Pecaut & Company

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EXECUTIVE SUMMARY

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MARKET UPDATE

"We look to buy value, we don't look to headlines."

- Warren Buffett, 2012 Berkshire Hathaway annual meeting

Starting out in the early 1980's in the old brokerage days, we at Pecaut & Company well remember that people were happy to buy stocks when earnings were good and the market was on the upswing. As budding value investors, however, we soon learned that the real money was to be made in buying what was cheap and unpopular. The hard part was that most stocks became cheap and unpopular because the market was down and there were problems in the business. In addition, there were always plenty of worrisome headlines providing reasons not to buy. The message was clear: being a value investor in a short-term gratification world was going to be an uphill journey. Thirty years later, we report that not much has changed.

Recent headlines have been cause for concern. The unwinding of the sovereign debt crisis is becoming increasingly messy. Coalition talks in Greece edged that country closer to an exit from the euro zone. Spain's borrowing costs have jumped in recent weeks. The ECB's 1 trillion euro bailout appears to have only bought weeks instead of years of time. A moment of irony - as regulators debate the Volker Rule (reigning in the ability of investment banks to trade for their own account), JP Morgan announces a $2.3 billion derivative trading loss. Investors continue to vote with their feet: U.S. equity mutual funds recorded $18 billion of outflows in April, the most since at least 1984, according to preliminary data from the Investment Company Institute.

Meanwhile, underlying economic strength in the U.S. continues to surprise. At Berkshire Hathaway, Warren Buffett reports that, with the exception of housing related businesses, all of Berkshire Hathaway's companies continue to experience slow but steady improvement. The top five non-insurance subsidiaries, Burlington Northern Santa Fe (BNSF), Iscar, Lubrizol, Marmon Group, and Mid-American Energy, are rolling. Each one is on track to earn record profits in 2012 and they could collectively earn over $10 billion pre-tax in 2012.

This is our time in a nutshell. For those looking to headlines, it is a time to flock to cash and bonds. For those looking to buy value, there is much to do in the world of business. And Berkshire has been busy.

THE UNIVERSITY OF BERKSHIRE HATHAWAY

John, Corey and Dan, made the annual pilgrimage to Omaha for the Berkshire meeting, joined by 35,000 of Warren Buffett's closest friends. The CenturyLink Center (renamed from "Qwest") convention floor was turned into the "Berkshire mall" with all sorts of subsidiaries hawking their wares. Buffett was pleased to announce after the weekend that Berkshire shareholders spent some $35 million on everything from See's Candy to Borsheim's jewelry, an average of $1000 per attendee! (Full disclosure, the analysts of Pecaut & Company, being more about investing than spending, did not contribute anywhere near their fair share of this record performance.)

Meanwhile, the convention arena was packed as eager attendees sought to hear the latest wisdom from chairman Buffett and vice chairman Charlie Munger during the 6-hour shareholder meeting. It is an impressive learning experience, especially considering that "Professors" Buffett and Munger (ages 81 and 88, respectively) are still going strong.

Buffett and Munger have presided over one of the greatest records of wealth building in history. Since Buffett took over Berkshire 47 years ago, Berkshire's per-share book value has grown from $19 to $99,860, a rate of 19.8% compounded annually. That's more than double the S&P 500's 9.2% annualized percentage gain for the same period. Since compounding is a geometric progression, a small advantage in the annual rate of gain creates a huge advantage in total dollars compounded over time. In terms of the overall percentage gain from 1964-2011, a dollar invested in Berkshire in 1964 experienced a gain of

513,055% versus a gain of 6,397% for the S&P 500. Really incredible.

Over those 47 years, Berkshire Hathaway has grown from a small New England textile company into one of the world's most powerful conglomerates. Berkshire ranks 7th in revenue ($144 billion), 16th in profits ($10.2 billion) and 14th in assets ($393 billion) in the most recent edition of the *Fortune 500*. Two years ago, Berkshire traded for around $117,000 per A share, roughly a 25% discount to our appraisal of intrinsic value per share at the time. Today the price is little changed, trading around $122,000 per share. However, intrinsic value has grown significantly so the value gap has widened, leaving the stock selling at about two thirds of intrinsic value.

"We look to buy value, we don't look to headlines."

