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Berkshire Hathaway Annual Meeting 2017: Four Keys for Investors

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Dear Fellow Investors,

Each year we like to drill down on the wisdom imparted by Warren Buffett and Charlie Munger at the Berkshire Hathaway Annual Meeting. This year, we thought there were four key takeaways we can consider in running our portfolio of common stocks at Smead Capital Management.

Interest Rates

Buffett did not disappoint us here. When asked about computing the intrinsic value of Berkshire Hathaway or any other business he said, "If I could ask you for one thing, it would be what the interest rate is going to be ten years from now." This reiterates what he said in his annual letter about how if interest rates stay at these levels for ten years, stocks are undervalued. For those who are skeptical of rates staying low, Buffett went on to say, "If you say you can't see how our interest rates will stay low, look at Japan." For the benefit of BRK.B shareholders like us, Buffett quipped, "With rates low and our size we are unlikely to earn terrible returns or spectacular returns." True to form, Munger jested, "We told you our size would lead to lower returns and we have proved ourselves right. Other people are trying to be brilliant and we just want to be rational."

Our takeaway from this dialogue is that we believe BRK.B to have solid and not spectacular performance, and significantly higher interest rates will take time.

Moats

Buffett used a wonderful metaphor to illustrate the competitive advantage of a business. He said, "View your business as a castle with a wide water way (moat) around it, and a strong Knight outside the moat warding off marauders." He later circled back to the metaphor when questioned about shares he owns in Wells Fargo (WFC) and American Express (AXP), both of which have stumbled on their own or lost a big contract in recent years (Costco). Buffett explained that, "There is competition in all these businesses and we bought them because they have very strong hands. They have the ability to ward off competitors and they are very well positioned."

These are common holdings we have with Berkshire, and it reminded us of why it is such a great thing to own wonderful businesses capable of beating back marauders and doubters within the short-sighted marketplace. It is for reasons like this we like to say, "Only the Lonely Can Play."

Ongoing Learning

Buffett and Munger constantly pounded home the point of ongoing learning and how it makes you a better investor. Someone in the audience asked how they found and understood what a great business looked like. Munger's answer was priceless, "In the early years, we were young and ignorant. We bought horrible businesses which were unfixable and we learned. We could see what a great business See's was because of what we learned."

Munger reinforced the idea of learning when answering why Buffett bought Apple shares (AAPL). He said, "Either he's crazy or he's learning. And I'd bet on the latter."

In my 37 years of common stock investing I have had the pain of owning some less than stellar businesses. We agree with Munger who said that, "Pain is the best teacher." It makes our eight criteria for common stock selection more valuable in our eyes because it leads to what Munger calls, "ignorance reduction."

No Regrets

Buffett's recent sale of a third of his IBM holdings has led to a media field day at Berkshire, so it came as no surprise that one of the early questions addressed it. Here is how Buffett and Munger responded to the question, "On IBM and Apple--what have you learned?" Buffett replied, "IBM hasn't done as well as I thought it would. Apple is more of a consumer business." Munger added, "In the past we have avoided tech stocks because we had no advantage. We should have figured out Google." Buffett added, "I blew it, because GEICO was paying $10 per click for advertising to Google and I knew how many clicks there were." Munger reminded everyone that years ago, "We blew it on Walmart, also."

Our view is that nobody said good stock selection and portfolio management means you never have duds. While IBM has markedly underperformed the S&P 500 since Buffett bought the stock, it hasn't lost him money. If you are right 60-70% of the time, your winners will grow to be multiple times your original investment and you need not form a pity-party. The job is not perfection; it is wealth creation, and nobody has done it better than Buffett and Munger.

In summary, this year's annual meeting of Berkshire Hathaway reminded us of some of the most important keys to successful long-duration common stock investing. Our interest in Berkshire Hathaway looks solid and we will continue to look for wide moat companies at reasonable to depressed prices in this low interest rate era. We will try to learn more and more about business with intangible assets and accept our victories and defeats with humility and without regret. We appreciate the wisdom of these investing masters.

Warm Regards,

William Smead

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