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EXECUTIVE SUMMARY

- **Market Update**
- **University of Berkshire Hathaway**
- **Berkshire's Cash/Bond/Stock Ratio**

MARKET UPDATE

For a couple of boring value guys it was quite a week. The Royal Wedding. The Berkshire meeting just down the road in Omaha. News of the death of Osama bin Laden. Then rock and roll legend Elton John came to town!

Worldwide, we read where 2 billion people watched the Royal wedding. That's nearly one third of all the humans on the planet and a reminder of how connected our world is becoming.

Bin Laden's death was big news for the U.S. on many levels. As Fareed Zakaria has noted, the new Mideast has been turning away from terrorism. According to the Pew Research Center, confidence in bin Laden dropped from 56% to 13% of respondents in Jordan from 2003 to 2011, from 15% to 3% in Turkey and from 72% to 34% in the Palestinian territories.

In the investment world, we had a flash crash in silver, cooling some of the speculative elements in the market. It has been our sense that a vast number of potential investors are still on the sidelines – pensions, endowments, individuals – still wary after the 2008-09 debacle. Filling the vacuum, a primary driver of the market's doubling over the last 2 years has been hedge funds. And they are primarily interested in the more speculative issues to goose their returns. Thus, junk bonds, emerging markets, commodities, and small cap stocks have been the biggest winners. This thought is consistent with the recent volatility in commodity prices as the hedge funds run for cover. Meanwhile, global multinationals have moved up moderately on excellent earnings. With their natural investors on strike (those pensions, et al), these companies still offer an impressive package of reasonable multiples, 3% dividend yields, powerhouse balance sheets, and a solid play on the remarkable growth of the emerging world for decades to come. One such package (ex the dividend yield) is Berkshire Hathaway….

THE UNIVERSITY OF BERKSHIRE HATHAWAY

The three amigos, John, Corey and Dan, all made the annual pilgrimage to Omaha for the Berkshire Hathaway meeting (though Corey had to hurry home for his daughter's prom night!). They were joined by 40,000 of Warren Buffett's closest friends. The Qwest center convention floor was filled with the usual assortment of Berkshire subsidiaries hawking their wares, from See's Candies to Justin Boots. In the packed arena, vice chairman Charles Munger joined chairman Buffett on the dais to handle questions from the throng of shareholders for about 6 hours. It is an impressive learning experience and even more so when one consider that "Professors" Buffett and Munger (ages 80 and 87, respectively) are as sharp as ever.

Buffett and Munger have presided over one of the greatest records of wealth building in history. Since Buffett took over Berkshire 46 years ago, Berkshire's per-share book value has grown from $19 to $95,453, a rate of 20.2% compounded annually. That's more than double the S&P 500's 9.4% annualized percentage gain for the same period. Remember that compounding is a geometric progression, so a small advantage in the annual rate of compounding results is a huge advantage in total dollars compounded over time. In terms of the overall percentage gain from 1964-2010, a dollar invested in Berkshire in 1964 experienced a **gain of 490,409%** versus a gain of 6,262% for the S&P 500 – a superior performance resulting in ***78 times*** *more dollars for the initial dollar invested in 1964*. Really incredible.

What's more, the S&P 500 had 11 down years in the 46 year period. (And here's a good rule of thumb – the S&P 500 will have a down year at least every four years or so.) The cumulative loss for the S&P for those 11 years amounted to 251.4% (simple interest calculations). For those same 11 down years, Berkshire Hathaway's per share book value had only two losing years, and the cumulative **gain** was 117.8%. That's a whopping performance advantage of 369.2 percentage points (again, simple addition of percentages) for the 11 years! Overall, we estimate that more than two thirds of Berkshire's outperformance over the S&P was earned ***during the***

down years. This is the fruit of Buffett's "Don't lose" philosophy. And it's the piece that we believe investors miss again and again about value investing. It's not the money made in bull markets but the losing ideas avoided that makes for a superior rate of compounding capital over the long run.

Over those 46 years, Berkshire Hathaway has grown from a small New England textile company into one of the world's most powerful conglomerates. As we estimated in last year's UBH newsletter, Berkshire rose to 7th in revenue ($136 billion) in the most recent edition of the *Fortune 500*. Berkshire ranked 10th in profits ($13 billion). A year ago, Berkshire traded around $117,000 per A share, roughly a 25% discount to our appraisal of intrinsic value per share. Since then Berkshire's stock has appreciated only slightly, currently trading at about $120,000 per share. Meanwhile, intrinsic value grew handsomely, widening the substantial discount. Berkshire continues to offer good value and outstanding quality.

