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EXECUTIVE SUMMARY

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

MARKET UPDATE

With the stock market up some 65% from its lows back in March of 2009, it's time to take a breath and reassess.

On the dark side of things, the extreme levels of sovereign debt have been making the headlines. The euro-zone essentially went for the "nuclear" option with its $1 trillion bailout of not only Greece but the entire region. The reduction of extreme debt levels worldwide will be a long and arduous process. In the U.S. we remain concerned about what happens when massive stimulus is removed and when artificially low interest rates begin to rise to more normal levels. We are also concerned about a Congress that doesn't seem to care about fiscal responsibility.

On the brighter side, we are amazed at how well American business has recovered from the crisis. Many businesses proved to be surprisingly nimble at controlling costs, refinancing debt, and sustaining the business through extreme circumstances. Now business is picking up. As Buffett told Becky Quick in a recent issue of *Fortune*, "You can just feel the pulse of industry quickening."

What to do? For those that need cash within the next year or two, now would be a good time to lighten up on equities. For those in for the long term we continue to see very high quality companies selling at very reasonable prices; companies with rock solid balance sheets to handle adversity, the global reach to keep growing, and the pricing power to handle higher inflation. One company in particular fits the bill: Berkshire Hathaway.

<u>THE UNIVERSITY OF BERKSHIRE HATHAWAY</u>

John and Dan made the annual pilgrimage to Omaha for the Berkshire Hathaway meeting. John went once before at around age 12. (As John puts it, this was his first Berkshire meeting as a "conscious adult.") 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 Justin Boots to See's Candies. In the packed arena, vice chairman Charles Munger joined chairman Buffett on the dais to handle questions from the throng of shareholders for nearly 6 hours. It is an impressive learning experience and even more so when one considers that "Professors" Buffett (79) and Munger (86) are as sharp as ever. Really remarkable.

Buffett and Munger have presided over one of the greatest records of wealth building in history. Since Buffett took over Berkshire 45 years ago, Berkshire's per-share book value has grown from $19 to $84,487, a rate of 20.3% compounded annually. That's more than double the S&P 500's 9.3% annualized percentage gain for the same period. Over those 45 years Berkshire Hathaway has grown from a small New England textile company into one of the world's most powerful conglomerates. In the most recent edition of the *Fortune 500*, Berkshire rose to 11th in revenue ($112 billion), 16th in profits ($8.1 billion), and 15th in assets ($297 billion). A couple of performance notes: for one, Berkshire has done this impressive compounding with great defense – Berkshire has consistently done better than the S&P during negative years and has *outperformed the S&P over every five-year period* since 1965. For another, Berkshire's enormous size makes compounding at past rates improbable and makes it nearly certain that Berkshire's performance advantage over the S&P will shrink in the years to come.

One other observation – adding in the revenues of the recently acquired Burlington Northern, Berkshire's revenues would have been around $126 billion for 2009 which would have placed Berkshire at 7th in the *Fortune 500*, just ahead of AT&T. Berkshire in the top ten by revenues, isn't that something! To go from a sleepy textile business to one of the ten largest corporations in America in one lifetime is truly an extraordinary achievement.

A year ago, Berkshire traded around $90,000 per A share, roughly a 25% discount to our appraisal of intrinsic value of about $117,000 a share. Since then, Berkshire's stock price has appreciated by 30% to, would you believe it?, $117,000 per A share. And, we calculate, the stock still trades at a 25% discount to our updated appraisal of intrinsic value in the ballpark of $155,000. In other words, the gain in last year's stock price merely approximated the gain in Berkshire's intrinsic value. Who says the market is inefficient! And, thus, Berkshire continues to represent solid value and unparalleled quality at current prices.

Corey and Dan also attended the Wesco Financial annual meeting over which Charlie Munger presides and have added some comments from that meeting as well. 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 one hour movie featuring commercials from its subsidiaries, skits, and news clips. Highlights this year included an extended Burlington Northern Santa Fe tribute, the annual GEICO employee rock video featuring Buffett doing an Axl Rose impersonation, and, my favorite, "Warren the Whip", good old number 1/16, coming in from the bullpen to bail out the Red Sox in the bottom of the ninth against the Yankees – a spoof where they squeezed in a mention of nearly every one of the 70 some companies that Berkshire owns. Buying railroads and striking out Alex Rodriguez – some billionaires get to live out all their fantasies!

