44th Annual Wesco Meeting,

May 7, 2003

Notes By Steve Check

Charlie Munger, Chairman of the Board
University Club, Pasadena, CA

Crowd doubled in size this year compared to last year; about 600 in attendance.

As a result of new regulations, two board members resigned and two new ones coming on board. New board members described as very capable by Charlie. One is a money manager, the other runs a private aerospace company. Money manager was at Blue Chip Stamps when Warren/Charlie came on the scene.

Charlie started the meeting with a bit of an introduction. It lasted for about 20 minutes.

He told us to look around and we'd see hardcore enthusiasts; we put up with 5 hours of questions in Omaha on Saturday and now we were at the Wesco meeting for more. We liked the value system, the cast of mind. Charlie said he was sympathetic to those with a similar mind.

Charlie, jokingly, said he and Warren were lonely. Academia thinks different from them: efficient market, prices tell all, etc. Charlie wondered out loud, "What other profession do the leading practitioners think so different than the leading theorists?"

He mentioned how money is generally managed poorly with the "help" of consultants, etc.

Charlie mentioned Warren's advice regarding a punch card with 20 investments in a lifetime. He said if you followed it you WOULD die a lot richer (assuming you are a smart, disciplined person).

He asked out loud, "How many things has Wesco done?" Not many. Maybe one every two years.

He noted it would be hard for money managers to operate this way. Clients would not want to pay for doing one trade every two years.

Beating The Market

Charlie noted that if you wanted to beat the market by 0.5% a year, it could be done with a stock portfolio with a fair number of names. But, if instead, you wanted to beat the market by 5% a year, you needed to be selective and bet big when the opportunities came along.

He then discussed diversification some. He said they pay people to teach this stuff at business schools. [Charlie is not a fan.]

He noted that no individual would feel bad to have 1/3 of their money in the leading shopping center in town, 1/3 in a great office building, and 1/3 in an apartment complex in a great location with a good manager. He noted this would all be in real estate, but would you be uncomfortable?

Munger asked, “Would you take an investment that would pay 12% per year for sure?" He noted many would not.

He asked, “Does it make any difference if someone is making more money than you?” Noted that envy was a bad sin. It was all pain, no fun (unlike other sins).

Go through life in an orderly way. Decisions are about opportunity costs, including marriage. A medium-looking person with a chance to marry someone has an opportunity cost decision to make.

Investments are about opportunity costs. Opportunity-cost bar is raised by looking at various investment options: stocks, junk bonds, etc. But you do have to be careful not to get outside your circle of competency.

American Express 1965

Warren put 40% of his partnership in AXP (1965?). He had to get his partners to agree to change the partnership agreement so he could do so. What mutual fund has ever done this?

At Wesco, right now, they have more capital than they know what to do with. He thinks a time will come when they will find something to do with the capital.

No overwhelming bargains in common stocks right now.

Not pleasant investment times with 5-year rates under 3%.

If you are securely rich, and if you don't do anything for 6 months, will you be in such a bad place? It will be 6 months later and you'll still be securely rich.

In markets strange things happen. Who would have predicted the World Trade Center disaster, that all Japan life insurance companies would essentially be insolvent because they guaranteed 3% returns, that interest rates would be so low?

Mutual funds: many times they have relatively few dollars in them when they are posting good returns and they have a lot of money in them when they are posting bad returns. The per-dollar returns are much worse than the regular way of reporting mutual-fund performance. This was especially true of venture-capital funds a few years ago.

This ended Munger's introduction

Meeting with Management.

At BRK meeting, Warren mentioned that he did not talk to company management before investing. Charlie thought that Warren did not do so anymore because he just did not want to. Charlie thinks there is value in talking to management, if you have access. Noted that Warren was trained by Graham, who did not believe in meeting with management. Graham was into the numbers. Charlie thinks meeting with management may help 60% of time, but hurt 40% of the time. He noted that Warren missed an investment opportunity after meeting with management. He said Warren came from the meeting (a long time ago) with a low opinion of management and decided not to invest. The stock, subsequently, rose 15% a year for 20 years.

Jewish T-Bills

Not much going on in event arbitrage unless you consider junk bonds a form of this. Arbitrage did work well for Graham and Buffett for 60 years, but not many opportunities these days. Charlie noted that Graham called arbitrage Jewish T-Bills. Hard to employ capital at their present scale.

When they were buying junk bonds a year ago, mutual funds holding junk bonds were selling to meet net redemptions.

[My note: if a mutual fund area is seeing big net redemptions, like value funds in 1999, junk bonds in 2002, look for investment opportunities.]

Desirable opportunities may not last long. Be ready to act. Have a prepared mind.

If taxes on dividends were eliminated, Wesco/BRK would not start paying a dividend for this reason. Tax policy would not dictate what they'd do. If they think they can still grow money at a decent rate, they will not pay a dividend. [They think they can still grow money at a decent rate over time.]

Corporate America should set a good example. CEOs should behave right. Be responsible. A sand shoveler may go to a strip club, but the Bishop of Boston should not.

Question about USG (questioner owned USG). Charlie said he did not think it would go to zero. It was worth something between zero and infinity.