Since 2008, retail investors have been selling stocks ($260 billion yanked out of U.S. equity funds) and buying bonds (adding $800 billion to bond funds). Meanwhile, what has the author of the incredible track record above been doing? Seldom has Buffett been more aggressive at putting money to work. During the first decade of this century (a/k/a "the lost decade"), Buffett was criticized long and hard for holding enormous amounts of cash and bonds. Since the subprime crisis, Buffett has been on an investing spree. Including the Burlington Northern Santa Fe acquisition, Lubrizol acquisition, high-yield lending during the subprime crisis, capital investments at BNSF and MidAmerican Energy, additions to the portfolio and bolt-on acquisitions by subsidiaries, we believe Berkshire may have put in the ballpark of $100 billion to work at double digit rates of return. While retail investors are selling, Buffett has been buying and buying.

Here are our notes from the meeting, aggregated by topic.

Sovereign Debt Crisis

Munger and Buffett agreed that the sovereign debt mess is the big question of the moment and tough to answer. There have been many failures through history. Buffett noted that the wealth doesn't go away – the farms, the factories and labor remain. Rather the wealth gets reallocated. It's a big reallocation of wealth. He compared the ECB's trillion euro bailout to giving a guy with a margin account more debt.

Munger observed that it is dangerous to go low on fiscal virtue, paraphrasing St. Augustine, "Everyone wants fiscal virtue but not quite yet." He recommended we follow the Roman example where two thirds of the Punic Wars were paid off before the war was over. He concluded that we need more sacrifice, more patriotism and more civilized politics.

Banks

Buffett asserted that American banks are in far better position than European banks. They have taken most of the abnormal losses, buttressed capital in a big way, and have "liquidity coming out of their ears".

Munger noted that we have a full federal union so we can print money. He's comfortable with the U.S. system. Buffett agreed noting that it's night and day. The U.S. Fed and Treasury had the power to do whatever it took. In contrast, 17 countries in Europe surrendered their sovereignty with respect to currency. As Henry Kissinger once said, "When I want to call Europe, what number do I dial?"

Regarding European banks, Buffett called the ECB coming up with 1 trillion euro ($1.3 trillion in U.S. dollars – an amount equal to 1/6th of all bank deposits in the U.S.) a huge act. Because European banks have less in deposits and rely more on wholesale funding, they needed to build more capital but have done little to do so. He noted one Italian bank had at least had a rights offering.

Munger noted that Canada kept to the old standards and had almost no trouble. We departed from sound decency and participated in folly with lots of disgraceful behavior and suffered enormous damage. Similar things happened in Ireland and Spain. Greenspan was wrong with his laissez faire policies. It is the duty of government to step on bad behavior. Once we were in it, we had to nationalize.

Buffett admitted buying some JP Morgan for his own account. His favorite bank is Wells Fargo which he buys exclusively for Berkshire, which now owns over 400 million shares. (Ed: Wells Fargo is now Berkshire's largest position after Coca Cola and is becoming just as dominant as Coke in its own way. Wells made 34% of the mortgages originated in the first quarter, more than triple the share of the closest competitor.)

Chief Risk Officer

Buffett noted that the role of the Chief Risk Officer (CRO) must not be delegated. He has seen risk management group reports ignored too many times. Buffett noted that he is the CRO at Berkshire and that along with capital allocation and the selection of managers are his primary duties. The two basic risks he analyzes are excessive leverage and insurance risk.

Munger averred that not only has risk management been delegated, it has been stupidly done. He characterized "Value at Risk" as one of the dumbest ideas ever put forward. Buffett agreed that PhD's that should know better but they got hooked on their fancy math which may not be applicable to human behavior.

Munger related the story of how Sandy Gottesman (who founded the investment advisory firm First Manhattan and joined the Berkshire board in 2003) fired a man who was his top producer. The man said, "How can you fire me?" Gottesman replied, "I'm a rich old man and you make me nervous". Buffett assured shareholders that no one at Berkshire makes him nervous.

Special Deals

Buffett acknowledged that he cold called Bank of America CEO Brian Moynihan to offer the preferred with warrants deal ($5 billion of 6% preferred with 700 million 10-year warrants to buy common stock at $7.14 a share). They had never talked before. However, Moynihan knew Buffett had 1) the ability to commit and 2) large sums available. Buffett asserted that Berkshire will still have this advantage after he is gone. While the next CEO might not have Warren's Rolodex, he will still have these unique Berkshire deal advantages. Buffett emphasized that the impact of special deals is peanuts compared to the long term impact of buying great businesses for Berkshire.