Here are our notes from the latest installment of the UBH lecture series.

UBH – THE MOVIE

Each year Berkshire kicks off the meeting with a movie featuring commercials from its subsidiaries, skits, and news clips. Highlights this year included the annual GEICO employee rock video featuring Buffett rapping and break-dancing (a stunt double) and a hilarious edition of "The Office" with both Buffett and Munger making appearances (one clip: employee getting interviewed – "Yeah, I'm just like Buffett. I save. I invest. And my kids ain't gettin' diddly-squat.")

FIRST QUARTER EARNINGS – A LOOK AT WHAT THE NUMBERS MEAN

Buffett has long been the accounting teacher. In four decades of annual reports, Buffett has covered many nuances of accounting convention versus a practical picture of business reality. The message throughout: look not what at the numbers are but what the numbers mean.

So we took it as highly significant that "Professor" Buffett opened this year's meeting with no less than four overhead slide projections, the first of which showed Berkshire's first quarter net operating profit of $1.6 billion versus $2.2 billion a year ago. $821 million of insurance underwriting losses obscured a decent increase in operating profits ex-insurance. Other than the residential construction area, Buffett was positive about the slow but steady improvement in the economy. In particular, Berkshire's purchase of the BNSF railroad was proving to be a real winner with its competitive advantages becoming more and more evident as fuel prices increase. What the numbers mean: with the exception of residential construction and some catastrophe losses, Berkshire's businesses are rolling.

Slide two showed Berkshire's estimate of its losses incurred from the recent catastrophes of flooding in Australia ($195mm), the earthquake in New Zealand ($412mm) and the earthquake in Japan ($1066mm) which came to $1,673mm. Berkshire estimates that $700mm of that total came from its 25% quota share arrangement with SwissRe. Buffett noted that historically, Berkshire experiences losses totaling some 3-5% of total catastrophe losses (which was true with Katrina). (Ed: So here's a really good unasked question: how can Berkshire have some 10% or so the world reinsurance market and yet consistently participate in only a fraction of that percentage of the losses when catastrophe strikes?) For perspective, Buffett noted that the New Zealand quake caused $12 billion in insured damages. Thus, New Zealand, with a population of 5 million people - just 1/60th of that of the U.S., suffered a catastrophe on a per capita basis that was *10 times Katrina* in scale. Buffett warned that the third quarter (hurricane season) is usually the worst for catastrophe losses, so 2011 might well go down as one of the worst years in history for such losses.

Slide three showed the phenomenal policy growth ongoing at GEICO, which added 218,422 policies q1 2010 and added another 319,676 policies q1 2011. Buffett values each policyholder at $1500 (about 1x premiums), so GEICO added nearly $500 million of value in the first quarter. Goodwill accounting does not reflect this increase in value. Buffett noted that GEICO's intrinsic value has grown to over $14 billion now and GEICO continues to gain market share every day. Buffett joked that if just 66 shareholders would sign up with GEICO in the convention hall that would add $100,000 of value for Berkshire and help pay for the annual meeting! (Ed: Here's another area of inquiry. Advertising does more than bring in new policyholders, building advantages in customer retention, brand, and share of mind. So this is oversimplified, however, we note that GEICO is spending $225 million per quarter in advertising – so that's about $700 per new policyholder for q1. If GEICO can average a 94 combined ratio (6% margin) on a $1500 average premium, that's $90 profit per year per policyholder. That means it may take Berkshire about 8 years to get its money back *just on the ad spend*. So what are the features (which no doubt include float creation) that make this business so darn valuable?) What the numbers mean: GEICO's growing intrinsic value is much greater than what the accounting reports.

Slide four touched on an accounting convention called "Other Than Temporary Impairment". It makes little sense, but the fact was that Berkshire took a mark down of Wells Fargo stock purchased at higher prices and a deduction of $337 million on the income statement due to this convention. Meanwhile, Berkshire's $3.7 billion of unrealized gain on its other shares of Wells Fargo were ignored. What the numbers mean: Ignore income or losses from investments in calculating Berkshire's operating earnings.