FIRST QUARTER EARNINGS – RECOVERY PICKING UP

Buffett opened the meeting with a slide showing Berkshire had a first quarter operating profit of $2.2 billion versus $1.7 billion a year ago, noting that the economic recovery has been picking up steam. Buffett was especially pleased to see a surge in heavy industry where there's no inventory fill. For example, BNSF railroad cars in use have jumped significantly. Iscar metal working tools, which are used on assembly lines around the world, have had a sharp uptick. Marmon Group was seeing improved sales.

Buffett added that the slide did not show earnings per share as a matter of principle, noting that the practice too often leads to a fudging of the numbers. He cited a *Wall Street Journal* article ("Quadraphobia" from 2/13/10), where a Stanford study looked at nearly half a million earnings reports to the tenth of a penny over a 27-year period. What they found is that the earnings numbers seldom ended in a fourth of a cent. The study concluded that the vast majority of companies were gaming the numbers so they could round up! (Hence the article's title.) The study went on to suggest that this fudging was a good leading indicator for companies that would later have accounting problems. Buffett concluded that this is not good for enterprise. Asked if he had anything to add, Munger said, "I agree with you." Buffett quipped, "He is the perfect vice chairman."

GOLDMAN SACHS

Anticipating a round of questions about the SEC's investigation of Goldman Sachs, Buffett had an extensive reply ready to go. He noted that as he understood the transaction in question (called Abacus), it was no different than many transactions Berkshire has done over the years. For every buyer, there is a seller on the other side. In particular, one of the parties in the transaction, ACA, was a bond insurer, so they were active in the business of handling these mortgage packages. These were hardly innocent parties. (In addition, our friend Gerry Curtis notes that a *Wall Street Journal* story of Jan. 8, 2008 indicated ACA had capital of $425 million and credit default swaps outstanding of $69 **billion** – hardly a risk averse group.)

Buffett displayed a slide showing an $8 billion municipal bond package with bonds from a number of different states that Berkshire had agreed to insure for a $160 million premium. Buffett noted that he came to that conclusion with his own analysis. He did not care who was on the other side of the transaction. If it makes sense and the premium is high enough, he'll take the deal. And he wouldn't dream of coming back later to cry "unfair" if he took a loss on the deal.

Regarding Goldman, Buffett lavished praise on Goldman CEO Lloyd Blankfein. Munger agreed saying, "There are plenty of CEO's I'd like to see gone – Blankfein is not one of them." However, Munger also noted that every business should decline some business – that we should aspire to a higher standard than merely what is legal. Buffett did have advice for Blankfein on how to handle a crisis: Get it right. Get it fast. Get it out. Get it over. He added that the SEC suit is actually a plus for Berkshire because it most likely delays the point at which Goldman can call Berkshire's $5 billion 10% preferred at 110% of par. That preferred pays Berkshire $500 million a year or $15 every second. Every extra "tick" between now and the calling of the preferred is another $15 for Berkshire. Tick, tick – while he sleeps – tick, tick on weekends - tick, tick… Buffett loves this investment.

Buffett threw in another slide of the tombstone of a 1967 $5.5 million 8% bond due 11/1/85 of Diversified Retailing (though it only had one store!). He noted that two of the most important underwriters were not listed. Gus Levy of Goldman Sachs and Al Gordon of Kidder Peabody each agreed to take $350,000 of the deal on the condition that they be left out of the tombstone! Buffett was grateful for their help 43 years ago. (And he clearly has a long memory when it comes to his friends.)

