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BERKSHIRE HATHAWAY'S 2013 ANNUAL MEETING

Once a year, shareholders and other admirers from around the world gather in Omaha, Nebraska to attend Berkshire Hathaway's annual meeting and learn from, arguably, the most successful investors of all time – Warren Buffett and Charlie Munger.

Having made the trip for well over a decade now, many of you have asked why we continue to go back year after year. There is no one answer to this question. It is partly to reinforce what we do in value investing, partly to reconnect with interesting people we've met in prior years and partly to get some incremental ideas. Perhaps the best way to put it is to say it is similar to going to church – despite knowing what it is all about, we always leave inspired.

This year's meeting was held on Saturday May 4th and, as usual, it did not disappoint. Past meetings have included warnings about the savings & loan crisis, derivatives, incentive compensation and the technology bubble to name but a few. As is tradition, we share with you here some of the most interesting questions – and answers – from this year's meeting. Enjoy!

CRUDE BY RAIL VS PIPELINES

- Buffett said that oil moves faster by rail than by pipelines and predicts that there will be a lot of increased rail usage in that area for a long time to come.

FUTURE EQUITY RETURNS

- Buffett said he and Charlie do not pay much attention to macro forecast. "In 54 years, I can't think of a time when we made a decision on a stock where we have talked about macro views. We don't know what things are going to look like in any precise way nor does anyone else, so why spend time talking about something you don't know anything about – it's not very productive."
- He added that it does not make any difference to him what any economist thinks about the future. "Throughout my adult lifetime and before that, there have always been all kinds of opinions about what is going to happen this year and next, but nobody knows. What you do know, with a very high degree of certainty in my view, is that a company like BNSF will be carrying more cargo 10-20 years from now and there will be no substitute for the service that they provide."
- He said "to ignore what you know because of predictions about what you don't know – or anyone else knows – is just plain silly."
- Buffett concluded by saying "people will do very well owning good businesses if they do not pay too much for them. However, if people try and time their purchases in some way by listening to forecasts about what is going to happen to business and try and buy and sell them, they will do very well for their broker and not so well for themselves."

SIZE MATTERS – IS BERKSHIRE MORPHING INTO AN INDEX FUND?

- Buffett said that there is no question Berkshire cannot do as well as they had in the past because size is a factor. But, even with some diminution from returns of the past, results will still be satisfactory.
- He said that performance was dependent on the nature of markets and added that when markets fall into bad times, like they did in 2008, size is an advantage.
- Buffett admitted that there are companies that they should have bought forty years ago that looked expensive at the time, but know now that paying up for an extraordinary business is not a mistake.
- Charlie added that he thinks they have a better system than most other people and that is why he believes they will do pretty well in spite of getting very big.

EFFECT ON ECONOMY IF U.S. DOLLAR LOSES RESERVE CURRENCY STATUS

- Buffett said that he thinks the dollar will be the world's reserve currency for some decades to come.
- He thinks that China and the U.S. will be the two economic superpowers, but that it is extremely unlikely that any currency supplants the U.S. dollar as the world reserve currency for many decades – if ever.
- Charlie added that there were advantages to a country that has the reserve currency and losing it would mean losing some advantage. He pointed to England and admitted that it had a better hand when it had the reserve currency but losing that status was not all that significant.

CORPORATE PROFITS NOW AT HISTORICALLY HIGH LEVELS

- Buffett said that considering the economic backdrop, corporate profits are extraordinary as a percentage of GDP compared to other points in history.
- He added that American business has done extraordinarily well and it will be interesting to see if these levels can be maintained. "Businesses have come back very strong in terms of profits from the precipice we were on in the 2008 panic, but employment has not come back the same way."
- Buffett said if he had to bet if corporate profits would remain at 10% of GDP, he would say they were likely to turn downward, but thinks that GDP will continue to grow over time and thus profits will not necessarily fall.
- Referring to Buffett's 1999 article in Fortune magazine in which he wrote about corporate profits not being sustainable above 6% of GDP, Charlie said he would not be surprised if the figure turned out to be on the low side of the estimate. "Just because Warren thought something twenty years ago, doesn't mean it's the law of nature."

CAN THE FED STOP ITS LOOSE MONETARY POLICY WITHOUT NEGATIVE IMPLICATIONS?