Buffett summed up the slides, decrying the news headlines that report the "all important number" which could easily be the "all deceptive number". Instead, investors should focus on gains in operating earnings, gains in book value and gains in intrinsic value. For q1 2011, Berkshire showed progress by each measurement.

THE SOKOL ISSUE – INEXCUSABLE AND INEXPLICABLE

As widely reported, David Sokol resigned from Berkshire recently and left controversy in his wake. At the center of the storm were questions about Sokol's purchases of shares of Lubrizol, contact with Citigroup - Lubrizol's investment banker, and a meeting with Buffett where Sokol pitched the idea that Berkshire should buy Lubrizol. Buffett reminisced that it was 20 years ago that he endured the Salomon scandal. That scandal, even after all these years, Buffett still describes as "inexcusable and inexplicable." His guess is that he may well say the same about this one 20 years from now.

Buffett noted that Sokol did nothing to hide the trades he made, so there was no deception there. He also noted that a decade ago, he offered an incentive bonus plan to Sokol where, if certain extreme goals were met, Sokol would get $50 million and his junior partner, Greg Abel, would get $25 million. Sokol agreed with the proviso that the bonus be split equally, $37.5 million each. So here was part of what Buffett found so inexplicable – here's a man of such great integrity voluntarily giving up $12.5 million of bonus and then, with Lubrizol, the same man acting in a seemingly suspect way for a profit of a mere $3 million. Munger's one word explanation for Sokol's actions, "hubris".

There was anger from some shareholders about a lack of outrage in Berkshire's initial press release which conveyed praises for Sokol's contributions as well as regrets for his resignation. Munger conceded that the press release was not the most cleverly written in the history of the world. At the same time, he held firm that it doesn't serve to make decisions in anger. He quoted Berkshire board member Tom Murphy, "You can always tell a man to go to hell tomorrow if it's such a good idea."

THE LUBRIZOL DEAL

Buffett noted that Lubrizol is a low-cost provider of fuel additives, a $10 billion market. It has a good sized, sustainable moat with lots of patents, number one market share, and regularly works with customers (primarily the major oil companies) to develop new additives. Buffett compared it to Iscar, which "shines up tungsten into tools and a durable competitive advantage". Munger noted that Lubrizol and Iscar are sister companies where their markets are small enough that they were not worth attacking. Buffett also noted that by spending $9 billion on the Lubrizol acquisition, Berkshire had used up a good chunk of the estimated $12 billion after-tax earnings he expects to come in this year.

SUCCESSION – INDEPENDENT CHAIRMAN

Buffett shared that on his demise Howard Buffett will likely become the independent chairman, as he will represent a large block of stock and receive little or no compensation. By separating the chairman and CEO positions, Berkshire can more easily correct mistakes with CEOs that don't work out. Fire one, hire another if need be. Buffett quoted the Bible, "the meek will inherit the earth" but then noted the next question is "Will they stay meek?" Thus it is critical to separate the chairman and CEO positions.

1776 - 2011

One long time shareholder asked Warren how he can be so infernally happy when we have so many problems. Buffett answered that he is indeed enthused about America. Since 1776, America has been the most extraordinary economic story in the world. If you had been told that following Aug. 30, 1930, the day Warren was born, the market would crash, 4000 banks would fail, the Dow would sink to 32 (32!!!), there would be 25% unemployment, a dust bowl, the grasshoppers would take over….you might think we were in big trouble. Instead, despite all those problems, since 1930 the average standard of living in America has increased 6 for 1. In contrast, Buffett observed that you can look at entire centuries in world history where nothing happened. The economic growth of America has been an incredible achievement.

Many have underestimated the resilience of our republic. Buffett said his father-in-law-to-be, Doc Thompson, was very anti-New Deal. He called young Warren over for a pre-marital talk, which made Buffett very nervous. He said that Doc went on for a 2 hour rant about the certain failure of the politics of the day and then concluded with this advice for young Warren, "You're going to fail but it's not your fault. Susie would have starved anyway. The Democrats are taking us to communism."

In 1951, the two men Warren admired most, his father and Ben Graham, both advised him against starting in the investment business at that time. The Dow at 200 (200!!!) was much too high. Better to park yourself on the sidelines for a while.