Insurance

A question on surprisingly higher than expected mortality on its Swiss Re life insurance business got Buffett going on one of his favorite topics. Buffett noted that surprises like this are why Berkshire's overriding principle is to reserve conservatively. GEICO is short tail business and has had redundancies in reserves year after year. While Gen Re was under-reserved when Berkshire bought it in 1998, reserves are developing well now under the management of Tad Montross. Munger inserted, "It's inevitable that some contracts work out worse than expected. Why would anyone buy insurance if that weren't the case?"

Buffett noted that after 9/11 it was very difficult to assess insurance damages. For example, what counts as business interruption? Similarly with the tsunami in Japan, does a U.S. auto parts company have a case for business interruption? These sorts of issues take years to sort out and argue again for reserving conservatively.

Pricing the reinsurance of catastrophes is very difficult. It's hard to detect a series of random events from what might constitute a long term trend. Buffett's tactic is to assume the worst and price from there. In the last few months Berkshire has written far more business in Asia – New Zealand, Australia, Thailand, etc. As he noted last year, Buffett pointed out that the second quake in New Zealand caused $12 billion of insured damage in a country of 5 million people. On a per capita basis, this was the equivalent devastation of ten Hurricane Katrina's. Events like this are why Buffett insists that Berkshire keep at least $20 billion in cash.

Buffett is very pleased with GEICO's continued success, asserting that GEICO is worth $15 billion more than what it is carried for on the books. (Ed: Buffett said last year that he would value GEICO at $1500 per policyholder. With over 10 million policyholders now times $1500 per, that would equal $15 billion.) GEICO is hitting on all cylinders. In 1995, GEICO had 2% of the market. Under Tony Nicely's superb management, GEICO now has nearly 10% of the market.

Buffett admitted, "Gen Re was off the tracks when we bought it - lots of 'accommodation business' emphasizing growth over profitability." Joe Brandon refocused the underwriting discipline and Tad Montross has followed through. Now the business is right-sized, the culture is good as are prospects for decent long term growth creating a terrific asset for Berkshire.

In valuing Gen Re, Buffett would calculate intrinsic value as a combination of net worth and float. In valuing GEICO, he would also include its significant underwriting profits for the next 10-20 years and its significant growth prospects.

Float

When Berkshire's float reached $40 billion, Buffett started talking about how it was unlikely float would grow much more. Now float is $70 billion. Ajit Jain has found innovative ways to create more float. However, some of the business such as retroactive insurance runs off by nature. He credited Ajit Jain for working miracles for Berkshire over the years and doing a spectacular job of managing the "melting ice cube" that is Berkshire's float.

In addition, because Berkshire's companies write profitably, Berkshire gets the economics of float at a bargain rate. As long as Berkshire underwrites at a profit, *people are actually paying Berkshire* to hold this $70 billion of float.

Munger concluded that property casualty insurance is not a terribly good business. You have to be in the top 10% to do well. Berkshire probably has the best in the world. To have something that is very good and not growing much is okay.

Running Berkshire

Munger suggests that it's an illusion that there is vast control at the average corporate headquarters. One of the beauties of Berkshire, he contends, is that it doesn't require much control from headquarters.

Buffett's key to motivating Berkshire's managers is giving them room to paint their own painting. Buffett joked that if someone told him to use more red than blue, he'd likely tell them where to stick the paintbrush. He likes painting his own canvas and getting applause for doing well. So he seeks managers who are wired in the same way, giving them the paintbrush and compensating them well for good performance. In addition, Berkshire managers don't have to talk to shareholders, lawyers, reporters, etc. so they can focus on their businesses. Buffett concluded that his focus is on not taking away something that's already good, a sort of negative art.

Munger noted how rational this approach is versus the percentages and quota arrangements dreamed up by human resource departments. Regarding compensation consultants, he suggested prostitution would be a step up for them.

Buffett quipped, "Charlie's in charge of diplomacy at Berkshire."

Valuation

Buffett confessed that he'd prefer that Berkshire would trade just once a year at a fair value that he and Charlie would come up with. This is how some private companies do it. However, public markets can do strange things. Buffett reminded us that Berkshire issued stock in the mid-1990's when it was overpriced. Surely a first for any public offering, on the prospectus Buffett and Munger stated that they would not buy the stock at the price nor would they recommend that their family buy shares.