- Charlie said that the questioner was right to suspect that it was going to be difficult.
- Buffett added that it was uncharted territory and pointed to the Hunt brothers failed attempt to corner the silver market when he said that it was a lot easier to buy things than it was to sell them. "The FED's balance sheet is up around 3.4 trillion now – those are a lot of securities."
- Buffett believes that the current situation certainly has the potential for being very inflationary. He said it has not been so far, but guessed that the FED wished it had been – at least a little. "If you are running up lots of debt, it gets measured in relation to nominal GDP and the easiest way to run-up nominal GDP is to inflate."
- Buffett said that when the market gets any kind of a signal that the buying will end and selling will take place, it would likely be the shot heard around the world. He went on to say that this did not mean that the world would

come to an end, but it certainly meant that everyone who had been driven into securities because of extremely low interest rates will start reevaluating their hand and warned that people reevaluate very fast in markets.

- Charlie added that what has happened in the realm of macro-economics has surprised all the people who thought that they knew the answers – namely economists. "Who would have guessed that interest rates go so low and stay so low for so long. Or that Japan, a mighty powerful nation, could have twenty years of stasis after using all the tricks in the economist bag." He thinks that given this history, economists out to be a little more cautious in believing they know exactly how to stay out of trouble when they print money in massive amounts.
- Charlie worries about more than just inflation and said "if we can get through the next century with the same results we had in the last century – which involved a lot of inflation over that long period – I think we will all be very satisfied." He suspects that the next century will be harder, not easier, and would predict that we may have more trouble than we now think.

INTEREST RATE POLICY AND ITS EFFECT ON PROFITABILITY

- Buffett said that current policies have helped profitability and that interest rates are to asset prices like gravity is to the apple.
- He pointed out that people are making different decisions today because they can borrow money for practically nothing compared to the decisions they made in 1981-82 when Volcker was trying to stem inflation and government bond rates got up to 15%. "Interest rates power everything in the economic universe and have some effect on the decision you make. That does affect what people are willing to pay, so it is a huge factor and presumably it will change at some point."
- Buffett acknowledged that bringing down interest rates and keeping them down has been a very smart policy, but warned that unwinding it will be more difficult by far.
- Charlie said he strongly suspects that interest rates will not stay this low for hugely extended periods, but pointed out that practically everybody has been very surprised by what has happened because it would have seemed impossible to practically all intelligent people not very long ago.

BERKSHIRE'S SUSTAINABLE COMPETITIVE ADVANTAGE

- Charlie said that their biggest advantage was that they have always tried to stay sane when other people like to go crazy.
- He pointed to Berkshire's practice of treating their subsidiaries the same way they would want to be treated if their roles were reversed as rare, and said it was one of the reasons people come to them as opposed to anybody else.
- Charlie added that they are leaving behind a field that is very competitive and getting into a place that they are more unusual. He joked that it was a very good idea and wished they had done it on purpose.
- Buffett said that people who sell to Berkshire know that they will be getting a permanent home for their business and that their competitive advantage is that they have no competitors.

WHAT HAPPENS IF MANAGERS BUY A COMPANY YOU DON'T LIKE?

- Buffett said he does not tell existing managers what to buy or how much to diversify. "They are managing money and when I was managing money I wanted to be a free agent."
- He elaborated by saying that early on in his career people were free to make the decision of whether or not they wanted to give him money, but once that decision was made, the responsibility for managing that money fell to him, so he required free reign as to how it was invested because he did not want to be held responsible for "doing things with his hands tied."

INVESTMENT SUCCESS & TIMING

- Buffett said that despite growing up in a very favorable environment, he envies the baby being born today in the U.S. and feels that they will do very well on a probability basis compared to when he was born.
- He said "a person who has a passion for investing born today and coming of age twenty years from now is likely to do very well and to live far better than we live today, just like we live far better than John D. Rockefeller lived many years ago."
- Charlie admitted that the competition was very weak in Buffett's early days and he didn't think the competition was as weak now.
- Buffett noted that despite *heightened competition* created by an influx of highly experienced, high IQ investment professionals, they still managed to make great investments in 2008-09.

