to even higher fees. The banks are paying for these actions through class action suits right now—and they should. Wise laws that constrain the worst activities that people somehow are able to rationalize are very valuable.

You are talking to a Republican who admires Elizabeth Warren. He then said that these comments are not quite as contemptuous as what he wrote in the piece about the people who were at fault for the Great Recession.

### Current Investment Scene

The scene is very difficult. Charlie likes the “new normal” concept from Bill Gross of PIMCO and thinks the world is going to be lousy. He said we can't love bonds because yields are so low. Further, with so much trouble, the old tricks no longer working in Japan and Europe, and those countries having an “adult” experience, the world looks lousy. Of course picking some stocks carefully will be profitable. However, these returns will be tempered by the fact that there are consultants, managers, traders, and analysts that cost so much and will take profits from the rest of us. Now people are doing what is basically legalized front running because of their skills in math and with computers. Our university endowment and pension funds are paying for this unfair advantage through lower returns. Even worse, the people with power in public pension plans are working in ways to escalate the size of the pensions. Soon-to-be retirees are manipulating pensions by working a lot of overtime during their last year to make the final year salary abnormally high. From there a police officer who has made \$50,000 his entire career can retire with a \$100,000 pension. This is evil and wrong.

Charlie said that one of his favorite incidents from history occurred in the days of the Punic Wars. Rome couldn't afford to lose wars because when that happened, people became slaves. But, in this unusual case, Rome paid back 2/3rds of the war debt (in hard money) before the war was over. The emperors kept debasing the currency during the period but the right lesson for us to take away was from the guys who had the discipline to pay back the debt. He doesn't like the message that we can't have tax increases in the US under any circumstance (the current stance of Republicans). But, the other idea that the rich should pay all the tax is equally crazy (the current stance of the Democrats). The rich should pay the majority of the taxes but everyone should pay moderate taxes.

In any case, extreme divisiveness is not good. He remembers real nobility among the American political class in the past. After World War 1 the Allies decided to make the Germans really pay for their transgressions and that decision led to the rise of Hitler. If he had been a little wiser, Hitler's ancestors might still be in charge of the world. Charlie claimed that the Allies won the war because of luck and Hitler's blunders. Fortunately, we learned after World War 1 that we don't want to do things that cause desperation and thus decided not to be vindictive after World War 2. The Germans had put Jews in ovens and the Japanese marched people to death. But, what did we decide to do? We decided to give them money and let bygones be bygones. It was a great decision, especially the Marshall Plan.

Keynes wrote *The Economic Consequences of Peace* (in 1919—in which he argued for a more generous peace) and people later realized he was right. Consequently, Americans behaved really well at the end of World War 2. It is hard to imagine the same will be true now. The politicians hate one another and he hates to watch it. He is mildly hopeful it could change. But, the current system is dysfunctional and we need change.

The combination of patience and opportunism is important. Charlie had a great grandfather who had a great influence on his life. This man was one of Charlie's only ancestors who became rich. He told Charlie that you have to be ready to take advantage of opportunities to succeed. This is what they do at BRK. They are always ready. You do not want to be timid when great opportunities arise. It is kind of like how most marriages don't work and you may have only one chance to marry the right person.

#### Question and Answer Session:

#### **Q1: At this point in your life, what are the 3 most important components of your legacy?**

**Munger:** Charlie hesitated to answer this question because he believes that he is not a good example. Most people who follow his example would turn out to be quite unloved. He is really into self-improvement but certain peculiarities of his personality should not be imitated. For example, copying his insistence on improving his own mind and his irreverence will get you in trouble. Rationality and objectivity work. But, the qualities that bring so many people to hear him speak may not work for others.

#### **Q2: The first question had to do with the Wall Street Journal's deterioration since Rupert Murdoch took over. The second question had to do with whether or not California should become a single chamber state.**

**Munger:** Regarding, the first part, he loves the Wall Street Journal (WSJ), although he has never liked the editorial page. However, the publication he likes best is The Economist. He believes it is the adult intellectual publication of the world. The WSJ is not as good but is good in its field.