We've had the Civil War…15 recessions….it certainly has not been a straight line of progress but the power of capitalism has been amazing. Stimulus has helped our recent problems, but what will really bring us out of recession is capitalism. And the world has caught on. Buffett predicted that in the next 100 years we will have 15 to 20 lousy years and that we'll be so far ahead of where are now that it will be beyond belief.

Munger, in his characteristically sunny way, concluded that "Europe had the Black Death where one third of the population died. The world will go on."

INFLATION HEDGES

Buffett declared the best inflation hedge is a company with a wonderful product that requires little capital to grow. As a test, he invited each of us to look at our own earning ability. In inflation, your compensation can go up without any additional investment. As a business example, Buffett noted that when See's Candy was purchased in 1971 it had revenues of $25 million and sold 16 million pounds of candy annually with $9 million in tangible assets. Today, See's sells $300 million of candy with $40 million of tangible assets. Berkshire needed to invest only $31 million to generate a more than 10-fold increase in revenues. In aggregate, Buffett noted that Berkshire has earned $1.5 billion in profits at See's over the years. See's inventory turns fast, has no receivables and little fixed investment. A perfect inflation hedge.

Buffett allowed that if you have tons of receivables and inventory, that's a lousy business in inflation. The railroad and MidAmerican Energy both have these undesirable characteristics but that is offset by the their utility to the economy and subsequent allowable returns. Buffett rued that there simply aren't enough "See's Candies" to buy.

Buffett added that being an investor has made him a better businessman and that being a businessman had made him a better investor. (Ed: We concur.)

Munger noted that they didn't always know this inflation-business element, which shows how continuous learning is so important.

WELLS FARGO/US BANCORP

Buffett asserted that both banks are among the best, if not the best, large banks in the country, with Wells being about four times larger than US Bancorp. Buffett predicted that banking profitability will be less than it was in the early part of this century due to reduced leverage, which is good for society. Significantly, Buffett said he thought that by far we've seen the worst of the banking crisis. Loan losses will continue to come down. Banks should be conservatively run given that they get very cheap money with an implicit Federal guarantee.

Buffett noted that the FDIC since 1934 has bailed out 3800 banks, 250 of which were in the last couple years, and all the money came from other banks. The FDIC has been a well designed mutual insurance company.

THE 3 CATEGORIES OF INVESTMENT

Asked about commodities, Buffett noted that when he took over Berkshire, the stock traded for three quarters of an ounce of gold. At $1500 an ounce, gold has a long ways to go to catch up to Berkshire's $120,000 per share stock price. Then he outlined 3 categories of investment:

Category 1 – Investments denominated in a currency. Buffett pulled out his wallet and took out a one dollar bill and read out loud "In God we Trust". He noted this is false advertising. What it should say is "In Government We Trust". God isn't going to do anything about that dollar. The point is that ***any currency investment is a bet on how government will behave.*** Almost all currencies have declined over time. Unless you get paid really well, these investments don't make much sense.

Category 2 – Investments that don't produce anything but you hope to sell at a higher price. Gold, for example. Buffett reprised his gold thought experiment where if you took all the gold in the world you could make a 67 foot cube weighing 175,000 metric tons. You could then get a ladder and sit on top of it, fondle it, polish it. But that cube isn't going to ***do*** anything. You are simply betting someone will buy it higher. He cited Keynes Chapter 12 - "The State of Long Term Expectation" from The General Theory of Employment, Interest and Money - that such investing amounts to a beauty contest where you are betting not on whom you believe to be the prettiest contestant, but who others will believe is beautiful. The self-effacing Buffett reminded us that he tried to do that with silver and proved to be 13 years too early.

Category 3 – Investments in assets that produce something. This is a play on what you think that asset will produce over time. For example, with a farm one can make a rational calculation on its value. Success will be determined on cash produced. You don't care about the quote the next day or month. You are looking to the business for your return. This is the basis for Berkshire's investments in Iscar and Lubrizol.

Buffett noted that rising prices create their own excitement. The neighbor gets rich. He owns gold. You know the neighbor's not that smart…yet he's doing better than you. Pretty soon you own gold. Munger added that gold is a peculiar investment in that it only works if everything goes to hell. Buffett joked that $100 billion of gold is produced annually, much of it taken out of the ground in South Africa to be shipped to the New York Fed where it will be put back into the ground.

