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BERKSHIRE HATHAWAY'S 2015 ANNUAL MEETING

While the glitterati recently made their way to Sin City to indulge in the pugilistic spectacle pitting Floyd Mayweather Jr. against Manny Pacquiao, we too here at Commodari Antinori Group were on the move. Much like the "*fight of the century*" our event, although less promoted, also came with a title – *Woodstock for Capitalists* – and actually lived up to its billing!

Of course we are talking about Berkshire Hathaway's annual shareholders' meeting. This year marked the 14th consecutive year that at least one of us has attended the meeting since 2001 and, more importantly, marked Warren Buffett's 50th anniversary at the helm of Berkshire.

Other than growing in popularity over the years, not much has changed since we started attending. The bulk of the meeting remains reserved for a question and answer session and, despite the growing attendance, still manages to take on the feel of a family reunion. Buffett and Munger's answers, as usual, were patiently delivered, detailed, informative and well-communicated. As is tradition, we share with you here some of the most interesting ones.

WAS BUYING IBM A MISTAKE?

- Munger said he did not try to talk Warren out of buying IBM. He went on to say that he thinks IBM is a very interesting company and pointed to how IBM totally dominated punch card computing and then later electronic computing. He said "it is very rare when technological change comes along that companies adapt as successfully as IBM. Now we have the personal computer and so far that has been a mixed bag, but I think IBM is a very incredible company."
- He added that they own many companies that had temporary reversals who once were mightier in some ways than they are now. "IBM is still an enormous enterprise and I think we bought it a reasonable price."
- Buffett said that he has always found it interesting that people think they ought to talk up the investments they own. He said they had no interest in encouraging others to buy the investments they own and that they were better off - if they are likely to be buying stock in the future - that the price does not go up. "Why would we want the stock to go up if we are going to be a buyer next year and the year after that? The whole mentality of Wall Street is wrong."

- He said that people mistakenly believe they are better off if prices go up next week or next month and that's crazy. Said "from our standpoint we would be better off - especially if a company was buying back its own stock - if prices stayed low, but people don't seem to get that point."
- Munger added that "if people weren't so often wrong, we wouldn't be so rich."

HEALTH CONCERNS – IS MOAT NARROWING FOR COKE?

- Buffett said that Coke's moat is enormously wide. Said there will be 1.9 billion paid out servings of Coca-Cola products consumed in the world today and he does not think anything revolutionary will come along that will change that.
- He added that all food and beverage companies adjust to the expressed preferences of their consumers as they go on. Said no company ever does well ignoring its consumers and he thinks that twenty years from now there will be more Coca-Cola cases consumed than there are now by a wide margin.
- Buffett pointed to an article that *Fortune* ran in the late 1930's saying that the growth in Coca-Cola was all over and added that when they bought their Coke stock in 1988, people were not enthused about its gross profit. He added that for the last 30 years one-quarter of all the calories he consumed come from Coca-Cola and that there was a lot to be said about being happy about what you are doing. "If I would be eating broccoli and Brussels sprouts all my life, I don't think I would live as long. Every meal would be like going to jail."
- Buffett acknowledged that obviously there had been some shifts in preferences over the years, but it is remarkable how durable items are in this field. Said Berkshire was the largest shareholder of General Foods from about 1981 to 1984 and today, those same brands spun out as Kraft through Philip Morris are still around.

GENERAL LEVEL OF THE STOCK MARKET

- Buffett said that American business has prospered incredibly over the years and that the ratio of market capitalization-to-GNP is very much affected by the fact we now live in an interest rate environment which he and Charlie would probably have thought was impossible not too many years ago.
- He said that companies are worth a whole of a lot more if the government bond yield is 1% than they are worth if the yield is 5%. "It gets back to alternatives and opportunity cost and for many people the opportunity cost is owning a lot of bonds which pay practically nothing or owning stocks which are selling at fairly high prices historically but they weren't selling at those historic prices with interest rates like this."
- Buffett said the real question is how long will low interest rates prevail. "Will it be something like Japan that went on decade after decade or will we go back to what we thought were normal interest rates?"
- He said "if we went back to what are normal interest rates, stocks at these prices will look pretty high. If we continue with these low interest rates, stocks will look very cheap. And now that I've given you the answer, take your pick."
- Munger added that since they have failed to predict what happened and what exists now, why would anyone ask them about the future.
- Buffett said that he and Charlie, to his knowledge, can't recall ever making or turning down a deal based on macro factors.
- Said general economic conditions just don't come up. Pointed to buying Burlington Northern at a time when the economic backdrop was terrible. He added that they know they don't know what the next 12 or 24 months will look like but it didn't really make any difference if

they are buying to own for 100 years. "What's important is: what is likely to be the average profitability of the business over time and how strong its competitive moat is."

