How to Invest Like Warren Buffett … or His Wife

AAII San Diego Chapter
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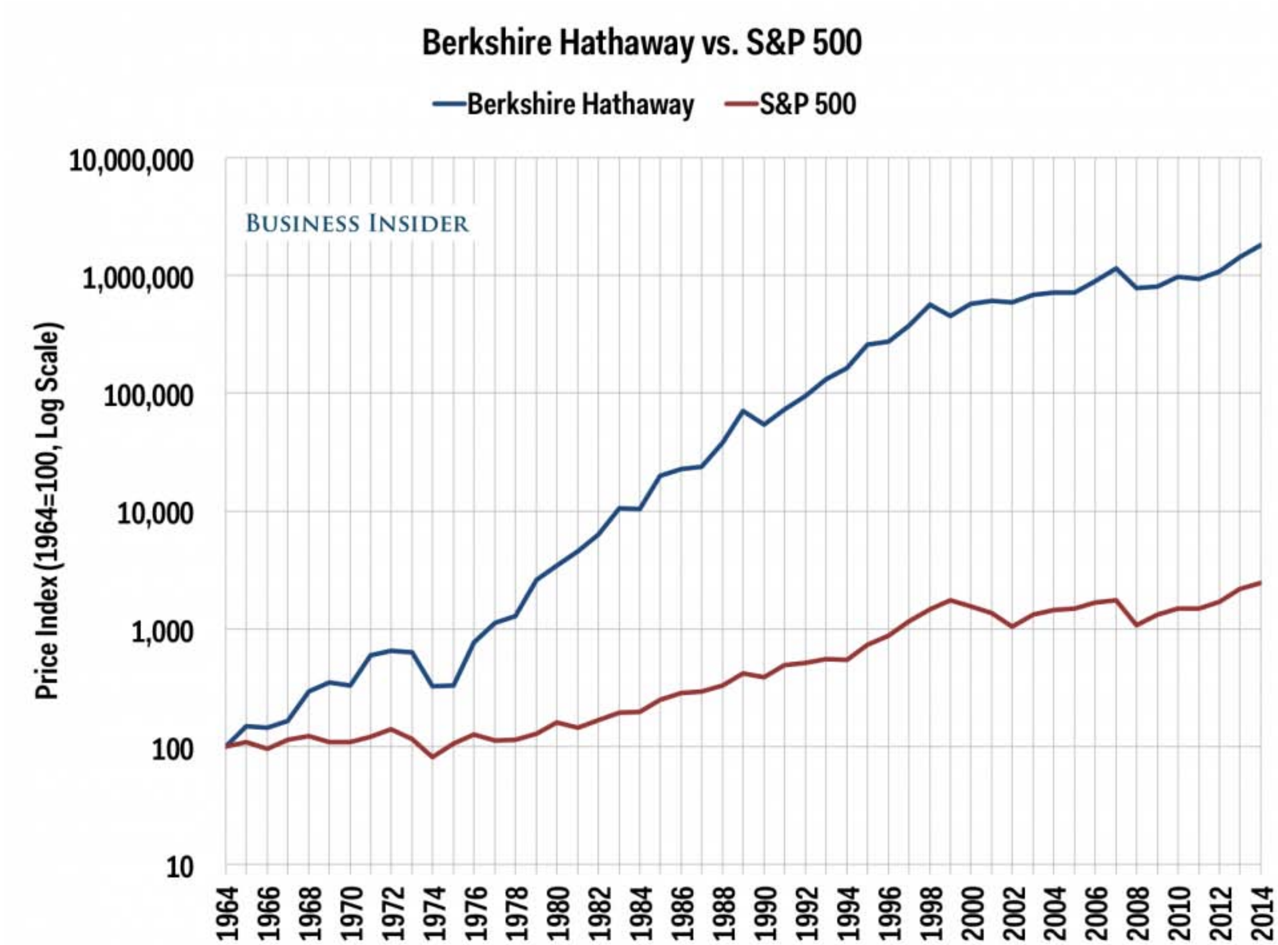
Why is this man smiling?