Regarding the second question, California should not have a unicameral legislature. He is agnostic on the subject, trending towards suspicious.

#### **Q3: What are your thoughts on Exchange Traded Funds (ETFs) and mutual funds?**

**Munger:** Said he didn't know because he never looks at them. In general, he likes low cost mutual funds and thinks people do better with them than by hiring fancy managers. He doesn't know which funds are better than others because he is not investing in them. He prefers to try to do considerably better by investing in specific companies.

#### **Q4: Question had to do with why Munger has chosen to fight a commercial real estate battle in Brentwood.**

**Munger:** Partly because he is crazy. To the extent that he is not crazy, he has done some things in his life that he knew would be very hard. He has occasionally taken on stuff that would make his life difficult.

He felt a duty to do the right thing, regardless of whether or not it would work out for the Mungers. There is a limit to this masochistic ethos however. His life has been so favored and he is so un-humbled by disposition that maybe he needs some masochism.

**Q5: Question had to do with whether or not BRK's stock is undervalued now.**

**Munger:** It is tough to buy stocks and operating businesses. He and Warren are better investors in stocks because they own the businesses and they are better business operators because they own stocks. When they buy companies they pay quite liberal prices—like they did for Dexter Shoes. But, in the case of Dexter, they utterly failed at an easy problem. When they do buy businesses they do not buy them cheaply—however some like See's Candy worked out really well. When all of the deals are averaged out he likes what has happened because BRK owns a ton of good businesses. The future can't be like the past because the weight of BRK's net worth and assets will limit returns. Having said that, he believes that someone who owns BRK stock and does nothing but hold it will do really well.

He likes to think that the culture of BRK has made a contribution to the world. Although, he has waited for a cascade of high ranking executive followers to take only a \$100,000 salary (like he does) but it hasn't come. Only the Rockefellers and Carnegies were willing to do that. Additionally, few corporations are as critical as BRK is of other business. As a result, deep down some people really don't like him. For instance, he doesn't make great friends on Wall Street when he says people there are stupid and evil. This is not the way to get ahead in corporate America.

**Q6: What recommendations do you have for successfully raising a family and dealing with adversity?**

**Munger:** When it comes to adversity, you have just to soldier through. Being too frightened leads to contempt. Coping with adversity brings opportunities. Don't panic or go crazy. People will always remember the person who could keep his or her cool. When Bobby Kennedy was dying and the entire Kennedy family was falling apart, Jackie Kennedy was the only person who kept her head. Who do we remember? We remember Jackie Kennedy.

**Q7: Given the fall in the share price, does BYD's stock represent is a major opportunity right now? What percentage of his money would he put in BYD shares?**

**Munger:** He doesn't want to tout one security—especially when he has avoided early stage companies for most of his life. BYD is a high technology company trying to make lithium batteries that do not blow up. They have 20,000 engineers to cope with these very difficult issues. He will hold his BYD stock to the bitter end because he loves the people. But, he can't say what other people should do with their money. He has very little experience in early stage venture capital (implying that the purchase of BYD shares was similar to a venture capital investment); he is investing in the company because he wants to improve his mind.

**Q8: Regarding inflation, what are his thoughts given all of the money printing? Is more inflation ahead? If the US was a corporation and each dollar represented a share of stock, would he buy, sell or hold? (The questioner mentioned that the dollar has lost 95% of its value since the early 1900s)**

**Munger:** He said it is pretty likely that we will have inflation over a 50-100 year period. But, contrary to people's fears, inflation has not halted the success of our civilization. We have had growth of 2% in GDP per person for decades despite the inflation we have had. The questioner suggested that the inflation in the pipeline would represent failure. However, failure is way worse than that. In fact, the situation the questioner described is hog heaven even though the dollar has lost 95% of its value. Charlie said he went to a hotel in Italy and paid his bill in billions. So, what the questioner described with horror is the top of success in Charlie's mind.