FINANCIAL REGULATION

Munger doubted that anyone in Congress has actually read the 1550 page bill for financial regulation. However, he sees a clear need to make the investment banking system less permissive. Reduce the allowed activities. Reduce the complexity. Reinstitute Glass Steagall. Similarly, the savings and loan industry stayed out of trouble for years with its narrow charter. As soon as the charter was loosened, major trouble ensued. He lamented, "Give human's a chance and they'll go plum crazy."

At the Wesco meeting Munger used the analogy of a soccer referee. If one team has an extraordinarily good soccer player, it's in the best interests of the other team to knock the crap out of him to slow him down. You need the referee to keep things civil. Likewise in the competitive world of investment banking, with everyone so aggressively trying to outdo everyone else, it creates a system where eventually everyone goes blooey.

He added that the investment banks will push back hard. Like a diver with an air hose, they do not want anyone stepping on their air hose. They will defend it as if their life depends upon it. So it will take stern measures. He concluded that if he were a benevolent despot, he would make Paul Volker look like a sissy.

DERIVATIVE REFORM

Buffett clarified some lobbying he had recently done to have one element of the fin-reg bill revised regarding collateral for existing derivative contracts. It appeared the bill might retroactively require hundreds of companies to post additional collateral without proper compensation. As Buffett put it, "If I sell you my house unfurnished, that's one price. If you later want it furnished, well then you need to pay me more." He noted that Berkshire had just been shown a contract that had two prices, $7.5 million with no collateral and $11 million fully collateralized. Munger concluded that the provision in the bill was of dubious constitutionality and was both unfair and stupid.

GREECE AND THE DOLLAR

Currencies worldwide appear to be in a race to the bottom. Buffett noted that events in the world over the last few years make him more bearish on all currencies holding their value over time. He emphasized that there is no possibility of U.S. default - because it prints its own currency and can simply print more money. Greece however is in a more awkward spot. While Greece is sovereign in terms of its own budget, it cannot print its own money as it is part of the euro-zone. This is a test case for the durability of the euro.

Munger noted that in the past the U.S. was conservative which gave it wonderful credit. Munger pointed out that credit status helped us fund World War II, and then, in one of the greatest foreign policy decisions in all history, funded the Marshall Plan to help reconstruct Germany and Japan. Now our government has pushed credit too hard for too long. Greece is just the start of an interesting period where we see what happens when government blows it by pushing too hard for too long.

Buffett chimed in that running a budget deficit of 10% of GDP is not sustainable. How the world weans itself off of huge deficits in country after country will be an interesting movie. Munger added that unfunded promises are miles bigger than the reported problem. It can work out as long as the economy grows. If growth stops, you have a very difficult problem.

HIGHER INFLATION

With the above observations, it follows that it is likely we will have higher inflation in our future. Buffett noted that since 1930 the dollar has depreciated by over 90%, yet the U.S. has done okay. Prospects for significant inflation have increased around the world. The medicine for the crisis – massive doses of debt – was okay but continuing to run high deficits as a percentage of GDP diminishes the value of the currency over time. Both Buffett and Munger are betting on higher and maybe a lot higher inflation in the years to come. (Ed: We note how Buffett has responded to this situation. He's fully invested in businesses and equities.)

BIGGEST GLOBAL CHALLENGE

As in years past, Buffett noted that the biggest challenge to civilization is a massive nuclear or bio-chemical attack. Over 50 years the probability of such an attack occurring is high. Over one year the probability is low. Buffett noted that throughout history there has been incredible progress, with lots of hiccups, in the state of mankind. The U.S. has been remarkable in unleashing human potential like no other country. In 1790, Buffett imagined that a farmer probably dreamed of a tool that would shorten the work day from 12 hours to 10. At that time, the U.S. had a fraction of the population that China had and look how well we have done. He noted that the Berkshire crowd was probably no smarter than folks 200 years ago, but boy do we live better.

SUCCESSION

Buffett once again assured shareholders that succession plans are in order. A new CEO would be ready at any time on short notice. Munger assured shareholders that he is quite optimistic that the culture of Berkshire will last a long, long time after the founder is gone. Buffett noted that the culture at Berkshire now is strongly selfreinforcing. He added that it is really tough to change an existing culture. A plus for Berkshire is that the culture has been so engrained, evolving since 1965 as Buffett added more and more complimentary companies.