Made book recommendation: A Matter of Degrees: What Temperature Reveals About the Past and Future of Our Species, Planet, and Universe by Gino Segre.

Banking industry. Perfect goldmine. Buffett/Munger may have blown it by not participating more. Many made money in banking industry; managements in many cases were only moderately skillful. Borrow short, lend long. More. More.

Consumer credit: Selling heroin to addicts.

Burlington Industries. Had a segment that BRK wanted. Would fit with Shaw. Could put up with the rest of Burlington for the price they were willing to pay. Did not like having to essentially give a free put option (buying out of bankruptcy issue). Walked away from deal.

Quoted someone: Too soon old, too late smart.

Graham good things: Mr. Market, margin of safety, always be rational. Charlie liked Graham, recognized his great mind. Charlie did not worship Graham like Warren did.

Dairy Queen – tax advantages for BRK in owning the whole company.

Accounting for derivative books at big banks overstates value of derivative books.

Charlie said "fist over hand" [as opposed to "hand over fist"]. Another example of a Charlie twist on a common statement.

Capital allocation at corporate America is inadequate. Berkshire worked hard at being rational. Did not care what other people were doing. Does not follow the crowd. Many just follow the crowd.

Social security. Old people versus young people. Charlie said if growth of the country continued to be 2% per year in real terms, there would be no problem.

Wealth tax. Germany did it once after war. Charlie afraid if US did it, politicians would keep doing it, it would not be once. Charlie is fine with gift and inheritance taxes.

Charlie thinks government screws up most things.

Thinks having social security invested in stocks would be a bad idea for many reasons. More government. Bad capital allocation decisions.

The more anything sounds like easy money, the more Charlie is skeptical.

Earthquakes. Hard to get %'s right. That's what BRK likes area. They take on the tough problems. They leave life insurance to others. Warren/Ajit are in charge of earthquake insurance. Charlie is comfortable with that.

People see Charlie as old and rich. They ask him for advice. They want to be rich, but faster. Charlie did it slowly. Inch by inch. Taking losses mentally. Tried to be a little bit wiser each day. Step by step. But not in little increments. Comes in spurts. Discipline. Don't go crazy when you get ahead. Don't think you need Zza Gabor or some big wealth trapping. Charlie's way. It works.

The way to get success is to deserve success.

The way to get a good spouse is to deserve a good spouse. Which, by definition, means not half nuts.

Warren is still improving at age 72. Rare in a 72-year old.

On Warrens Death

When Warren dies, if stock goes down, **BRK could buy back stock.**

Mid American has very capable people in charge. Will be a lot bigger.

Ajit is young.

Warren dying would not be a big problem to shareholders.

Loss of dominance is 100% eventually. Civilizations, companies.

BRK will not deteriorate like General Motors has. GM gave too much to unions. Employees ended up owning the company at the expense of shareholders. Not BRK way.

Charlie likes to look at leaders from 50 years ago and see what happened: GM, S, KO.

On Clayton Homes

With Clayton Homes they were buying in a period of great distress in the industry. Likes company and management.

BRK way is to talk down stock when it is overpriced. BRK stock is reasonable now, which is why they are saying so little these days.

Any new bad accounting areas? [question from audience] No, derivatives and pension accounting are the big ones.

BRK stock has dropped 50% twice while Charlie has owned it. Did not lose a wink of sleep. Happens to all stocks eventually.

Recommended biography on Carnegie. Interesting to see how things were for workers 100 years ago. So different. Interesting to think of how things will be 100 year from now.

SQRZ

SQRZ. Buffett looking for something to do. Charlie would not have bothered. Warren was excited about selling a bond with negative interest. Indicated that BRK stock was probably a bit overpriced at the time. (*Berkshire was selling at about $78,000 at the time)*

When asked why Buffett did SQRZ, Charlie said "Warren has a big motor. He did it because he could."

Figure out what does not work and avoid it.

Iraq. Afghanistan. Suffer now, reward later. Charlie agrees with this approach. Likes that it was tried. We'll see how it works out. Investing is suffering now, reward later.

Charlie has never known of a single wise person [or was it a great investor?] that did not read all the time. Never ever. Charlie reads all the time. His family can't believe it. He says he probably looks like a book with legs sticking out of it. Charlie said Warren also reads all the time.

Business publications are very good. Lots of brains at Forbes, Fortune, Wall Street Journal.

Housing prices. Charlie did not see big boom, so why should he try to give any advice now? Low interest rates were a big part. Also, buying a house has worked for everyone, so it builds on itself. Buy a house when you need one. Don't try to time the market.

Wal-Mart

Sin of omission for Buffett/Munger: Not buying WMT stock.

WMT screwed up in not buying COST when it could have. It was a sin of omission by WMT. COST and WMT would be much more profitable if they did not have to compete with each other.

Cort. Bad times. Dotcom bust. Much used furniture on the market. NetJets is also having bad times (used jet prices have dropped a lot). Both will do well long term.

Bass Fishing Tournaments. You have the fisherman. You have the lure sellers and advice givers. Who makes the most money?

RoughlyRight