If every person in this room had to live with a real investment return of 0%, after tax, he thinks we all should be reasonably happy. A lot of people would not be happy though—look at Greece for example. In Greece, they don't want jobs: they want to sit on their asses as the money comes in. A job is a burden; it wastes 8 hours a day. If he were running the European Union (EU) he would not have let Greece in. He said that we should have an EU, but not for basket cases. When you get into a mess like Europe is in, you have to draw a line somewhere. In his mind, they can't let the depositors of their major banks get wiped out. They can let the shareholders of the banks fail but not the depositors. He knew that the Euro wouldn't work and at some point the EU will have to face the music.

We drew the line pretty well in this country with Lehman Brothers. But, after Lehman failed, we had to intervene to a major degree. He feels good about the way that Hank Paulson, both parties and George Bush handled the Great Recession. The massive intervention was successful. If you assume things will be really tough but you can bear it, you just smile and go on. And if the world is so tough that the Munger's fortune loses purchasing power, so what? Such great wealth may not be good for the family anyway.

**Q9: In the US engineering cultures are important. Are there historical precedents of what happens to companies that the market currently thinks are deteriorating (the questioner mentioned Google, Intel and Apple)?**

**Munger:** This is something that he does not know enough about. He does not know how you displace Google but a lot of the other companies will have competitive troubles.

**Q10: Munger has been very critical of the financial activities of others. However, in his financial activities, has he added value to society?**

**Munger:** If all he ever did was figure out what securities would go up in price and sat on his ass, then that is not much of a contribution. The only difference is that he is ashamed of it so he has added all of these other activities—like his masochism with property development in Brentwood. He then said that we may think we were at this event due to some nobility in his nature. However, in fact, hosting an event like this is nothing more than atonement.

**Q11: He seems like he was very strict as a father. What is his relationship with his children now that they are older? Has he helped his children financially?**

**Munger:** Of course he has helped them financially. Rich people who don't help their children out at all end up having children who hate them. He was lucky in a sense that he was not always rich. He probably

raised his earliest children better than the later ones. Will rich children ever be as motivated as people who had to struggle? No. You won't get people to be willing to suffer and provide "wonderful" hardships for their family. Thus, the answer is that rich people should lose graciously. But, this does not include providing artificial hardships for children—it is just not practical.

**Q12: Which economic entities in history were most similar to BRK? What are BYD's competitive advantages?**

**Munger:** If you go back to 1911 and look at the top ten companies of the time, many of them are gone. The 2 main ones that remain are General Electric and Standard Oil. Of all of the big companies of today, Standard Oil stands all by itself. It succeeded because of its engineering culture and from being in the right place. Everything was working for the company. When oil was seeping out of the ground, you didn't have to be that smart. You just had to be early rich and have the ability to buy oil-rich properties. The nature of the game was that as energy supplies got shorter and shorter, oil prices went higher and higher. In fact, Paul Getty became very rich precisely because he had oil reserves that he couldn't pull out of the ground quickly enough and then, while the oil was still underground, the price appreciated enormously.

What is the Standard Oil of today? He doesn't know. There were 13 Standard Oil companies when it got broken up and they were all huge successes. He has no idea what the next Standard Oil is.

Regarding BYD, he likes the fact that they are tackling tough engineering problems. He likes that they put their heads down when they fail and keep trying. He has gotten so old that he would rather make money thinking about people he admires than dealing with other people he doesn't care as much for. Luckily, he admires BRK so he doesn't have to worry about his money.

**Q13: Chuck Gillman of Boston Avenue Family Office- Would you like to see more value investors run proxy battles at under-performing companies?**

**Munger:** Charlie said he is conflicted about this subject. He doesn't really like people who run around like vultures raising hell. However, he also doesn't like entrenched managers who are not good and who are over-indulgent. In the end, he does not want more corporate raiding though. He would rather endure the evils we already have.