CAPITAL INTENSIVE BUSINESSES

Buffett said this is the number one question he would ask of himself: why is Berkshire investing in capital intensive businesses? Berkshire's hallmark has been to find companies that gushed cash and required little or no capital reinvestment. Companies like See's Candies. As that cash flow got funneled to Omaha, it was then Buffett's job to reinvest in the next cash machine. However, as Berkshire grew, Buffett found it more and more difficult to put those billions of dollars of cash flow to work. So Buffett shifted gears.

Starting with MidAmerican Energy in 1999, Buffett saw the appeal of companies that could reinvest all the cash they generated assuming they could do so at decent returns. Owning a utility like MEC fit the bill. MEC has invested every dime of its cash generation back into its utility businesses, mostly at regulated rates of return in the 11-12% range. Not brilliant but the investment has worked out very decently. With that experience in his pocket, Buffett was ready for another. Berkshire recently closed on the acquisition of Burlington Northern Santa Fe, another highly capital intensive business where he expects low double digit rates of return on investment. In the first quarter 10-Q, Berkshire estimates that the two subsidiaries will have capital expenditures of $3.9 billion for 2010.

DEBT VERSUS EQUITY

Buffett noted that the analytical hurdle for buying a bond requires answering the question; "Will the company go out of business?" while buying an equity requires answering the more difficult question, "Will the company prosper?" This is why Berkshire bought the 15% notes of Harley Davidson rather than the stock. He had no question the company would stay in business, quipping, "You have to like a business where the customers tattoo your name on their chests!" But gauging Harley's long term prosperity was much more difficult, especially during the throes of the crisis. Surprisingly (to us, anyway), Buffett added that had Goldman offered him a non-callable 12% instead of a callable 10% plus warrants, he would have taken the 12%. Buffett added that Berkshire has some $60 billion of liability in insurance with some exposures lasting as long as 50 years, so Berkshire will never have all its money in stocks. Munger piped in that Berkshire is investing as a fiduciary, so it is constrained in how aggressively it buys equities. Though, Munger added, investing in the equities of distressed companies can be a very promising area.

AJIT

Buffett annually sings the praises of Ajit Jain who heads up Berkshire's National Indemnity reinsurance unit. In the annual report, Buffett joked, "If Charlie and I and Ajit are ever in a sinking boat – and you can only save one of us – swim to Ajit." Jain has been a key player in expanding Berkshire's insurance float far beyond what Buffett thought possible many years ago. Three years ago Ajit took over huge liabilities from Lloyds, a contract that brought Berkshire a $7.1 billion premium. Last year, Ajit negotiated a life reinsurance contract that could produce $50 billion of premium for Berkshire over the next 50 years. So while Buffett doubted that Berkshire's $63 billion of float will grow much in the years to come, he allowed that there could always be the float-expanding deal. Buffett shared that Ajit runs a staff of 30 in a way that makes the Jesuits look liberal in what they allow the members to do. It's one disciplined operation. If Ajit weren't there, it would be a huge loss for Berkshire, but Berkshire could still do some of the large deals it has become famous for.

LEARNING MONEY LESSONS

Buffett noted that people do crazy things from time to time and it is not a function of IQ. You cannot modify the madness of mankind. On a personal basis, Buffett emphasized how important it is to get good financial habits early in life. He noted that he and Charlie got lucky. They grew up in households that taught the basic money lessons. It is far more important to get the elementary ideas than those that come with an advanced degree. Munger added that McDonald's has been a great educator for the American workforce. They teach folks to show up on time, do their work efficiently, and so on. It's had an enormous affect on training the country. Buffett also plugged a cartoon series seeking to train kids about money called "The Secret Millionaires Club".

TAXES

Buffett has been criticized for suggesting higher taxes are in order for the wealthy, while he has avoided estate taxes by gifting his Berkshire shares to charity. Buffett welcomed people to follow his example. It does avoid taxes and likely the money will do a lot of good. Munger added that Warren, as will we all, will ultimately pay a tax of 100% - when we die we leave it all.