- He joked that any company that employed an economist certainly had one employee too many.

MONETARY POLICY & INFLATION

- Buffett said that so far, he has been very wrong and would not have predicted that they would have 5-6 years of close to zero rates and now negative rates in Europe.
- He added that America is running a fairly large deficit but that as a percentage of GDP it was manageable. He joked that the word *deficit* is not a dirty word but warned that very large deficits could sometimes be uncontrollable.
- Buffett said that the Federal Reserve has done a lot of things that were not in his economics 101 course and so far, nothing bad has happened except for the fact that people who saved and kept their money in short-term savings instruments have just totally gotten killed in terms of the income that they received from that.
- He added that it is still hard for him to see how you can toss money from helicopters and eventually you don't have inflation. Said certainly if the money supply grows faster and faster relative to the output of goods and services something like that is supposed to happen. Said he has been surprised by what has happened and added that bonds paying negative interest rates were not on his list of forecasts a few years ago. "We are operating in a world that Charlie and I don't understand very well."
- Buffett said that Berkshire will do better than most big companies in almost any environment because they are prepared for anything and if they see really unusual opportunities, they are also prepared to act and that gave them a real advantage over most big companies. "We don't count on anybody else. We are sitting with over $60 billion right now. We will be ready and prepared to act if economic turbulence of any kind occurs, and most people won't be."
- Munger added that they made very little progress over time trying to outguess macro-economic factors. Said they have basically abdicated doing this and instead focus on swimming all the time and letting the tide take care of itself.
- Buffett pointed out that you do not see great successes by people that have been involved in macro predictions. He commented that "they get a lot of airtime, but that is about all that happens."
- Munger added that the trouble with making economic pronouncements is that people gradually get to a point where they think they know something. He believes "it is much better just to say you are ignorant."
- Buffett closed by saying they will find things to do, but that they don't come in an even flow and you can't predict their size. He said you can be sure that over the next 10 years, you will see lots of things that you didn't think were possible and they will occasionally see something that makes sense for Berkshire and when that happened, they will be prepared to do something both psychologically and financially.

CHARACTERISTICS OF A BUSINESS THAT GIVE CONFIDENCE IN MAKING PROJECTIONS

- Munger answered first saying, "no one size fits all. Every industry is different. We can't give you a formula but we try learning from the past. What we did ten years ago we're doing better now. We keep learning all the time."

- Buffett says he doesn't have a list of five characteristics. He said that "most of the things going through my mind will stop us from going further." Buffett likes companies that he has a reasonable idea of how they might look in five years. He added that "there are a lot of filters there, in the business and who we're dealing with that will stop us from going to the next layer. Also, it's not the same five characteristics for all businesses."
- The key issue according to Buffett is the owner: do we want to be in partnership with this person and can we count on them to behave well in the future? "That stops a fair number of deals," Buffett concluded.

HOW TO VALUE UNFAMILIAR BUSINESSES

- Buffett said that when they started out, they stuck with companies where they were pretty sure they knew what the future of that business would be five or 10 or 15 years out. Plus, they had to know their limitations and learned to stay away from some things. "Prices were lower at the time, which made it easier."
- Said that there were no planning sessions; it was more like learning by putting one foot in front of the other. Buffett said they made some of their luck by being curious: "just keep reading and comparing opportunity A with B."
- Also, "in those days, we were capital constrained" so if they bought something, they had to sell something else - which helped sharpen their thinking Buffett said.
- In addition, they favored investments in companies where they were pretty certain of a "decent result" instead of a chance of a "brilliant result". But they had a few stumbles along the way, in investments in department stores and elsewhere. Of those failures, Buffett says: "It sharpens your ability to make distinctions" between investments.