**Q14: How should we prioritize our time based on which stage of life we are in?**

**Munger:** Charlie said that he did not have much advice apart from his general advice to invest in personal learning—he believes in continuous improvement. He doesn't believe that you can change your life midway. You can't be a total jerk and then be nice later in life. If you know where you want to go, you might as well get there sooner. Lifelong learning works and it is a lot fun. He is 88 years old and he is learning more about astrophysics. What could come from it? Very little—but he is really enjoying it. The good news is that he understands astrophysics better than an average 88 year old.

**Q15: Will he do this event again next year? How does BRK take care of its cash? Is the company at risk to bank or counterparty failure?**

**Munger:** Said he is glad to host the event this time but he doesn't want to continue because he thinks we need a new cult hero. So, by not hosting the event next year, he is actually trying to help us by allowing us to move on.

BRK is dependent on the modern financial/deposit systems and computer trading systems. Unfortunately, BRK has to deal with people who Warren and Charlie don't like or are whose actions elicit skepticism. For example, he doesn't like credit card companies that are pushing credit on people who will inevitably hurt themselves with credit. At one of the Wesco meetings he said that firms should only make money by selling things that are good for customers—not things that are more like gambling. Yes, he is directing these comments at our leading investment banks.

**Q16: If you were a college age students and had 20 years to become an expert in a specific field, what would focus on?**

**Munger:** He said that this is an easy question. When you are looking around for something to do as a young person, you have to select something you like doing. He has never been good at things he wasn't interested in— he is way more effective when he is interested. If god has given you a passion for drawing buildings then you have to be an architect—which is a terrible way to make money by the way. However, he has an architect friend who says he doesn't care if it is a bad way to make money. The man doesn't care because in his mind it isn't work.

A man is a prisoner of his talents. This statement is true in his life as well. He couldn't have been a ballet dancer or a professional football quarterback. Law may not have been perfect for his talents and interests but it was the next best. Unlike others, he was not willing to be ill-paid.

**Q17: He once said he sold the best hour of his day to himself. What does that mean? Is Coca Cola (KO) as good today as it was 20 years ago?**

**Munger:** When he was a lawyer, he said he spent an hour to himself in the morning and then gave the rest of the day to his clients. Most people would not admit it if they did that but he thinks it was very valuable.

KO is not as good as it was 20 years ago. Compared to the big companies that sell consumer products however, it is better. But, it is like BRK in that the company is so big that it is hard to move the needle. Think about it this way: if we have to drink 8 glasses of water a day and company can slightly improve the taste of that water, it is a cheap and easy way to get people to drink those 8 glasses of water. It is hard for competitors to knock off a cheap product with a great brand name. That may not be true with a \$500 computer though. If he were investing for pension funds, there wouldn't be an account that didn't have KO in it. It doesn't mean KO will do wonders for people, but compared to other companies, he would rather own KO.

**Q18: How does he plan his day?**

**Munger:** Said he fills his duties first because he doesn't want to disappoint people. But he says no to many new opportunities—he is brutal in that way. He has an amazingly open calendar—like that of

Buffett. He likes to have the freedom to take calls from friends and family. He doesn't want to be booked like a busy dentist and this flexibility has worked for him. There is an advantage if you have a temperament that allows you to cope with problems that others can't understand. He prefers hard problems and doesn't want to be a dentist (who follows simple processes over and over).

**Q19: Regarding Buffett's comments on future performance, is it unrealistic that BRK will outperform indexes slightly over a few years?**

**Munger:** No, it is not unrealistic. If they just held big common stocks it might not work. But, with a mixture of operating business and business owners selling to them because they don't want to sell to someone else, Buffett may get his wish. However, Buffett might not get his wish to be there for 20 years to see it happen.

**Q20: What is his advice regarding raising a son?**

**Munger:** Don't preach one thing and then live another life!

**Q21: Has being a cult hero limited or improved his ability to do what he wants?**

**Munger:** It has done both. It is only peculiar people like us that he wants to impress. He is lucky because we are the only people he has ever impressed. To the extent he is known by this crowd, he thinks it is a net plus. But, he doesn't want a bigger house or more acclaim. In fact, he has outshot himself already on those fronts.