On a national scale, the government budget equals some 25-26% of GDP, with roughly 15% from tax revenues and 10% from deficit financing. Buffett said that reducing the deficit will need to involve some balance of lower expenditures and higher taxes.

NET JETS

Buffett admitted making a mistake with NetJets buying too many planes at too high a price. He gave David Sokol enormous credit for turning things around and getting the operating costs more in line with revenue. He added this isn't the first mistake he's made. Berkshire was in textiles for 20 years even though he knew it was a bad business. He joked, "I finally woke up. I was Rip Van Winkle."

Munger gave the episode some context. He said if you have 30 businesses with historically successful managers and that works 95% of the time, then you will have one case that doesn't work so well. And in the case of NetJets the franchise is fine – what was lost were past profits. Overall, this is a very good system.

BYD

At the Wesco Financial meeting, Munger gushed that he'll be surprised if they ever find another business as good as BYD. He noted that David Sokol was key in enrolling him into looking at it. BYD had a track record of rare accomplishment, so this was no start up. He was especially impressed with the founder, Wang Chuanfu (who was recently crowned China's richest man due to the sharp rise in BYD's stock price). Munger asserted that BYD will work out well as it solves significant world problems with its batteries and electric cars. He added that with Burlington Northern, MidAmerican and now BYD, that adds a fair amount of engineering to Berkshire which he likes.

In his younger days, Munger shared how he lost a bundle in a venture capital investment - they lost their main inventor to another company and then their oscilloscope was obsolesced by the new technology of magnetic tape - and that soured him on technology ventures ever since. Until BYD. Munger suggested that BYD illustrates their ability to keep learning at Berkshire.

COMPENSATION

Buffett shared that Berkshire owns more than 70 different businesses so it needs a variety of compensation arrangements. For example Burlington Northern requires lots of capital and See's Candies requires none. Each business has its own key measures of building business value. What Buffett wants to pay for is widening the moat. Munger noted that GE and many other large companies have centralized personnel departments for such things. Imposing policy from headquarters can build resentment. Berkshire is the opposite - totally decentralized management. Munger mused that it is amazing how simple it's been, how well it has worked, and how little time it takes.

ALLOWABLE RETURNS

Utility returns are based on returns on equity averaging between 11-12%, depending on the state regulators. Berkshire is almost certain to earn that rate as demand for power is unlikely to fall off much. Railroads are riskier as they are more sensitive to the economy. However, it serves society to have railroad investment exceed depreciation. That common interest suggests Berkshire will earn decent returns on Burlington Northern And there will be much needed investment in the railroad over the next 30 years. Munger observed that the railroads have been hugely successful in a regulated system. They've been totally rebuilt over the past 50 years and the average train has doubled in both length and weight.

INSURANCE RISKS

Buffett shared that earthquakes and hurricanes are the two biggest catastrophe risks. Currently rates are soft so Berkshire has been doing less business. Berkshire is willing to take on a maximum risk of $5 billion. Katrina was $3 billion. 9/11 was $2 billion. Berkshire is deliberately seeking big overall losses on occasion when everyone else is trying to avoid them. That's a big competitive advantage. Buffett said it's actually close to a permanent advantage that gets wider every year. By taking the other guy's desire to smooth earnings, Berkshire gets big premiums up front and books larger, though lumpier, earnings over time.

SPECULATION

"Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done."

Buffett kicked off an extended discussion on the nature of speculation with this quote from chapter 12 of John Maynard Keynes' The General Theory of Employment, Interest and Money. (Buffett added that he thought Keynes' chapter 12 was the *bes*t description of the way capital markets function.) Wall Street has always been partly a casino operation as well as a socially important operation in the raising and allocating of capital. However, this casino element became unbalanced with the advent of options and derivatives. According to Buffett, Pandora's Box was opened in 1982 when Congress approved the creation of S&P 500 contracts. It changed the game. Now anyone could buy the index and ignore real companies. The casino was then officially opened to all. In addition the contracts received preferred tax treatment, 60% long term gain and 40% short term gain, regardless of the holding period. Buffett wrote Congressman Dingell that year, suggesting that 95% of the trading in these contracts would be gambling. Munger noted how it was crazy and that Warren was the only one to write in opposition of the bill. Munger concluded quoting Bismarck: "You shouldn't watch two things – sausage making and legislation making."