REPUTATION & BUILDING AN ENTERPRISE THAT WILL LAST

- Munger said reputation is critical and that you build it over time and there's no way to guarantee a corporate powerhouse. "That's something Berkshire had to acquire. Hardly anything is more important than behaving well as you go through life." Munger added that they behaved better as they became more prosperous and recommends that people follow those same old-fashioned principles.
- Buffett said he was once told that when you get old, you'll get the reputation you deserve and that it is also true for businesses. He remarked that "Berkshire has benefited a whole lot from its reputation."

BREAKING UP BERKSHIRE – ACTIVIST INVESTORS

- Buffett mentions his assertion from this year's annual letter that "there are a lot of benefits to Berkshire" in the way it's structured and there'd be nothing to be gained by splitting it up. "I think it's unlikely in any long term or intermediate term that the value of the parts will exceed the value of the whole."
- Buffett says that the best defense against activist investors is through performance. He thinks Berkshire's value will keep rising in the years to come and make an activist play even more unlikely than it is now. "Even if all the activists gathered together, they wouldn't be able to do much about it," he said.
- Buffett and Munger turned the conversation to a discussion of activist investing in general and said today, activists were really reaching in their targets and proposed changes.
- Munger said activists urging companies to buy back their shares in the current stock-market environment is not smart.

- Buffett added that there has been more stupid stuff written and done surrounding stock buybacks than on almost any other corporate topic. He agreed with stock repurchases only "if the needs of the business are being taken care of and the stock is trading at below what it's worth." Said its become a contorted and silly discussion and noted that when stocks are cheap buybacks tend to fall off and when stocks are overpriced buybacks pick up. "We'll buy back stock at 1.2x book but not at 2x."
- Munger adds: "It's hard to think of many activists I want to marry into my family." Buffett ends this round by saying he better move to the next question before Munger starts naming names.

CONSUMER STAPLES & CONSOLIDATION

- Buffett admitted that there were bound to be deals in the future.
- He pointed to a strong brand like Coca-Cola and said last year they sold more cases in beverages than any year in their history and predicted they would sell more this year. "A strong brand is really potent stuff."
- He said you will always have the fight between the retailer and the brand. Said the retailers will use all the pressure they've got and therefore the brand has to stand for something in the consumers mind because in the end, the retailer wants to shift to a house brand of private label.
- He added that brands needed to be nourished and taken very, very, very good care of because they have to stand for the promises in consumers' minds.

VALUE INVESTING AS APPLIED TO OTHER MARKETS

- Buffett said that investment principles do not stop at borders. He would invest in China or any other place and would advise exactly the same principles that he learned from Ben Graham's *Intelligent Investor*:
    - Think of stocks as a small piece of a business
    - Think of investment fluctuations being there to benefit you rather than hurt you
    - Try to focus your attention on businesses where you think you understand the competitive advantages they had and what they would look like in five or ten years.
- Buffett added that they would do best over decades if they operated in markets where people operated very foolishly. And, the more people respond to short-term events and exaggerate things and cause people to get wildly enthusiastic or depressed actually is what allows people to make lots of money in securities.
- He pointed to 1973-74 as being the most extraordinary time. Said stocks were unbelievably cheap – cheaper than happened in 2008-09. "It doesn't make sense, but people act foolishly and will continue to act foolishly over the next fifty years."
- Buffett said if you are a young investor and are able to stand back and value stocks and businesses and invest when things are very cheap no matter what anybody is saying on television or what you read, you will do well. "It is really not a very tough intellectual game - it's an easy game if you can control your emotions."
- He added that nobody buys a farm to make lots of money next week or next month. "They buy it based on what they think the long-term future is and, if they get a reasonable calculation of that, and the purchase price looks attractive then they buy and don't get a quote on it every week/month or even every year. That is a better way of looking at stocks."