Buffett confirmed that the intrinsic value of Berkshire is significantly higher than the book value, so he is very comfortable about the idea of buying in shares at 1.1 times book. He would love to buy tens of billions of dollars in at 110% of book, consistent with maintaining his cash cushion of $20 billion. Such a move would be certain to increase intrinsic value per share so doing it on a big scale would be an obvious winner.

Buffett noted that Berkshire nearly completed a $22 billion deal recently, suggesting there is plenty to do in the world of adding value in ways other than buying in shares.

Buffett noted he has seen the stock cut in half four times and that the beauty of stocks is that they can sell at silly prices sometimes. Buffett was definitive, "It's how we got rich."

As he has in years past, Buffett asserted that the Intelligent Investor chapters 8 (Mr. Market) & 20 (Margin of Safety) give you all need to know. Build into your system that stocks get mispriced. In the next 20 years Berkshire will be significantly overvalued and undervalued at different points. The stock market is the most obliging of money making entities. Armed with the right system, the rules are stacked in your favor.

In valuing the operating businesses, Buffett said he would love to buy the group for 10 times pre-tax earnings or maybe even more.

Natural Resources

Buffett observed that cheap natural gas has been a huge plus for the trade deficit. The U.S. energy picture has changed a lot in three years. Buffett noted that there has been a remarkable decrease in electricity usage as kilowatt hours used declined 4.7% in the first quarter. In addition, with natural gas at $2 per mcf and oil at $100 a barrel, that creates a 50/1 ratio of oil to gas pricing, something he didn't think was possible. Now natural gas is supplanting coal at these low prices.

Munger called the using up of our natural gas reserves "idiotic". He would use up our less precious thermal coal first. That would be rational and exactly the opposite of what we are doing. He asserted that we would have been better off to keep oil and gas, the hydrocarbons that are the single most precious resource of the U.S., in the ground over the last 50 years. In his usual understated manner, Munger summed up his point, "Energy independence is stupid. We want to ***conserve*** it and use the other fellow's resources. "

Buffett joked, "This is Charlie's version of saving up sex for old age."

Munger retorted, "But we're going to use the oil!"

Business School

Buffett and Munger took their annual shot at Modern Portfolio Theory and the business schools that teach it. Buffett noted that business schools focus on one fad after another, usually mathematically based. Buffett said if he ran a business school he would have just two courses: 1) How to value a business and 2) How to think about markets. He noted that Ray Kroc had no need to know the option value of McDonald's but thought long and hard about how to make better fries. Buffett concluded, "If you think about business and buy businesses for less than they're worth, you're going to make money."

Munger added that valuing a very long term option on a business you understand does not fit the Black Sholes option pricing model. It makes no sense. However the accounting profession wanted some standardized way of valuing them. And they got one.

The Buffett Rule

Buffett took pains to note that his idea of having the rich pay more taxes applied to only the 400 largest incomes, which now average $270 million each. 131 of that group paid taxes at less than a 15% rate. This compares to 1992 where the 400 largest income earners averaged $45 million and just 16 paid less than a 15% rate. Buffett's point is that a group that has done so well over the last two decades should be paying taxes at least at the same rate they did 20 years ago! For himself, Buffett said he has no tax planning, no gimmicks. He earned between $25 and $65 million the last few years. And he had the lowest tax rate in his office at about 17%.

Mid American Energy

Buffett said MEC has done a lot with wind power, thanks to a ten year subsidy of 2.2 cents per kilowatt hour. Otherwise, the economics would not work. MEC owns half of two large solar projects as well. Both solar and wind need subsidies to develop. In addition, given that wind is unpredictable, you can never count on wind power for your base load. Wind will always be supplementary. MEC CEO Greg Abel noted that with solar incentives they will recover 30% of the construction cost. Since Berkshire is a full tax payer, it derives full benefit from these tax incentives. In contrast, Buffett asserted that 80% of utilities cannot reap full tax benefits because they wipe out their taxable income with depreciation.

Buffett noted the MEC is capital intensive and a reasonable expectation for return on investment with this utility would be 12%. Buffett surprised us a bit, saying that MEC may have enormous opportunities in the next 15 years to invest, perhaps as much as $100 billion.

Systemic Risk

With regard to systemic risk, Buffett noted that his first rule is to play tomorrow. That means not going broke no matter what happens. So keep plenty in reserves and go low on debt. (Again, at Berkshire that reserve number is now $20 billion in cash.) If that is handled, then you can invest.

