Ten Takeaways From The Oracle of Omaha

SYNOPSIS

- Warren Buffet is regarded as one of the greatest investors of all time, and each year I dedicate a few hours to read his annual letter.
- Not only do I get smarter from reading his thoughts, I am also reminded that value investing is the true path to long-term gains.
- Berkshire's most recent annual report was released last weekend, and here are 10 key takeaways.

currie financial group

Warren Buffett Has Done Alright

I dedicate a few hours every year to study Berkshire Hathaway's annual report. Warren Buffet has remained at the helm for over fifty years and is regarded as one of the greatest investors of all time. It's a great read, and I always feel smarter in some way after finishing the report.

I strongly urge those who have an interest in business, investing, and the economy to take the time to read the first 34 pages that are written directly by Mr. Buffett himself (the link to the report is here: http://www.berkshirehathaway.com/2015ar/2015ar.pdf).

For those who would rather take my word for it, here are my 10 takeaways from Warren Buffett's 2015 Annual Report:

10. "Today's politicians need not shed tears for tomorrow's children"

I am so glad that someone with a little more clout than I finally addressed this subject, particularly during an election year. One of my biggest pet peeves with politicians are their constant use of negativity towards the direction of our society as tactic to push policy "solutions" that never seem to get implemented anyway.

The fact of the matter is that people today are so much better off than they were in past generations. Sure, Millennials are living at home after graduation because they can't afford to rent an apartment, and yes, some may never pay off their student loans.

However, these are first world problems that can be easily resolved. What's not simple to fix is polio, world wars, poor education, being trapped in an avalanche without a GPS-enabled smartphone to call for help, etc. Mr. Buffett summarizes it far more eloquently on page 7:

"The babies being born in America today are the luckiest crop in history"

9. Companies don't need to cheat to win.

Berkshire owns a company called Clayton, which provides loans to lower income families to buy their manufactured homes. Given the news of so many players in the mortgage business paying billions in fines, I was curious how Clayton has fared since the depths of the financial crisis.

On page 19, Mr. Buffett states that Clayton has paid next to nothing in mortgage-related fines, only 2.4% of their mortgages were foreclosed last year, and 95.4% of their borrowers were current on payments and moving closer to owning a debt-free home.

Furthermore, they don't sell their mortgages to "de-risk" in the same manner as their competitors. When they make a loan, they keep it rather than pass it along to someone else.

Clayton remains a market leader and an incredibly profitable component to Berkshire's empire, and they have done so while running a clean operation. Simply put, companies don't have to mislead, lie, cheat, and steal from their customers in order to make a profit.

8. Conservative investments and patience are the keys to financial success.

Berkshire Hathaway is a huge company with several businesses under its umbrella. Overseeing so many different enterprises requires a strict focus on disciplined risk management.

One commonality across each investment and acquisition is his insistence on being conservative. He owns boring companies with consistent profitability rather than swing for the fences in riskier areas. For example, even in boom years, his insurance businesses rarely take on too much risk because all it takes is one greed-inspired mistake to end decades of success.

Simply put, his strategy is one of sacrificing homeruns for singles and doubles and being patient so that returns can build over time.

7. Mr. Buffett has been wrong a lot, which is why he's so successful.

Although Warren Buffett is worth tens of billions of dollars, he's still as human as the rest of us. He makes big mistakes and bad decisions with his money on a regular basis. In fact, the overwhelming majority of investors are wrong far more times than they are right. I know I am.

Investors only have to be right a few times to achieve success, and the way to be right is to learn from past mistakes. Mr. Buffett has made a career of screwing up, assessing why he screwed up, and then applying his lessons learned against future investment ideas.

What he does not do is the "should have, could have, would have" routine, where so many fall victim. He also bluntly sets his investors' expectations for the future on page 16:

> *"I will commit more errors; you can count on that."*

6. His acquisition criteria create a brilliant blueprint for an investment portfolio.

Warren Buffett maintains a list of six basic criteria when assessing potential acquisitions for Berkshire Hathaway:

1. **Large purchases that fit into existing business units**: Large companies usually have proven business models in well-understood sectors, which limit risk.
2. **Demonstrated consistent earnings power**: Four very strong words. "Demonstrated consistent" meaning proven and less cyclical; and "earnings power" meaning profitable.
3. **Good returns without too much debt**: Look for companies that use debt wisely with little reliance on it to grow a business.
4. **Management already in place**: Mr. Buffett wants dedicated, seasoned, and proven managers of companies because the time and cost to find new leadership creates risk.
5. **Simple businesses**: Mr. Buffett has mostly avoided tech because he admittedly does not understand the sector all that well. Invest in what you know.
6. **An offering price**: No matter how attractive an investment may screen, it all comes down to price. If no price is offered, then he is not interested.