NEW FUNDS ENTERING THE INSURANCE MARKET

- Buffett said hedge funds have aggressively entered the reinsurance business in the last few years because it gives them a chance to operate in places like Bermuda thus allowing them to defer income taxes and the idea is easily marketable to would-be investors.
- He said "anything that Wall Street can sell, it will sell. You can count on that!"
- Buffett warned that you cannot afford to go along with the crowd when it comes to investing, or insurance, or a lot of other things. "It can be irritating to have an irrational competitor, but the nice thing about insurance is that the standby costs are not huge to do nothing."

HIGH COSTS INVESTORS BEAR TO BE SOLD PRODUCTS

- Buffett said the investment world has been very good at extracting a very significant percentage of the returns of investors for themselves.

QUANTITATIVE METRICS WHEN VALUATING A STOCK

- Buffett said they are not looking at the aspects of a stock but rather, they are looking at the aspects of a business and it was very important to have that mindset. "We always think of them as businesses no matter how much worth of the stock we are buying."
- He added that over the years, they have accumulated a background of knowledge on many kinds of industries and companies – some of which they cannot make an intelligent analysis on – and that different numbers have different importance depending on the kind of business.
- Buffett said that his investment decisions are not made because he calculates some precise PE ratio or metric, but rather, because he has some idea of what the company may look like in 5-10 years, he has a reasonable amount of confidence in that judgment, and there is a big disparity between price and value.
- Charlie admitted that they may be influenced a little by some of that data, but that they need to know more about how a company actually functions before buying it.
- He said "people with very high IQ's who are good at math naturally look for a system where they could just look at the math to know which security to buy – it's not that easy. You really have to understand the company and its competitive position and the reason why its competitive position is what it is. And that is often not disclosed by the math."

HOW DO YOU STAY SO RATIONAL?

- Buffett said that they know what they want to accomplish and have the benefit of a very long time horizon and of being a controlling shareholder so they do not have outside influences pushing them in directions that they don't want to go in.

- He said if they do something stupid, it is because they do something stupid! Not because they had external factors pressing on them. "For most people it is very hard to resist things that Wall Street is applauding."
- He gave the example of people buying internet stocks in the late 90's. "All around you, you had people with high IQ's doing it and being successful with it. Everyone from your spouse to your employer to the press was saying how come you are avoiding this when everyone else is making lots of money. This creates this social proof where it works for a while – that's the great danger period. What starts out as skepticism ends up with your neighbor getting richer than you because he went along and you didn't. That sort of thing is very hard to resist!"
- Charlie said that people have been having trouble with envy for a long time which is why the bible spoke out against it through the Ten Commandments. He joked that envy was a perfectly terrible thing to do because it was the one sin there was no fun in.

ATTRACTING MONEY TO INVEST

- Buffett said you should always be cautious about investing money with other people even when they have a track record – "most don't mean anything."
- He added that to attract money, you should deserve money and you should develop a record over time that shows that. Most importantly, you should be able to explain to people why that record is a product of sound thinking rather than simply being in tune with the trend or simply being lucky.

FAIR PRICE FOR HEINZ ACQUISITION

- Buffett admitted that there is no perfect mathematical formula. "Looking back when we bought wonderful businesses that turned out to continue to be wonderful, we could have paid significantly more money and they still would have been great business decisions, but you never know 100% for sure, so it isn't as precise as you might think."
- He added that generally speaking, if you get the chance to buy a wonderful business – one that has economic characteristics that lead you to believe with a high degree of certainty that they will be earning unusual returns on capital over time – you probably should stretch a little on price.
- Buffett said that the stock market will offer you the opportunities for profit – percentage wise – that you will never get in a negotiated purchase of a business. "In negotiated purchases, you are almost always dealing with someone who has the option of selling (or not selling) and can pick the time when they decide to sell. The stock market [on the other hand] is an auction market and crazy things can happen. So you will see opportunities in the stock market that you will never get in the business market."

LOW INTEREST RATE ENVIRONMENT

- Buffett feels sorry for people that have clung to short-term fixed dollar investments during a period like this and doesn't know what he would do if he was in that position.
- He said for everyone he has ever advised, he has always felt that owning businesses certainly made more sense than fixed dollars under most circumstances and this certainly made dramatic sense a few years ago when equities were marked down to where they were terrific buys and you could see the prospects that fixed dollar investments were going to pay very little for a considerable period of time.
- Buffett added that the fallout from low interest rates has hit millions of people in a very harsh way, and that it was a good argument for owning productive assets rather than dollars during a period like this.