**Q22: Could we get a list of the 99 mental models he uses?**

**Munger:** The women who asked the question appraises him higher than he does himself. He can't do that!

**Q23: Question had to do with the prospect of a BRK dividend.**

**Munger:** He said that some of us will live to see a BRK dividend but he doesn't want to see it. It will mean that the company does not have great investment opportunities available any longer. He doesn't want to see what he would consider failure.

**Q24: When assessing durable competitive advantages, what does he consider the most?**

**Munger:** He and Warren only look at industries and companies that they have a core competency in. Every person has to do the same thing. You have a limited amount of time and talent and you have to allocate it smartly.

**Q25: Do you see parallels between the decline of the US and that of the Roman Empire?**

**Munger:** Of course he sees parallels. The failure rate of great empires in terms of geography is 100%. Just look at Athens and Britain today—everyone has passed the baton in due course. However, there is one sense in which these empires are still with us today. What was great about ancient Greece is with us in the world today—it has just moved. You can be confident that the US will not be the most dominant

and admired country in the world forever. We may have a longer run than most— we may even have a long run ahead. But, we will eventually fall from the top.

But, the US has had a huge, constructive influence on Asia. Asia is important for the future of the world and many people there have learned from the US's experiences. Another person who has been a great instructor to the world is Lee Kwan Yew of Singapore. He helped change China. Where did Lee Kwan Yew learn his values? He was educated in England and was English speaking all of his life. As such, a lot of the culture of this room was absorbed by Singapore. If China becomes the greatest nation in the world, some of our best virtues will be a part of that country as well.

**Q26: Do you see a depression in the near future due to high unemployment?**

**Munger:** Employment conditions are bad compared to what we desire. Employment is going to be a problem for a considerable period. But, that doesn't ruin life. He was raised in the Great Depression and it did not ruin his life. A good way for us to deal with the employment problem is gumption. (Gumption is one of his favorite words that no one uses anymore.)

**Q27: Is there anything he suggests that can be done to help employment?**

**Munger:** Like Japan had in previous decades, the US has had huge new competition from places like China. This dynamic has reduced employment opportunities. These are very real issues that investors have to take into account. Going forward they have to be wiser than BRK was when it bought Dexter Shoes (and the company soon lost out to cheaper Chinese competitors). Part of the trouble is that the Asians are so talented. They were held down so long because they were stuck in a Malthusian trap—they didn't have enough to eat and now that problem has been alleviated to a large extent. These people now have been unleashed and they have great ambition and culture. We have benefited from Chinese goods being better and better and cheaper and cheaper. But, as a side consequence we have a lot of competition in terms of manufacturing.

Charlie said he is very philosophical about stuff like this. He likes that the Chinese are coming up. He likes what was achieved by Japan's success. Look where car and TV production went—it went to Korea and Japan and away from the US. He can hardly believe the modern products that are developed. For example, his dentist has had at least 4 total equipment makeovers during the years he has been going there. The equipment is so good he thinks even he could use it. The dental assistant now has the modern equivalent of miner's lamp that helps her see better. Now she is less likely to stick something into his gums rather than where she wants to.

**Q28: What does he advise for concentrated investors who run pension money?**

**Munger:** Modern consultants with their style boxes and all of the fees are not going to work worth a damn, on average. But, he believes that someone with the attitude and philosophy of the questioner will do better than average. But better than average may not be good enough for certain employers. He would never let pension funds make 8% return assumptions. With low yielding bonds and stocks, how do you come up with 8%? You come up with it because that is what you want. That is not the Munger

system. In his eyes you go through life looking for pain and taking it advance. It makes you a protector of yourself and your employer.