POSSIBILITY OF ONE OF BERKSHIRE'S INVESTMENT MANAGERS AS SUCCESSOR

- Buffett said that wasn't impossible but it was unlikely. He noted that he is a better investment manager because of his experience in operations and "would not want to put someone in charge of Berkshire with only investing experience and not any operational experience." He added that he learned a lot through operations that he wouldn't have learned had he stayed only in investments all his life and that having someone who had the dual experience in both would be optimal.
- Munger added that Berkshire needs expertise beyond that of a typical portfolio manager.

WHAT MATTERS MOST?

- Munger said that he was better at figuring things out than anything else and that early on he got the idea - partly from his family - that his main duty was to become as rational as he could possibly be. He admitted that since he was good at that and no good at anything else, he stuck with it. He said that "rationality is a moral duty and that Berkshire is sort of a temple of rationality and that easily removable stupidity is dishonest."
- Buffett said what matters most to him is that Berkshire does well. We probably have a million or more people involved, and it's enormously enjoyable to me, so I can rationalize it, Buffett adds. If Berkshire wasn't building something that was continuously getting better, Buffett says he wouldn't be happy.
- Munger adds that they "hate losing someone else's money. A good doctor doesn't like it when the patient dies on the table either."

U.S. DOLLAR AS A RESERVE CURRENCY

- Warren said that he thinks the dollar will be the world's reserve currency 50 years from now and although it was not certain, he would bet a lot of money on it.
- Charlie said that he was probably more nervous than most when it comes to printing lots of money and spending it. There are times when you have to do it – we just came though one – but I am happier when we print money and use it improving infrastructure than I am if we just spread it around with a helicopter.
- Charlie added that it is always more dangerous than the economic progressive thinks.

MOST MEMORABLE FAILURE

- Buffett said it was back in the 1990's when he decided to pay $400 million dollars for something that was destined to go to zero in a few years and on top of that, he paid the purchase price with Berkshire stock - that same stock would have been worth $6-7 billion now. Said he was not misled in any way but simply looked at it and came up with the wrong answer.
- He said that they have always been very, very, very cautious in what they have done and there probably were times when they could have stretched a little and pulled off something quite large that, in retrospect, was a mistake not to have done, but they passed because he did not want to take even a 1% chance that his Aunt Phoebe's net worth could be wiped out. "It is just not something in life that I could live with."
- Said that he would rather be 100 times too cautious than 1% too incautious and that would continue as long as he was around. "People looking at our past would say that we missed some big opportunities that we understood and could have swung at if we weren't worried about losing part of our money."
- Charlie added that had they used the leverage that a lot of successful operators did, Berkshire would be a lot bigger but they would have been sweating at night and "it's crazy to sweat at night."

FUTURE OF THE EURO

- Munger said the Euro had a noble motivation with a promise of doing a lot of good and has done so, but it is a flawed system in some ways because it puts countries together that are so different and at the moment, "it is strained."
- He added that the big stains are from countries like Greece, Portugal and so on and said that he thinks they created something that was probably unwise because they included countries in the Euro that probably should not have been in there. "You can`t form a business partnership with your thriftless monkey brother-in-law."
- Warren said that he thinks the Euro was a good idea but it still needs a lot of work. "It has been a good thing up to this point but it is flawed and the flaws are apparent, but that does not mean it can`t be corrected."
- He added that he does not think the fact that it was not perfectly designed initially should condemn it to being abandoned and thinks that if there are flaws, the European Union has to face up to them.
- Warren said he believes it is probably desirable to have a properly designed and enforced Euro currency so that the rules really apply and noted that despite originally having rules on the Euro, they got broken very early on by member countries.
- He said that he thinks the Euro can and probably should survive but it will take some real changes and maybe some examples to the network to do so. "It will either go in the direction of more cohesion or less and it will do so probably very soon. In its present form it is not going to work."

Mario Antinori
Associate Portfolio Manager
Tel.: 514.286.7311
mario.antinori@nbpcd.com

Alessandro Commodari
Associate Portfolio Manager
Tel.: 514.286.7254
alessandro.commodari@nbpcd.com

May 7, 2015

BMO Wealth Management
BMO Nesbitt Burns

COMMODARI ANTINORI GROUP
1501 McGill College Avenue, Suite 3200
Montreal, Quebec H3A 3M8
www.commodariantinorigroup.com

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