READING THE TEA LEAVES FOR THE U.S. ECONOMY

- Buffett said that the U.S. economy overall the last four years has not come roaring back in any way shape or form, but it has never faltered and he would not be surprised if it continues that way.
- He said that if they heard about a business that they liked – U.S. or otherwise – and it allowed them to deploy 15-20 billion of their capital, they would move in an instant, and if they didn't, they would simply do nothing.
- "We just never know when opportunity will come along, but it does come along from time to time. And sometimes, in financial markets, it comes in a huge way. That will happen from time to time. Most people in this room will see incredible opportunities offered in equity markets four or five times in their lifetimes. Things will happen, but you have to be able to act – both in terms of having the ability, but also having the mental fortitude to jump in when most people are jumping out."

INVESTING IN EMERGING MARKETS

- Buffett said that he and Charlie don't talk in the morning to see if it's a particularly good idea to invest in places like Brazil, India or China. "It just won't happen and most people's strength is not there." He said although it sounded good, it is not the best way to look at investments".
- Charlie added that it was a great way to sell investment advice to have everything in different categories – "lots of commissions, lots of advice, lots of action."
- Buffett said that when he hears people talk about concepts of any sorts – including country by country concepts – he tends to think that they will do better at selling than investing.

IBM MOAT

- Buffett admitted that he does not understand the moat around an IBM the same way he understands the moat around a Coca-Cola. But he feels good enough about IBM that he put considerable amounts of money in it.
- Buffett has enough conviction about IBM's position that they took a very large position. He likes their financial policy and feels the odds are good that their position will be maintained in a strong way over time.
- Buffett pointed out that IBM had a very large pension obligation and thus was a large annuity company on the side and would rather they didn't have those obligations, but was a factor he took into consideration.
- Charlie added that all over the world life insurance companies have been experiencing the tortures of hell and that at least the IBM pension fund had the resources of IBM.

WORRIES FOR BERKSHIRE AFTER BUFFETT IS GONE

- Buffett admitted that he thought about this all the time and that is why the culture and businesses they own are all-important – "trains will keep running and people will keep calling Geico the day after I die."
- He said the key was preserving the culture and having a successor who has more brains, energy and passion for the business than even he has. He said it was the number one subject that the board considers at every meeting and that they are solidly in agreement as to whom that person should be.
- Buffett thinks Berkshire's culture has intensified year after year. "Making sure that everyone who joined us – owners, shareholders, directors, managers – took time, but Berkshire is really one-of-a-kind."
- He added that any foreign type behavior would be cast out because people self-selected into the company.
- Charlie said that his thoughts were very simple and urged the many Mungers in the audience not to be so stupid as to sell the shares after he and Buffett are gone.

SMALLER UNITS LEAVING LESS FOCUSED BUSINESS FOR SUCCESSOR

- Buffett said his successor may organize things a little differently, but not dramatically so. He reaffirmed that the principle of their CEO's independently running their units in all ways except for capital allocation will not change.
- Buffett said that someone coming in fresh will understand the major units, but when you get down to the smaller ones, things may get rearranged but that would not make much of a difference – "the real money is made by the big businesses."
- Charlie agrees that it would be unwieldy to have so many businesses, many of them small, if they were trying to run them through an imperial headquarters that dominated all the details, but said their system was different. "If your system is decentralization almost to the point of abdication what difference does it make how many subsidiaries you have."

BERKSHIRE TOO BIG TO FAIL

- Buffett said that he considers the banking system in the U.S. to be stronger than any time in the last 25 years – capital is dramatically higher & troubling loans are gone.
- Buffett does not worry about the banking system being the cause of the next bubble – "it will be something else." He said we will always have bubbles in capitalism because of the humans who operate within it.
- Charlie is less optimistic about the banking system then Buffett and would like to see something more extreme in terms of limiting bank activities. "I do not see why massive derivative books should be mixed up with deposits that are insured by the company."
- Charlie said the more bankers want to be like investment bankers instead of bankers, the worse he likes it.

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