



**William Smead**  
Chief Executive Officer  
Chief Investment Officer

## Berkshire Hathaway Annual Meeting 2018: A Mirage of Feelings

Dear fellow investors,

Much like the 1975 Billboard top ten hit song, Feelings, Warren Buffett and Charlie Munger laid out their feelings on a variety of issues in Omaha at the Berkshire Hathaway (BRKB) Annual Meeting. We believe even the greatest investors of all time are being influenced by a mirage. This mirage comes from historically low interest rates and fantastic returns coming out of a narrow group of technology stocks. Buffett and Munger's feelings ranged from optimism to pessimism and included some very mixed feelings on important subjects. Overall, we at Smead Capital Management are very encouraged by what we learned and think that our opportunity is to not let our feelings become a part of this mirage.

### Optimism

1. *Buffett*: By sharing the newspaper headlines from 1942 and explaining how well stocks have done over long-duration time periods, Buffett expressed great optimism and redirected investors' focus away from the temporary ups and downs.
2. *Buffett and Munger*: Both men feel the parent company will be able to take advantage of many of the same competitive advantages in common stock and private equity ownership that exist while they are at the helm of the company. They think the talent pool at BRKB is

strong in stock picking (Todd Combs and Ted Weschler), financial strength and corporate management.

3. *Buffett*: Warren is very optimistic about the US. He pointed out that he has lived under 14 Presidents and the people who would have you believe that this is the most divided we've ever been don't know history or aren't old enough to know.
4. *Wells Fargo (WFC)*: Buffett reminded investors that large companies will make big mistakes from time to time. For example, Buffett said there is probably an employee of Berkshire doing something very wrong every business day. Wells Fargo created incentives which led to very bad behavior. Buffett pointed out that he never would have owned American Express (AXP) if they had not made a bad decision about running warehouses on the docks of New York in 1964. Munger pointed out what a good job Harvey Weinstein has done in changing behavior.
5. *American Express (AXP)*: Buffett and Munger sang the praise of AXP and called it a "wonderful company." They seemed very optimistic, even though the stock market has had an ongoing love affair with Visa and Mastercard. Buffett gave us a sense that he would love to own a much larger position in American Express.

## Pessimism

1. *Buffett*: “Bonds are a terrible investment at anywhere near current yields.” He continued, “The only time bonds were interesting was in the early to mid-1980’s.”
2. *Cryptocurrencies*: Buffett explained that cryptocurrencies are an “unproductive asset” like gold and rely on the ability of the speculator to have someone come along behind them to buy at a higher price. He added, “It’s a breeding ground for “charlatans” who take opportunities to rip off people trying to get rich in something they don’t really understand.” *Munger*: “I like cryptocurrencies a lot less than you do,” replied *Munger*, 94. “To me, it’s just dementia. It’s like somebody else is trading turds and you decide you can’t be left out.” You might say that cryptocurrencies create something of a mirage.

## Mixed Feelings

1. *The healthcare partnership with Amazon (AMZN) and JPMorgan (JPM)*: Buffett doesn’t seem to be sure at all about what they are going to accomplish in the partnership. He said they would hire a CEO, but that they wouldn’t form a company to do it.
2. *The use of cash held on the balance sheet of companies*: Buffett seems to like stock buybacks and doesn’t prefer dividends. *Munger* feels that buying other companies via large-scale mergers is usually a disappointment. They both complained about the way private equity investors have bid up deals that might come to Berkshire otherwise.
3. *The effect of technology on moats*: “Elon says a conventional moat is quaint, and that’s true of a puddle of water,” *Munger*, 94, said. “It’s ridiculous. Warren does not intend to build an actual moat. Even though they’re quaint.”

## Smead Capital Management’s Feelings

1. Some industry experts believe we have the most over-lap with Berkshire Hathaway’s stock holdings of any large-cap equity mutual fund. Buffett and *Munger* had very positive things to say about our holdings BRKB, AXP and WFC. In past meetings they have raved about Bank of America (BAC), another common holding.
2. Buffett and *Munger* spoke very little about the psychology of the stock market. We believe it is because of their size. Buffett needs to put \$10-20 billion into each idea and we put a small fraction of that into each company. The Berkshire Hathaway stock market universe is narrower, so they are less interested in what Mr. Market is saying to his partner and more interested in getting a call from a company seeking to go private. We have numerous stocks to purchase with historically strong moats, who are threatened and live with some uncertainty. Buffett and *Munger* have said many times, “Uncertainty is the friend of the value investor.” The current investment environment could put its mirage in the way of today’s value investors, including Buffett and *Munger*.
3. *Munger* pointed out that cheap money helps the “undeserved” wealthy, like Buffett and *Munger*, in society. This voting machine effect is in place today pushing securities higher as rates stay historically low. He noted that he hopes they (meaning Berkshire) continue to benefit.

We at Smead Capital Management don’t believe this is the benefit that Charlie should be seeking, because, although they have benefited in the short term, it may be hurting them in the long term. Low rates cause marginal players to enter the market because funding costs are low. Scott Galloway of NYU says that high price-to-earnings tech companies have a “zero cost of capital.” The longer this goes on, the higher the probability there will be a money-



losing entrant invading your industry. Each time that has happened in recent history, existing industry participants feel the blues.

As Buffett noted, it feels like moats appear more penetrable today. His feeling might be the illusion that this environment won't change. We believe cheap money is like a mirage. It always vanishes and you end up with a lack of liquidity, just when you desperately need it. We believe Munger and Buffett are being tricked by the mirage. Our portfolio managers have a combined 73

years of experience in the investment business and we've learned that the only guarantee is that things will change. In this era of growth stock popularity, it appears even the 'Oracle of Omaha' and his brilliant sidekick, Charlie Munger, are affected by this mirage of feelings tied to investment size, low interest rates and stock market popularity. 🐦

Warm regards,



**William Smead**  
Portfolio Manager

**Tony Scherrer, CFA**  
Co-Portfolio Manager

**Cole Smead, CFA**  
Co-Portfolio Manager

---

The information contained in this missive represents Smead Capital Management's opinions, and should not be construed as personalized or individualized investment advice and are subject to change. Past performance is no guarantee of future results. Bill Smead, CIO and CEO, Tony Scherrer, CFA, Director of Research, and Cole Smead, CFA, Managing Director wrote this article. It should not be assumed that investing in any securities mentioned above will or will not be profitable. Portfolio composition is subject to change at any time and references to specific securities, industries and sectors in this letter are not recommendations to purchase or sell any particular security. Current and future portfolio holdings are subject to risk. In preparing this document, SCM has relied upon and assumed, without independent verification, the accuracy and completeness of all information available from public sources. A list of all recommendations made by Smead Capital Management within the past twelve-month period is available upon request.

This missive and others are available at [www.smeadcap.com](http://www.smeadcap.com).