MUNICIPAL BONDS

Asked about the possibility of municipal bond defaults, Buffett noted that Harrisburg, PA had recently defaulted. The real key, according to Buffett, was *correlation* - could a contagion break out where many municipalities defaulted at the same time? For bond insurers, the amount of liabilities is extraordinary relative to the capital backing them. Buffett also noted that the government bailed out GM, so how could it not also come to the aid of a troubled state. The problem is moral hazard: if the undisciplined are not punished for it, then why should others be disciplined? Munger concluded that it is wise to invest in places that are prosperous and disciplined – integrity still matters.

BUY AMERICAN UPDATE

Buffett was asked about his famous *New York Times* article from October 2008 entitled "Buy American. I Am." Buffett noted that he writes very seldom and he was pretty premature on that one. Yet, he knew that stocks would be better than bonds or cash over the long run. Even after the market rally, he said he would rather own stocks than bonds for the next 10 or 20 years. Munger was less sanguine, saying that equities were the best of a bad lot of opportunities and that he sees a long period of dull returns ahead.

ENERGY

Buffett observed that there are 500,000 producing wells in the U.S. and that we've really exploited what took millions of years to create. It has contributed significantly to the world's prosperity. Buffett said not to give up on humans' abilities to solve problems. In fact, leaving aside the nuclear and bio-chemical threats, this is a great time in history to be born. Munger noted that the world is less dependent on oil than in the past. In the 1850's the technology of the day needed oil to get ahead. Today, oil is not so essential. He cited physicist Freeman Dyson (the Templeton Prize winner in 2000) who points out that the world going off oil is not that dire – we may go from 85 million barrels/day to 55 million barrels/day over the next 50 years. Munger concluded that if it doesn't bother Freeman Dyson, then it shouldn't bother you.

Munger asserted that solar power is coming because it is so obviously needed. However, he wouldn't buy solar panels yet, as they will get cheaper in the future. He continues to be concerned about ethanol, calling the use of fossil fuel and water to grow corn to make ethanol a "stunningly stupid idea." He is optimistic that we will build a smart electric grid eventually. Munger believes our energy problems are solvable and the right answer may end up being counter-intuitive.

KRAFT

Berkshire owns 8.8% of Kraft. Buffett did not like the price Kraft paid to acquire Cadbury's. Nor was he happy about Kraft's tax inefficient sale of DiGiorno Pizza to Nestle's to raise cash for the deal. He did say Kraft is selling for considerably less than its constituent parts. The present price is below the value of very good businesses like Kool-Aid and Jell-O.

Munger opined that many top U.S. business leaders think they know too much and dream of running easier businesses with less competition. He recalled Xerox buying Crum and Foster (an insurance company) – no tough Japanese to compete with in the insurance business. It was just an awful deal. Munger went on to add that Berkshire avoids a small subset of stupidities by not having around an army of sales folks pushing deals.

INTEGRITY

Munger asserted that the financial crisis was formed by a lack of integrity in management. Munger poignantly quoted Pope Urban about Cardinal Richelieu: "If there is a god, he has much to answer for. If there is no god, he has done rather well."

Buffett added that the "everyone is doing it" factor is tough to handle. For example, when the Accounting Standards Board (as instructed by the Senate) allowed options to be treated as an expense (the preferred way) or to be treated otherwise, 498 of the S&P 500 opted for otherwise. CEO's surrendered, "I have to do it if everyone else is doing it." The situational ethics problem is huge. Buffett recommended that the key to handling it is to create a structure that minimizes the weaknesses in human nature. Munger added that much bad behavior is subconscious and the cure is to have folks bear the consequences of their decisions. Seen from this perspective, Wall Street is an irresponsible and immoral system. Munger lamented, "Who do you see apologizing? People think they did fine."