**Q29: Which is the company you love the most outside of BRK? What CEO do you admire the most?**

**Munger:** His only other directorship position is on the board of Costco. He is on the board because it is his wish and also because many companies avoid him and wouldn't want him on their boards. He would argue that Costco is one of the most admirable firms in the world and that CEO Jim Sinegal is one of the top executives in the world. Charlie can't say enough about his admiration of Costco. But the world has figured it out and the stock sells at 25x earnings. The world should work that way—finding great places to invest. If you are comfortable with 25x earnings, slow advances, and working with great people, Costco at 25x earnings is one of the most admirable capitalistic institutions in the world. It is a total meritocracy. They pass on savings to their customers as if it were a moral duty. The company is losing money in the short term to make money in the long term. Everyone in the room should go through Costco's annual report. In fact, every time Donald Trump says something and you get discouraged, just think about Costco.

**Q30: The question had to do with what books he reads and what he does if he starts a book he doesn't like.**

**Munger:** As he starts regretting reading a book, he starts turning the page faster. But, he is not too burdened by god awful books because he either avoids them altogether or desists after a short time. He passionately read the world's great fiction when he was young. But, he gradually drifted out of it after he knew most of the tricks. He moved to non-fiction for the most part and rarely reads fiction now even for pleasure's sake.

When he was a kid he loved Sherlock Holmes. Then, later in life he read a paperback that included the total work of Arthur Conan Doyle. He found that some of the non-Sherlock Holmes stuff was just awful. The Sherlock Holmes genre was a gold mine. Conan Doyle wasn't even that good—he just stumbled into the right gold mine. However, Charlie likes the idea that he can now admit that what he once admired was not that good. He also likes to better understand how important it is to stumble on the right gold mine.

Similarly, he loves to admit it when he is a total horse's ass. Recently, his country club wanted to tear out a lot of trees at an exorbitant cost and he fought the plan. Now that the trees are gone, he sees that it was worth spending the money and that he was a horse's ass. You take the pain out of being foolish if you take pleasure in rubbing your nose in your own mistakes. It is a wonderful thing to do. You will never lack for opportunities.

**Q31: How would you approach selecting an investment manager if you could not see his or her returns?**

**Munger:** It is very hard to do. Tons of people come to BRK who are very high grade investors but picking a manager is not like shooting fish in a barrel. You don't want to find people who will only be really good

if they stick in their niche. Charlie and Warren could scale and that was their advantage. He only knows of one person right now who can scale in that way. He doesn't like the manager's manager concept (funds of funds for example)—too many people and complexities. He is going to leave that selection process to Harvard—an endowment that makes a lot of asinine mistakes.

It is easy to find people to avoid but it becomes tough with admirable people. This is especially hard as the managers get bigger and hire more people. The big investment firms underperform as they get more money. But, it sure is a wonderful problem to be so rich that you need an investment manager.

**Q32: Will recent and continuing disasters change the property and casualty insurance industry?**

**Munger:** This business is continuing as it has in the past—it has always been a mediocre business. Any business where you take in money, keep it for a while and then have to give it back much later will attract a lot of dumb people. The business has no receivables and is very attractive on paper. But, the insurance industry always goes a little crazy. Although, it is not terrible in the way finance is—where people go plum crazy. The casualty business is a very tough business and life insurance is even harder. He then said that the insurance business is currently normal, despite recent awful events.

**Q33: What is your perception of how the US will become more adult?**

**Munger:** As Dickens said, it is the best of times; it is the worst of times. For example, people have looked at the energy situation and decided to turn corn in fuel. This is an asinine idea and people are just starting to see how stupid it is. He knew it all along but couldn't do anything to stop it. He mentioned that 20% of BRK's Iowa utility's power comes from wind. Before the world could think seriously about having energy without hydrocarbons, you could be glum about human's future. But now we can be more optimistic—we are likely to have enough energy to face the depletion of certain resources. We are going to have to pay more for things like shale natural gas. But, having access to that gas is a very positive thing. We are going to take a lot of energy through the sun in the future. We are going to have a big national grid at some point. We are learning from China as China is putting in a huge grid.

Many technical problems are solvable if you have power. We will have global warming and man may have some impact on it. But, he doesn't believe that it will be that bad. There are people who like to sit around and think about how bad things will be but mankind has adapted to temperature changes in the past. It has been colder and hotter during periods of time. We now even have the power of geo-engineering. We can change the temperature of the earth if we are not happy about it. We can reflect more light if we want to. He also said that it might be a good idea to have a slightly warmer world. He doesn't see many people moving to North Dakota from Southern California. Also, there is a lot of land in Canada that could be much more productive if the world warmed a bit. He likes the work of a guy named Freeman Dyson on this subject.

