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Buffett: No Fish in the Barrel

Dear fellow investors,

The Berkshire Hathaway Annual Meeting was a mixture of caution, wisdom and honesty. This was very refreshing after last year's historical pep talk, which was void of any pep and was light on wisdom.

Caution

Buffett started out by showing the 20 largest capitalization companies in the world today. Then he showed the 20 largest in 1989. He asked how many remain among the largest today. The answer was zero. It was dominated by Japanese companies which were at the top of a mania. Beside Saudi Aramco, today's list is loaded with U.S. technology giants and included Berkshire Hathaway (BRK.B). Buffett bought into Coca Cola (KO) in 1989, which wasn't in the top 20 at that time.

The irony of this terrific exercise was the conclusion Buffett drew from it. Buffett used it to endorse ownership of the S&P 500 Index. History shows that the worst time to buy the index is when it is dominated by popular stocks. Imagine you bought the Nikkei Index in 1989 owning the largest Japanese stocks in the top five of the world list. Here is the Nikkei Index of the Tokyo stock market from 1989-2009. Who would be excited by the 20-years of losses in that index?

Sometimes we think that Buffett wants investors to be left with two choices for common stock investing, indexing or BRK.B. It seems a little out of line as we enter an era that is likely to reward a completely different set of investments than the prior era.

Warren and Charlie warned of "rampant speculation" as exhibited in SPACs and IPOs. He shared his favorite John Maynard Keynes quote:

> *"Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done."*

Trust Buffett and Munger, there will be torture in the stock market from this euphoria episode.

Buffett took a pretty good shot at today's mega-popular growth stock managers emphasizing disruptive companies. There seems to be hundreds of disruptive companies out there and supply is only held back by an under-funded SEC. He used the auto industry as his poster child.

There were about 2,000 auto companies in U.S. history and the industry did truly change everything in society. In totality, investors took a massive bath in losses from 1929 through 1981 because picking winners in the auto industry was like finding a needle in a haystack. There have been two government bailouts of the industry in 1980 and 2008. Will today's disruptive industries produce a much different result? History and Buffett argue, "No!"

Wisdom

Berkshire has no issue owning Chevron in light of climate change and ESG concerns and said he wouldn't mind owning the whole company. He expects the company to benefit society over the long run.

> *"People who are on the extreme of both sides are a little nuts. I would hate to have all hydrocarbons banned in three years. It wouldn't work. And on the other hand, what's happening will be adapted to over time," he said.*

He went on to remind folks that there are imperfections in every company if you want to dig in. Berkshire never bought tobacco companies (nor do we), but he has owned companies who make a pile of money selling cigarettes.

> *"There's something about every business that, if you knew it, you wouldn't like ... if you expect perfection in your spouse or in your friends or in companies, you're not going to find it," he said.*

Holding winners to a fault was revisited by Buffett and Munger. Warren apologized for selling some Apple shares late in 2020 and Charlie chided him for doing so. Remember, the math of common stock investing is that there are limits on what you can lose on the downside and no limit on the upside of long-term winners.

Honesty

Buffett reminded us that he is at his best when shooting fish in a barrel. In the 1950s and 1960s, his barrel of fish came from having better information and the foundation of Ben Graham's value discipline underneath him. He bought many things at huge discounts to their actual value, because nobody else had his information access or educational background.

In the 1960s, he met Charlie in Omaha and when the bear markets of 1968-1969 and 1973-1974 crushed all stocks, Warren started shooting wonderful companies at cheap prices in a barrel. By 1981, interest in the stock market and participation by U.S. households bottomed and interest rates peaked at 15% on long-term Treasury bonds. This led to the second phase of barrel fishing. He had very little stock-picking competition and he and Munger always say that "weak competition is the key to investment success."

By 2000, Buffett entered his third phase of shooting fish in a barrel. Berkshire became the go-to investor for public and private companies to sell their company outright and keep everything in place. Berkshire became the go-to financier when the financial crisis demanded massive equity quickly. Think Goldman Sachs in 2008 and Bank of America later on.

His problem now is his investment vehicle, Berkshire, is way too big to play in anything below a $50 billion market cap company. Information is available to everyone and microscopic interest rates have drowned private equity firms and other deal competitors with capital to outbid Buffett. There is no gravity due to microscopic interest rates, just like in 1989 Japan.

Buffett touched on his second problem, currently. He pointed out that four-week Treasury bills pay 0%. He explained that low rates have effectively "eliminated gravity" as it pertains to stock prices. Buffett said, "If you eliminate gravity, I could compete in the Tokyo Olympics!" The history of the markets show the only guarantee is that things will change. We will assume that gravity makes a comeback on interest rates and imposes its will on stock prices.

Lastly, Buffett and Munger paid respect to Professor and Nobel prize winning economist Paul Samuelson. His nephew, Larry Summers, is a lone voice in the desert warning of explosive inflation. Here is what Munger said about inflation:

> *Yeah. And there's one very intelligent man who thinks it's dangerous and that's just the start.*

In conclusion, the meeting was meaty and valuable. We thank these two investment giants for sharing with us.

Warm regards,

William Smead