Buffett claimed that in 53 years, he and Charlie had never had a discussion about buying a business that included a talk about macro affairs. "If it's a good business at a good price, we buy it. There is always going to be bad news out there." He said he bought his first stock in 1942, when we were losing the war! Buffett reminded attendees that it was during the swoon in 2008 that he wrote his "buy stocks" op-ed piece for the *New York Times*. Buffett concisely summed up, "We look to buy value, we don't look to headlines."

Railroads

Buffett noted that railroads have improved their position over the last 15-20 years. Railroads are an extremely efficient and environmentally friendly way to move goods. The assets can't be duplicated for probably six times what they are selling for. Buffett noted that he expects BNSF to spend far more than its depreciation over the next 10 years and anticipates a good return. With the sums Berkshire is working with, he's satisfied to earn a 12% return on capital, especially with Berkshire's low cost (or no cost) float. It takes the railroad one gallon of diesel fuel to move one ton 500 miles. Trucks cost three times more. Railroads move 42% of all intercity traffic now, offering very powerful economics compared to the cost, congestion, and emissions of moving by roads. BNSF will spend $3.9 billion to improve and expand its systems, all this year without a check from the government.

Munger allowed that BNSF has had some breaks with technology and the oil boom in North Dakota. And while it will have some bad breaks too, averaged out BNSF is a terrific business with terrific management.

Berkshire Investment Managers

Buffett has been pleased with Todd Combs and Ted Weschler, the two hedge fund managers hired to manage a portion of Berkshire's portfolio. He feels he hit a homerun with both.

Buffett allowed that each could make more money elsewhere – though, he joked, they do have access to the free Coke machine in the office. They receive $1 million a year plus 10% of the amount by which their portfolio beats the S&P on a 3-year rolling basis. To encourage teamwork, 80% of the bonus is each man's own effort and 20% is on that of the other. Berkshire had a similar arrangement with Lou Simpson who ran the portfolio at GEICO for many years. Buffett reported that the arrangement is working better than he hoped, and he added $1 billion to each portfolio so they are each managing $2.75 billion now.

Newspapers

Asked about Berkshire's acquisition of the *Omaha World Herald,* Buffett noted that 50 years ago newspapers were the primary source. Now so much information is free and immediately online. To survive, newspapers must be primary in something. In addition, newspapers need to shift to paid subscriptions on the web so they don't give their product away.

One strategy Buffett put forward was for newspapers to focus on being a primary source for the local community market. In this way, Berkshire is making some money in

Buffalo with the *Buffalo News*. Buffett shared that Berkshire may buy more newspapers. (Ed: Berkshire bought 63 newspaper properties this week from Media General.) While the economics are not as good as they once were, newspapers still have a role to play. (Ed: In April it was reported that Berkshire bought $85 million of Lee Enterprises debt for 65 cents on the dollar from Goldman Sachs. Lee is a premier publisher of local news through 49 daily newspapers and 300 weekly papers.)

Shrinking Businesses

Talk of newspapers led to a discussion of how it is more profitable to own growing businesses, though shrinking businesses can generate a lot of cash. Berkshire has owned its share of them. In fact, Buffett noted, Berkshire started as a New England textile mill. Then Berkshire got into retail with Diversified Retailing, a Baltimore department store, with Sandy Gottesman in 1966. And Charlie presided over a company (Ed: probably Blue Chip Stamps) whose sales went from $120 million in 1967 to $20,000 today. Buffett concluded that they were "masochistic" in those days. Munger added, "Ignorant, too."

Avoiding Mistakes

Buffett suggested that investors stay away from businesses they don't understand well. You want to be able to have a decent idea of what the business will look like in 5-10 years. Then wait for a crazy price. Avoid new issues – the insiders are selling their company so it's ridiculous to think that an IPO will be the cheapest thing to buy in a world of thousands of stocks. The IPO sellers pick the time to sell. So don't waste five seconds on it.

Use filters so you don't waste time on unproductive ideas. Avoid big losses. Munger said to avoid issues with a large commission attached. Instead, look at things other smart people are buying. Buffett recalled eagerly reading the Graham Newman reports years ago just for that reason.

Think about playing tomorrow. Avoid the worst case mistakes. On the other hand, Buffett admitted that he and Munger both have instincts to do big things. Don't dwell too much on mistakes. Learn from other people's mistakes. Buffett noted their constant study of others' disasters has helped them enormously. Read the stories of financial follies.