**Q34: Jeff Ellis of UCLA Anderson and West Coast Asset Management- Questioned about the role of the Chairman when Buffett dies. Would Bill Gates be a better Chairman than Howard Buffett?**

**Munger:** Would not comment on whether or not one of Buffett's sons would make a good a Chairman.

**Q35: Victor Liu of Causeway Capital- Does he favor public school or private school education?**

**Munger:** Public schools are now nowhere near as good as private schools like Harvard Westlake. He wonders how much better he would have done if he would have gotten an education for Harvard Westlake instead of Omaha's public schools. But, he thinks his public school education was good enough. He thinks he would have forgotten calculus quickly in any case—it wouldn't matter when he learned it.

In the end you need to get a certain baseline education for a child. But, dragging a kid a few years ahead can be problematic. He was obnoxious enough as a kid as it was. He thinks it is worth it to push the best modern schools. He wants to see how good we can make our system. But, whether the students who graduate from these schools will have a major advantage is unknown. What he does know is that there are a lot of defective college students. Kids who come from great schools just run rings around them.

**Q36: What advice does he have for judging good management?**

**Munger:** Judging the management at a company like Iscar is easy—those people are enormously talented and wonderful. But, there aren't many managements like that and few people with the incentive of such intensity. Failure is not an option in Israel—they have no hydrocarbons and enemies everywhere. It is easy to judge great managers.

On the other hand, he knows of a company with a great culture and a great business and he and Warren admire the guy who runs the company. But, the man just made an awful acquisition. Charlie believes that you have to be willing to be disappointed by managers. All managers are going to drift. If he and Warren could be so wrong as to buy Dexter Shoes then we should not be surprised that others make acquisition mistakes. If you are not frustrated by what you see, you don't understand it.

**Q37: US Bank (USB) and Wells Fargo (WFC) have done better than other banks but could get pulled down by bad actors in the industry. How can they avoid that?**

**Munger:** No one can 100% stay away from trouble. However, companies like USB and WFC are better at avoiding the common stupidities of banking than most. BRK doesn't get to have perfect managers either. There is always a compromise—like what his wife did when she married him. They have to deal with what is available. He knows people who will not own financials because they think the banks will go crazy. Charlie knows this is not an irrational statement. But, he likes that these banks acknowledge this problem. Bankers from WFC admit that they had their heads up their asses when they made a lot of 2<sup>nd</sup> mortgage loans.

Look at the troubles that Bank of America got into. Talk about a disgrace in terms of decision making. Of course there are risks with these companies. But, manufacturing companies are not perfect either. His life expectancy is not what it used to be but he is still here relatively cheerfully. Would it be better if he were on the floor sobbing about it?

**Q38: The question was about the prospects for Level 3 Communications?**

**Munger:** He said he didn't know much about the company. People build too much fiber optic cable just like they built too many train tracks in the past. They then got the same outcome: a huge contraction. He has never looked at Level 3. He has three folders on his desk—in, out and too tough. Level 3 fits in the too tough bin.

**Q39: The question was about Ben Franklin's role in his life.**

**Munger:** Franklin said something to the effect of: "When the citizens of the world find out that they can vote themselves into money, they end of the civilization is nigh." People now act as if they need it, want it and deserve it (money and power that is). These are pathetic adults acting like children. If Franklin were alive today he would highlight this issue. Our ancestors limited this by only allowing property owners to vote but we are having trouble with it because of our voting rules. He used to ask why everyone should vote. He has always opposed mandated voting because he thinks it would actually hurt the civilization if everyone voted.

**Munger's response to the applause at the end of the Q&A session:** He liked the reaction he got and the great turnout as opposed to the huge turnout the dead man gets when people show up to the funeral just to make sure he is dead.