The world's richest person

- 1956: $100,000 → 2015: ~ $73 billion, or $109 billion before charitable contributions
- 1964: BRK.A @ **$19** → Friday: **$211,560**
- 1964: **$1,000** → **$11,134,737**
- 1990: **$1,000** → ~ **$33,000**

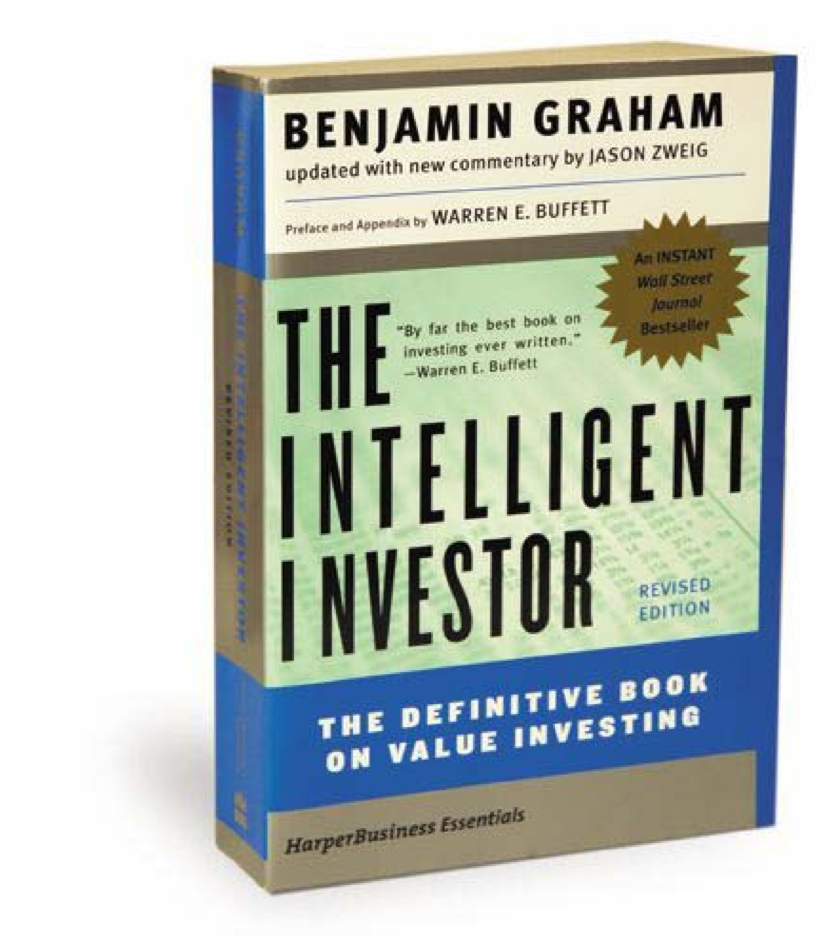
21.9% vs. 9.9% a year



Just lucky

225M Americans wager $1 on coin toss each morning:
After 10 days, ~220,000 “earn” $1,000 each
After 20 days, 215 people will have over $1 million each

"My greatest investment"



Mr. Market

- Is emotional, euphoric, moody
- Is often irrational
- Offers that transactions are strictly at your option
- Is there to serve you, not to guide you.
- Is in the short run a voting machine, in the long run a weighing machine.
- Will offer you a chance to buy low, and sell high.
- Is frequently efficient … but not always.

The basic idea: Few are great

- They have a good return on capital without a lot of debt.
- They are understandable.
- They see their profits in cash flow.
- They have strong franchises and, therefore, freedom to price.
- They don't take a genius to run.
- Their earning are predictable.
- The management is owner-oriented.

GEICO, a love story

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- In 1951, when Buffett was 21, his investment portfolio totaled $19,737, of which $13,125 was held in GEICO stock.
- He sold it to buy a “better” stock, whereupon his foregone GEICO stake grew to $1.3 million.
- Today GEICO produces $1.2B/yr in underwriting profit and $13.5B in float

Hitting the books

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- Consistent, growing net earnings that are retained. Beware of EBITDA!
- Low long-term debt
- Goldilocks return on assets
- High gross profit margin, cash flow
- Low, steady R&D spending
- Low capital spending requirements (See’s)