No Dividend

Buffett noted that as long as each dollar retained creates a dollar or more of value, retaining profits is the way for Berkshire to go. If people need income, Buffett suggested just selling off a few shares each year. Buffett concluded, "We paid out 10 cents a share in 1960's and it was a big mistake. We'll think about a dividend when we're older."

Remembering What Can Go Wrong

An interesting aside, Buffett said that in 1962, with an art budget of $7, he made copies of 7 financial days of crisis. One was in May of 1901 – the Northern Pacific Corner. E.H. Harriman of the Union Pacific Railroad and JP Morgan each owned over 50% of the stock. Harriman was trying to take control of Northern Pacific to get railroad access to Chicago. The stock went from 170 to 1000 in one day, squeezing the shorts. Margin calls ensued. A brewer committed suicide by diving into a vat of beer. Buffett concluded that he never wanted to die in a vat of beer.

Munger added that there's a lot of false confidence on Wall Street. Risk on Wall Street may be measured with Gaussian curves, but the fat tails are not fat enough!

Barriers to Entry

"We buy barriers to entry, we don't build them", declared Munger. Buffett concurred noting that some industries just don't have them – you just have to keep running really fast. However, if he had $30 billion to knock the Coca Cola brand off the shelf, he couldn't do it. To further his point, Buffett took note of how Richard Branson's Virgin Cola came and went, joking that a brand is a promise but he's not sure what the promise was with Branson's product. Buffett also declared that no one will ever build another railroad. Munger noted that all it takes is one competitor to ruin a business. Buffett remembered owning a gas station at 30th and Ruddick in Omaha that suffered from the daily competition of a Phillips 66 station across the street.

Plutocracy

With $48,000 in per capita GDP, America is a rich nation. However, far too much compensation has gone to the top executives over the last 20 years. The tax code has encouraged this trend. Buffett mused that this could be the natural progression in democracy to move toward plutocracy. (Ed. Plutocracy – from the Ancient Greek "ploutos" meaning "wealth" and "kratos" meaning "power".) Society needs some mitigating factors.

Munger recalled that when he went to Boston for the first time, Mayor Curley was running the city…from the penitentiary! Boston politics have been littered with egregious behavior.

Taxes and Tapeworms

Asked about the U.S. corporate tax rate, Buffett replied that the top rate is 35% while 13% is the average rate actually paid. You can write off 100% of most fixed asset purchases. However, he asserted, corporate profits, balance sheets, and liquidity are not the problem. Corporate taxes equal just 1.2% of GDP. Meanwhile medical costs equal 17% of GDP, a seven point disadvantage to the rest of the world. Medical costs are the tapeworm of American industry.

Munger opined that it is time for a value added tax. It is logical to tax consumption to equalize the trade deficit and it creates a steadier income stream.

<u>How are you feeling?</u>

With the recent announcement of his prostate cancer, Buffett answered the inevitable question: "I feel terrific. I love what I do. I work with people I love. I have more fun every day. And I have a good immune system."

Munger joked, "I resent all this sympathy for Warren. I probably have more prostate cancer than he does. I just don't know it because I don't let them test for it."

<u>Long Term Outlook</u>

Buffett declared that if the population grows 1% per year and GDP grows 2.5% per year, by the standard of 1000 years ago, this would be a remarkable achievement. We would quadruple real GDP per century, remarkable for a country that already has such a high standard of living.

Buffett noted that in his lifetime real per capita GDP has increased *six-fold*. We are unbelievably rich, hugely abundant. Folks in the 1930's would have thought such growth nearly impossible. The country is not a mess. The outlook is terrific. The system still works. Even after the incredible crash of '08/'09, business has proven to be extraordinarily resilient.

Munger was less bullish. He said he'd settle for 1% real (net of inflation) growth in GDP with a mature economy such as ours with a big social safety net and emerging competition. Expectations are too high.

<u>Berkshire's Future</u>

Munger noted that the first $200 billion was hard. The next $200 billion will be easy now that Berkshire has momentum, people, and culture in place. Munger said that he hopes the Munger family will stay with this heirloom.

Berkshire's Cash/Bond/Stock Ratios 1979 through 2011

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 large share of Berkshire's value. We find it worthwhile to contemplate changes in allocations. Note that the investment portfolio increased over 250-fold in 32 years. The chart illustrates that Berkshire has been a significant buyer of equities and other deals - increasing the percentage from 53% to 58% last year. Buffett keeps a minimum of $20 billion in cash 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	147,772	24	23	53
2011	153,909	22	20	58

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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