FEAR AND OPPORUNITY

Buffett repeated his old mantra that successful investing requires the right temperament – to be greedy when others are fearful. If you get scared yourself, then you won't make a lot of money in securities. Munger shared that he developed courage after hardship. Maybe it's a good idea to get your feet wet in some failure. Buffett suggested that most people would invest better with no daily quotations. Buy a good business and hold it for a long, long time.

Munger concluded with a joke. The man says, “Would you still love me if I lost all our money?” The wife replies, “Yes, I will love you always and I would miss you terribly.”

THE ELECTRONIC RECORD

Asked why he is on TV so much, Buffett responded that he likes having the electronic record so there is no chance of him being misquoted or misunderstood. (Ed: In this year’s Berkshire annual report, Buffett cited how badly misquoted he was by the media after last year’s annual meeting.) If he’s on Charlie Rose, he knows the record will be permanent and will be exactly what he said.

0% INTEREST RATES

Buffett wryly noted that while it is called an easy money policy, it isn’t so easy on the people that have the money. It has been tough on savers. Meanwhile purchasing power is being eaten away by inflation. He asserted that it won’t work forever to have huge budget deficits and 0% rates. By the way, he added that if this goes badly, don’t blame the Fed, blame Congress. Munger agreed that it is enormously depressing. Stocks are up in part because the savings rates are so low. It cannot last.

MAKING IT IN BUSINESS

Buffett quoted Emerson, “The power that resides within you is new in nature.” He shared how Rose Blumkin, who never went to school, was a force of nature, turning a $500 investment into a $400 million business sitting on 78 acres called the Nebraska Furniture Mart. He remembered visiting Mrs. B at her home once and she had green sales tags hanging on the furniture. Buffett quipped that he said to himself, “Forget Sophia Loren, this is my kind of woman!”

Buffett shared that there’s nothing like following your passion. That’s the common factor with all of Berkshire’s excellent managers – they love what they do. Buffett also shared some of his classic bits of wisdom about growing wealth. Spend less than what you make. Know and stay within your circle of competence. The only businesses that matter are the ones you put your money in. Keep learning over time. Don’t lose. Insist on a margin of safety. Munger suggested making it your practice that you go to bed each night wiser than when you got up. You may rise slowly, but you are sure to rise. Munger reminisced that the only business course he ever took was accounting. As a little boy he saw a man who hung out at the club all day. He asked his dad why. His dad explained that the man was very successful in business because he had no competition - he rendered dead horses. Munger said he has been interested in business ever since. In Omaha many businesses have come and gone, but he said you could predict that Kiewit would be a success because they worked hard and were disciplined.

CAUSES FOR OPTIMISM

Long noted for being a bit of a curmudgeon, Munger may have surprised the crowd with a list of things he is quite optimistic about: 1) The main problems of civilization are technical and solvable, all with energy, with huge benefits for civilization. 2) Berkshire’s culture will continue to work for years to come, 3) He likes to see people rising rapidly from poverty and that is happening in China and India, 4) Maintain low expectations – that is the key to happiness. Munger finished with a flourish, “Seeing as I’ll be optimistic when I’m nearly dead, surely the rest of you can handle a little inflation.”

PRAGMATISM

Asked about their theory for life, Munger seized the microphone, and said, “Pragmatism!” Do what suits your temperament. Do what works better with experience. Do what works and keep doing it. That’s the fundamental algorithm of life – REPEAT WHAT WORKS.

So there you have it. The secret to Berkshire Hathaway’s amazing compounding - a relentlessly rational and pragmatic approach to business and investing.

Berkshire's Cash/Bond/Stock Ratios 1979 through 2009

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 237-fold in 30 years. The chart illustrates that Berkshire has been a significant buyer of equities and other deals - increasing the percentage from 41% to 59% over the past four years. With Buffett keeping a minimum of $10 billion in cash for insurance catastrophes, Berkshire is "all-in" for now.

		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

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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