A compounding machine

Wells Fargo

Wells Fargo Historical Return on Equity									
	ROE	*Earnings (millions)*	*Dividends (millions)*	*% of Earnings Retained*		*ROE*	*Earnings (millions)*	*Dividends (millions)*	*% of Earnings Retained*
1972	11%	*$39*	*$16*	60%	**1993**	17%	*$612*	*$136*	78%
1973	11%	*$44*	*$18*	59%	**1994**	22%	*$798*	*$216*	73%
1974	11%	*$49*	*$19*	61%	**1995**	30%	*$990*	*$224*	77%
1975	12%	*$55*	*$19*	65%	**1996**	9%	*$1,004*	*$427*	57%
1976	12%	*$62*	*$20*	68%	**1997**	13%	*$2,456*	*$1,019*	59%
1977	14%	*$86*	*$24*	72%	**1998**	10%	*$1,915*	*$1,149*	40%
1978	16%	*$116*	*$31*	73%	**1999**	18%	*$3,712*	*$1,307*	65%
1979	16%	*$123*	*$39*	68%	**2000**	16%	*$4,009*	*$1,546*	61%
1980	14%	*$122*	*$44*	64%	**2001**	15%	*$3,994*	*$1,727*	57%
1981	13%	*$124*	*$45*	64%	**2002**	20%	*$5,710*	*$1,890*	67%
1982	13%	*$139*	*$46*	67%	**2003**	19%	*$6,202*	*$2,546*	59%
1983	13%	*$155*	*$51*	67%	**2004**	20%	*$7,014*	*$3,186*	55%
1984	13%	*$169*	*$53*	68%	**2005**	20%	*$7,671*	*$3,411*	56%
1985	14%	*$190*	*$57*	70%	**2006**	20%	*$8,482*	*$3,683*	57%
1986	15%	*$274*	*$72*	74%	**2007**	17%	*$8,057*	*$3,951*	51%
1987	2%	*$51*	*$90*	0%	**2008**	5%	*$2,369*	*$4,391*	0%
1988	24%	*$513*	*$130*	75%	**2009**	10%	*$7,990*	*$2,227*	72%
1989	25%	*$601*	*$172*	71%	**2010**	10%	*$11,632*	*$1,045*	91%
1990	25%	*$712*	*$199*	72%	**2011**	12%	*$15,025*	*$2,533*	83%
1991	0%	*$21*	*$182*	0%	**2012**	13%	*$17,999*	*$4,653*	74%
1992	7%	*$283*	*$96*	66%	**2013**	14%	*$20,889*	*$6,080*	71%
		Average Return on Equity Since 1972				**15%**			
		% of Retained Earnings Since 1972				66%			

Wells Fargo

	1972	2014
Book value	$0.40	$31.18
Share price	$0.59	~$52
ROE	10.9%	13.5%
P/B ratio	1.5	1.6

As an interesting side note, Wells Fargo carries less than half the leverage in 2014 than it did in 1972, a market "bubble" year.

Buffett’s advantages

- Low costs
- Low taxes
- Patience
- Regular cash injections for investment (float)
- Access to special opportunities
- Doesn’t fear holding cash

A note on costs

Accumulation	Active Fund	Index Fund	Index enhance	% increase
10 years	$44,000	$50,000	$6,000	13%
20 years	$130,000	$164,500	$34,500	27%
30 years	$286,000	$412,000	$126,000	44%
40 years	$561,000	$927,000	$366,000	65%

Assumes 30-year-old investor begins to save for retirement at age 70, a span of 40 years, by investing in a tax-deferred 401(k) or IRA plan. She earns $30,000 annually at the outset, compensation grows a 3% annual rate thereafter, and she invests 10% of her income each year.

Assumes all-in costs of 2.27% for active fund, and 0.04% costs for the index fund, 7% average annual return for both funds.

On Time and Compounding

- Warren Buffett is 84 years old.
- His best performance (30% average annual returns in the partnership) came between 1956 and 1969, and Berkshire’s best years came after 1974.
- Of his estimated fortune of $73 billion, he earned $70 billion of the total *after he turned 60*.

Lazy and greedy?

- Buy Berkshire Hathaway stock whenever the ratio of price to book value falls below 1.2 value. Friday the class B shares stood at 1.36.
- Buy Markel (MKL) at P/B less than 1.2