All of these criteria must be met before Berkshire will consider an investment. Furthermore, they only consider "friendly" acquisitions, where both sides welcome the deal, and businesses that don't require much change. Often times, change equates to risk, and Charlie Munger, Berkshire's second in command, says it best on page 6:

> *"If you want to guarantee yourself a lifetime of misery, be sure to marry someone with the intent of changing their behavior."*

Investors can use these same principles as a blueprint for their own portfolios. Buy high quality companies with good management teams in sectors that you understand at an attractive price.

5. Productivity will continue to be the all-important factor in America's economic growth.

The link between productivity and prosperity is often underestimated. Mr. Buffett uses farming as an example to prove his point:

In 1900, over 40% of the American work force worked in farming. The leading crop then, as now, was corn, and around 90 million acres were dedicated to corn production with a yield per acre of 30 bushels, totaling 2.7 billion bushels annually.

Today, around 85 million acres go to corn, but thanks to technological innovations such as tractors and computer modeling, yields have improved to over 150 bushels per acre, for an output of 14 billion bushels.

What makes the story even more compelling is that the physical output has fallen from 40% of the work force down to 2%. Human resources have been reallocated to other ways to gain similar efficiencies on other areas of our economy. For example, John D. Rockefeller had power and money, but he could never buy an iPhone.

> *"U.S. citizens are not intrinsically more intelligent today, nor do they work harder than did Americans in 1930. Rather, they work far more efficiently and thereby produce far more."*

These gains are incredibly important to economic growth and prosperity and should not be hindered. America has been a leader in productivity gains, and the benefits will continue to make our country even stronger.

> *"For 240 years, it's been a terrible mistake to bet against America, and now is not the time to start."*

4. Railroads are incredibly fuel efficient.

What I love most about this business is that I am constantly learning, and no matter how long I work, I'll never know it all. Within this context, here's a quote from Warren Buffett on page 14 that I would have definitely guessed incorrectly in a bet:

> *"Class I railroads use only a single gallon of diesel fuel to move a ton of freight almost 500 miles. That makes the railroads four times as fuel-efficient as trucks!"*

Imitation is the sincerest form of flattery, so be sure to have this fun fact memorized and ready to go at your next cocktail party.

3. Watch your back when walking down "The Street."

Try not to act too surprised, but Wall Street does not always have your best interests in mind. He warns to exercise caution while reading research reports from "The Street" because it can be biased.

For example, research analysts at large investment firms can get blacklisted with management teams if they report anything too negative about a company under their coverage, which is one reason why Wall Street is so bullish so often.

Additionally, never buy a financial product that you don't understand. Heed Mr. Buffett's advice on page 18:

> *"When Wall Street gets 'innovative,' watch out!"*

2. Low investment returns transform into very attractive returns for patient investors.

Warren Buffett takes issue with commentators who complain about the current 2% growth in our economy. On page 7-8, he walks through a very basic example of how low annual growth can still turn into astounding gains over time due to the power of compounding.

He also preaches a long-term investment approach on page 23:

> *"… investors who diversify widely and simply sit tight with their holdings are certain to prosper: In America, gains from winning investments have always far more than offset the losses from clunkers."*

1. Annual stock performance is not always indicative of company performance.

I saved the best for last. Back in early January, Financial news networks ripped Mr. Buffett because his stock lost 12.5% in 2015 versus the 1.4% gain in the S&P 500.

The network pundits just could not help themselves. They had to take the opportunity to address a series of idiotic questions that pointed to the notion that Warren Buffet has somehow lost his touch for no reason other than his company's stock failed to outperform a benchmark over the time that takes the Earth to circle a huge ball of gas.

For a moment, let's put aside the fact that since 1965, he has outperformed the S&P 500 by almost 1.6 *million* percent. Let's also ignore that although he underperforms the S&P 500 one out of every three years, he has never underperformed any 15-year period.

The real question that pundits should ask is how well the underlying business performed. According to the annual report, Berkshire's gain in net worth during 2015 was $15.4 billion, which increased the book value of the company by 6.4%. Furthermore, book value has grown from $19/share in 1965 to $151,501/share today, a rate of 19.2% compounded annually!

The point here is that share price does not always reflect the underlying direction of a company's profitability. Berkshire had a good year (read page 4 for more details), yet their stock suffered due to short-term forces that not even one of the best investors of all-time can control.

The bottom line is that those investors and pundits who believe that stock performance over a single year is relevant are sorely mistaken.

Sincerely,

Mike Sorrentino, CFA
Chief Strategist, Aviance Capital Management
mikeonmarkets.com

This commentary is not intended as investment advice or an investment recommendation. It is solely the opinion of our investment managers at the time of writing. Nothing in the commentary should be construed as a solicitation to buy or sell securities. Past performance is no indication of future performance. Liquid securities, such as those held within DIAS portfolios, can fall in value. Global Financial Private Capital is an SEC Registered Investment Adviser.