All the gold in the world is currently worth about $8 trillion. With that amount of money you could buy all the farmland in America, 10 Exxon Mobils, and still have $1-2 trillion of walking around money. Buffett concluded that he will bet on good businesses to outperform gold.

CONGLOMERATES

Buffett conceded that Berkshire is, indeed, a conglomerate. At their best, *conglomerates enable the tax efficient transfer of cash from businesess that can't use the money intelligently to those that can.* Berkshire is a very rational conglomerate.

The word conglomerate got a bad rap from the 1960's Ponzi schemes of Gulf and Western (Charles Bluhdorn), LTV (Jimmy Ling), etc. where there was an unspoken conspiracy and where stock was issued like confetti to buy real assets. It ended badly and the word "conglomerate" left a bad taste.

LEGACY

When asked what he'd like to be known for, Buffett quipped, "Old age." Munger said that what Warren most wanted to be said at his funeral was, "That's the oldest looking corpse I ever saw." In a more serious vein, Munger mused that he'd like something like "Fairly won, wisely used" on his tombstone. Buffett thought perhaps he'd go with "Teacher". He acknowledged that he loves teaching and he's grateful for the great teachers he's had, including his father, Ben Graham, Tom Murphy among others.

CURRENCY DEBASEMENT

Buffett noted that from his birth in 1930 to today the dollar has depreciated by 16 to 1 (i.e. $1 today buys what 6 cents bought then). Yet, inflation did not destroy us. Some subsidiaries of Berkshire earn their money in other currencies. Coca Cola receives 80% of its profits in non-dollar earnings.

Munger observed that Greece is an awful situation. People there, while wonderful in many respects, do not want to work or to pay taxes. He quoted Adam Smith, "A great civilization has a good deal of ruin in it." Despite these concerns, Buffett concluded that if he had a choice, he would be born in the U.S. today over any other place in the world.

LOWER EXPECTATIONS

Buffett shared his usual advice that the average investor would do fine to simply buy shares of an index fund over time. Munger asserted that he'd definitely rather own Berkshire over an index fund. He also predicted that the next 50 years will not be as good as the last 50 years for skilled investors. Buffett averred that Berkshire's mission was to increase earning power and intrinsic value that is what they think about each day with 100% alignment with shareholders. Luck has helped but there is no way Berkshire will compound at rates anywhere close to when it was working with smaller sums. Munger said he was confident Berkshire will outperform U.S. industry in aggregate. He suggested that reduced expectations are the best defense for the investor. He added that lowering expectations was how he got married – "my wife lowered her expectations". Buffett immediately quipped, "And he lived up to them!"

TRUST

Given the Sokol situation, Buffett had a number of questions around rules and compliance. Buffett reiterated his desire that employees honor both the spirit and letter of the law. However, with 260,000 employees at Berkshire, a number roughly equal to the households in Omaha, not all will match the rules. Buffett noted that you can have all the rules and records in the world and someone can still go off and trade in some cousin's name. Munger shared that it is fun to be trusted and to have much self respect. In his view, an attitude of trust was the best compliance. He noted that you can find huge compliance departments on Wall Street – and that is where the biggest scandals occur.

THE ECONOMY

Buffett observed that we have had the foot to the floor with both monetary and fiscal policy in America and this will go on for an extended period. He noted that many people think of our "fiscal policy" as having passed a "stimulus bill". Buffett suggested we look past the words. Forget the "stimulus bill". What is really happening is that we have a 10% deficit, which is gigantic. We're taking in 15% of GDP and spending 25% of GDP. That is huge stimulus.

Residential construction has flattened to 500,000 units per year, so the crazy excesses of the boom are getting worked out. (Average construction runs around 1.2 million units per year. Bubble year construction ran around 2 million units per year.) When that ends, we'll see employment pick up much more than most people think. Construction has a ripple effect through many ancillary businesses. Buffett stuck with the prediction he made in the annual report that we'll see improvement in residential construction by year-end.

Munger added that one advantage of buying into cyclical industries is that many people don't like them because the earnings are so unpredictable. At Berkshire, they don't mind having lumpy earnings over a business cycle. For example, Berkshire just bought the largest brick company in Alabama. Nobody's bidding on Alabama brick when there are no customers. Buffett chimed in that See's Candy loses money 8 months of the year. Yet we know that Christmas will come, so there's no reason to look at one losing month and panic. Over the next 20 years there will be some lousy years, some great ones, and plenty of okay ones.