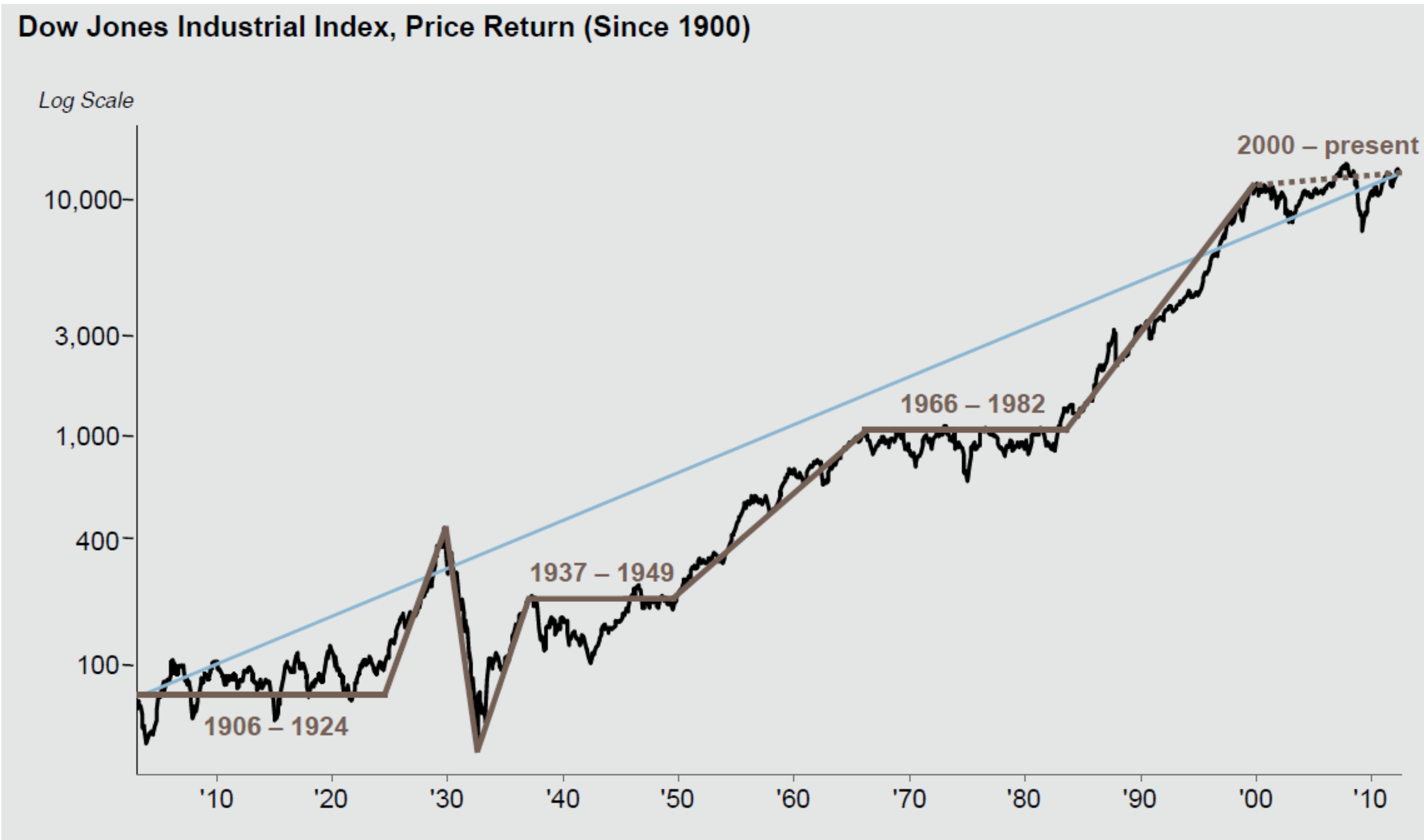
MKL vs Berkshire and S&P 500			
	Markel Book Value	S&P 500 Total Return	Berkshire Hathaway Book Value
5 Year CAGR	16.5%	18.0%	13.9%
10 Year CAGR	13.0%	7.1%	10.3%
15 Year CAGR	12.9%	4.9%	8.9%
CAGR Since 1986 IPO	20.1%	10.3%	16.7%

Warren's plan for his wife, Astrid Menks

"What I advise here is essentially identical to certain instructions I've laid out in my will. One bequest provides that cash will be delivered to a trustee for my wife's benefit … My advice to the trustee could not be more simple: Put 10% of the cash in short-term government bonds and 90% in a very low-cost S&P 500 index fund. (I suggest Vanguard's.) I believe the trust's long-term results from this policy will be superior to those attained by most investors …"

-- Letter to shareholders, 2014

How to stay cool …



… in times of crisis

"Over the long term, the stock market news will be good. In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a flu epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to 11,497."

-- Warren Buffett, Oct. 17, 2008