



Missive

FEBRUARY 22, 2023

Ramblings From My Idol, Charlie Munger

Dear fellow investors,

On February 5, 2023, Charlie Munger sat down as the Chairman Emeritus of the Daily Journal Corporation (DJCO) to answer questions from shareholders and the public. We think of it as the question-and-answer session of the Berkshire Hathaway meeting with an extra serving of pithiness and wit. We at Smead Capital Management believe Mr. Charles T. Munger is one of the wisest people to walk the earth today, particularly in the category of worldly wisdom. We stand at attention anytime he decides to opine on subjects. I wanted to write on a few of the subjects he touched on as we believe they are helpful for our investor.

Rules-based investing vs. experiential investing

Early in the Daily Journal meeting, a question came in about the three evils that ruin people. Becky Quick said:

Somebody else wrote in, and I don't have the e-mail in front of me at the moment, but he wrote in quoting you, where you said the 3 things that ruin people are ladies, liquor and leverage. So why would you use leverage when you know that's 1 of the 3 things that can destroy somebody?

Munger responded by pointing out that Buffett and he had both used leverage on arbitrage situations earlier in their investing career. He referred to the fact that Ben Graham (himself Jewish) referred to these as Jewish Treasury Bills. They would employ leverage on these arbitrage situations, but those opportunities are fewer today in a much more crowded space. Despite that, Berkshire is currently employing a Jewish Treasury Bill approach on Activision. Becky Quick went on to ask, "So is leverage the least evil of the 3 Ls?" Munger responded:

I think most people should avoid it, but maybe not everybody needs to play by those rules. I have a friend who says, the young man knows the rules, and the old man knows the exceptions.

This kernel of wisdom got me so excited because it was a truth that we have already witnessed as investors. Generally speaking, the oil business is not the easiest business to get wealthy in. Also generally true is that companies with larger amounts of leverage don't succeed. These are the rules of investing, in our opinion. Many investors will exclude the energy industry or other companies based on these rules.

Then the Spring of 2020 shows up in your life where you see investors leaving assets, like the commodity of oil, for dead. This is where the exceptions lie. The lack of willing investors required the companies to conserve capital, a discipline they were not used to. This caused balance sheets to rapidly get repaired and caused the return on equity of these businesses to explode. Rules-based investors missed this opportunity and are still missing this today. The investors of Smead Capital Management and the Vice Chair of Berkshire understand this is an exception.

The problem with population

Becky asked a question that is being debated in the court of public opinion today:

This one is an interesting question. It came in from [Eric Howe] in Milwaukee, who says, "The population of the world is thought to have increased by more than fourfold time since you were born. Mind you, I'm not holding you personally responsible, but there has been that magnitude of growth. Is there a point where the biggest existential threat to humanity is the growth of the population and humanity? If so, how do we discern when that point has arrived?"

Charlie responded:

Well, that's an interesting subject. If you'd look at the way things have happened in the past, you would have concluded like Paul Ehrlich did that the world is headed for an absolute population disaster. But what actually has happened is quite different. What's happened is that as the world has gotten more and more prosperous, including in places like China, the birth rate has gone down, down, down. And so there's actually sort of a population shortage in a place like Japan. So the prediction of all the great experts based on extrapolating the past graphs, they turn out to be totally wrong. It now looks all the world's population in the advanced countries will sort of self-limit.

Charlie Munger is rebutting a major argument when he says this. Paul Ehrlich, who was made famous for his 1968 book *Population Bomb*, set his thesis on Malthusian foundations. He explained that we would have unsolvable problems if we didn't stop the growing population of the World. Ehrlich has only been wrong for 55 years so far. Charlie is just admitting the fact that having more people has created more prosperity, not less. We find this quite interesting as Charlie Munger has been a proponent of Planned Parenthood, which follows an Ehrlich-like ideology.

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How to sum up such a contentious subject like this came in the next exchange when Becky Quick said, "I mean, that kind of puts you in the same camp with Elon Musk. He has made some of the same arguments that it's really shrinking population that's a bigger threat to humanity."

Munger responded, "As I said, he's a smart man sometimes. Sometimes, like all the rest of us." We agree with Munger on Musk, but also know that Munger is a smart man...sometimes. We are glad that he is now right that to be a prosperous society, we need more people!

Loyalty to shareholders

In the later part of the meeting, Becky Quick asked a question about Warren Buffett as a learning machine. Munger replied by saying:

Well, Warren is not only a very good thinker and a good learner, which is important, but Warren has a big strong fiduciary gene. He cares about what happens to the shareholders. Warren and I were lucky in that the early shareholders that really trusted us, we were young and didn't have a reputations and so on.

And naturally, we feel an exceptional loyalty to those people. And of course, naturally, they're all dead now. We're still loyal to them. Warren and I still care what happens to the Berkshire shareholders, a lot. And I think that helps us. I think that it helps if you're good at loyalty.

Speaking for my dad, my colleagues at Smead Capital Management and myself, this tugged at our heartstrings. The trust shareholders have provided to Warren and Charlie, particularly the partnership

investors of Buffett, whose estates are still owners, continue to sit heavy in the mind of Buffett. He views this almost as if they are still serving them directly today. While they are not, they are serving those same shares. They think in the best interest of Berkshire shareholders by acting in ways that are beneficial to not just them but all holders of the company. This is what happens when people have skin in the game. They have a higher level of fealty to the people that have joined them in the business risk they are taking.

Bill and I feel this in our loins. We often get asked about what our personal asset allocations look like. We own two investments in our liquid net worth. We don't buy stocks outside of our two strategies. Why would we be so dogmatic in our own investment approach? We feel loyal to the investors of Smead Capital Management. A favorite saying of ours is uttered when someone asks us who our favorite investor is. The one we already serve. We have an intense fiduciary gene to our investors because they are co-investors or partners alongside us seeking success in common stock ownership. As Charlie might say, "If you think that is not the correct approach, we don't care." To fashion this in the wisest Charles T. Munger way, we think that is right and have no further comment.

Fear stock market failure,



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