As for Berkshire's other businesses, he says that steady improvement is widespread. Railcar loadings peaked at 219,000, bottomed at 150,000 and are now running at 190,000. Iscar has seen month by month improvement.

FINANCIAL REFORM – OR THE LACK OF IT

Munger felt it was a huge mistake not to learn more from the subprime mortgage debacle. In his view, we haven't throttled the sin and folly of asinine and greedy behavior. He would take an ax to the financial sector, whittling it down to a more constructive size. He would change the tax system to discourage trading, so that securities would trade more like real estate. He asserted that the lack of contrition on Wall Street for the debacle makes Sokol look like a hero. Buffett piped in, "He's warming up!" Then Buffett noted the inanity of a tax system where a 6 second trade in a S&P 500 futures contract results in 60% of the profit being taxed as long term capital gain. Munger concluded that having a system where hedge funds are taxed at rates less than those for professors of physics or taxi cab drivers is demented.

Munger noted that past panics and depression started on Wall Street with great waves of speculation and bad behavior. This last mess should have caused a 1930's type reaction (like the Securities Act of 1934). It hasn't, so Munger confidently predicted that we'll have another debacle. Munger asserted that it was really stupid not to have done more; that part of the stupidity was in the way finance and economics are taught at the universities; and that finance attracts the same sort of people who are attracted to snake charming. Buffett quipped, "If there's anyone else we forgot to insult, just pass their names up."

BYD

While BYD trades roughly double Berkshire's cost in the shares, the stock is down some 80% from its high. Munger was unconcerned, noting that a company trying to move as fast as BYD will have delays and glitches. In trying to double auto sales each for 6 years, BYD did it for 5 years and then had a glitch. Overall, Munger asserted that he's quite encouraged. In a rare and sweet role reversal, Buffett muttered, "I have nothing to add."

TOO BIG TO FAIL

Buffett acknowledged that there are institutions in the world that governments should properly save. Europe is in the process of deciding whether *whole countries* are Too Big to Fail. Buffett suggested that this problem will always be with us, so our best tactic is to reduce the propensity to fail. One measure he proposed was that those institutions that put society at risk and fail should leave the CEO and spouse dead broke. The board should also suffer severe penalties. If society needs to save you, you should have very painful penalties. Musing on the miserable case of Fannie Mae and Freddie Mac, Buffett called them Too Big to Figure Out!

GREAT INSURANCE COMPANIES

Buffett got quite enthusiastic discussing Berkshire's insurance empire. He called GEICO, now the third largest auto insurer, a fabulous company. GEICO debuted the idea of selling direct (without an agent) way back in 1936, and few have been able to copy it. Meanwhile, Ajit Jain built Berkshire's reinsurance business from scratch. Buffett loves Ajit, claiming that he can't think of any decision Ajit has made that he'd have done any better. Ajit is as rational as anyone Buffett has met, loves what he does, is very creative, and unfailingly thinks of Berkshire first. (Interestingly, Buffett claimed later in the meeting that Berkshire spent its first 15 years in reinsurance not making money. It wasn't until Ajit came along that reinsurance became a real profit center for Berkshire.) Berkshire's GenRe unit, with Tad Montross, runs a disciplined business and Berkshire's smaller insurance units have unusual franchises. And it all started when Berkshire bought National Indemnity for $7 million in 1970. Now, in that same building, they run an insurance company with the largest net worth of any in the world and some $66 billion of float.

Munger noted that Berkshire has a number of best-in-class companies. BNSF is certainly one of the best railroads in the world. MidAmerican Energy is top-ranked among utilities. Munger concluded that it's not all bad to be world-class in your main businesses. Buffett noted that the high speed rail proposal in California came with an estimated cost of $43 billion, a cost that would be sure to go up. Meanwhile Berkshire paid about $43 billion for BNSF and got 22,000 miles of track, 6000 locomotives, 13,000 bridges (anyone want to buy a bridge?). So the replacement value of BNSF is huge. The country will always need railroads. It's a terrific asset to own.

COSTCO

Munger, a board member of Costco, made his annual assertion that Costco (the $80 billion membership warehouse club retailer) is the best in the world in its industry. It's a meritocracy that takes it as its extreme ethical duty to pass along savings to its customers which in turn creates ferocious customer loyalty. Costco has a store in Korea that will do $400 million in revenue; something that one would think can't exist in retail, yet there it is. Costco has the right ethics, diligence, and management to continue its winning ways – quite rare. Munger observed that it's a problem to prevent success and wealth from creating your demise. General Motors was the most successful company in the world at one time and then became a victim of its success with large unionization and very tough competition eventually wiping out the shareholders. Munger asserted that if he taught business school, he would do the full sweep of the history of a business.

Buffett joked that he and Charlie were hijacked by terrorists who decided to shoot the capitalists. They allowed them one last request. Charlie said, "I would like to give once more my presentation on the virtues of Costco with slides." The terrorists reluctantly agreed. Then they asked Warren for his last request. Buffett said, "Shoot me first."

CASH IN TREASURIES

Buffett agreed that investment choices for short term money are lousy right now. However, he emphasized that he doesn't mess around with short term money. Basically at Berkshire cash is always in Treasuries. While it may be irritating that they pay virtually nothing, Berkshire will not reach for another 10-20 basis points. "It's a parking place and we want our car back when we're done parking," Buffett declared. Buffett shared how critical it was when panic hit in 2008 that Berkshire had the money to do deals. It was not in a money market fund or commercial paper. Munger noted that he's seen a lot of people struggle stupidly to reach for an extra 10 basis points. He noted that they were able to buy pipelines because they could agree to a deal on Friday and produce the cash on Monday. Buffett added that the seller was worried about going bankrupt the next week. Buffett concluded that "If panic breaks because Ben Bernanke has run off with Paris Hilton, we're ready."

LEARNING

Munger noted that we're here to go to sleep each day smarter than when we woke up. Buffett shared how he lived at the Omaha Public Library for 4 years. (Ed: Buffett is reported to have read every investment book in the library.) He also noted that his Dale Carnegie course in 1951 cost him $100 and the value was incalculable as the value of good communication skills so dramatically enhanced his life. So Buffett's big point was to develop yourself. Find your passion and improve your skills.

The shareholders of Berkshire are permanently indebted to Buffett and Munger for doing just that, and in the process, creating one of the greatest wealth compounding machines ever built.

Berkshire's Cash/Bond/Stock Ratios 1979 through 2010

In a reprise of our April 1999 newsletter, we review Berkshire's cash/bond/stock allocations. While Berkshire's operating businesses are of growing importance, investment assets still comprise a significant share of Berkshire's value. We find it worthwhile to contemplate changes in allocations. Note that the investment portfolio increased over 240-fold in 31 years. Cash swelled as Swiss Re paid back its double digit yielding notes issued in 2008. (Goldman Sachs and General Electric are paying theirs back in 2011.) Buffett keeps a minimum of $10 billion in cash (about 7% of investment assets) for insurance catastrophes.

		Percentage Allocation		
Year	Investment Portfolio (in millions)	Cash and Cash Equivalents	Securities with Fixed Maturities	Equities and Other Investments
1979	$ 615	5%	30%	65%
1980	764	8	24	68
1981	911	8	22	70
1982	1,162	5	16	79
1983	1,516	5	14	81
1984	1,710	10	18	72
1985	2,676	38	18	44
1986	3,288	9	34	57
1987	4,666	5	44	51
1988	5,639	5	32	63
1989	8,263	2	34	64
1990	8,994	3	34	63
1991	12,283	6	19	75
1992	14,948	8	14	78
1993	16,487	11	13	76
1994	18,355	2	15	83
1995	26,362	10	6	84
1996	35,537	4	18	78
1997	47,548	2	22	76
1998	74,589	18	29	53
1999	73,565	5	41	54
2000	77,086	6	43	51
2001	72,471	7	51	42
2002	80,494	13	50	37
2003	95,589	33	27	40
2004	102,929	39	22	39
2005	115,615	34	23	41
2006	125,715	30	20	49
2007	141,217	27	20	53
2008	122,025	20	22	58
2009	145,982	19	22	59
2010	147,722	24	23	53

Note: In 1985 cash swelled due largely to the buy-out of General Foods by Philip Morris**.**
The 1998 General Reinsurance merger shifted the percentage in equities from 76% to roughly 55%.

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