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The Woodstock of Capitalism

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For the sixth consecutive year, Jonathan and I along with the Spectrum Team of Manuel Rosado, Sam Vanden Heuvel and David Marshall embarked on our annual pilgrimage to Omaha, Nebraska to attend the Berkshire Hathaway shareholder meeting. Our group also included Gary Vanden Heuvel (Sam's father, President of the BLC Community Bank in Little Chute, WI) Gary's son Casey and John Wiley, a long time friend of Gary's.

This year's **Berkshire Hathaway Shareholder meeting** was again attended by over 35,000 people at the CenturyLink Center (formerly the Quest Center) in downtown Omaha. The Berkshire meeting never gets old for our group. I'm sure many would compare it to an annual fishing or hunting trip. We enjoyed the meeting so much we already made room reservations for next year.

The older **Warren Buffett** (81) and **Charlie Munger** (88) get, the more in demand the meeting becomes, because this experience won't last forever. Despite their age, they both still exude a lot of energy. They no longer drink Cherry Cokes during the meeting, but rather feast on water. Both still nibble on See's Candies® Peanut Brittle however. Berkshire Hathaway owns See's Candies®. The sugar high apparently kept them going for the five-hour question and answer session (with a one hour lunch break). Warren and Charlie do not rehearse for the meeting. After a 40 minute video highlighting the 80 Berkshire Hathaway companies, they both come out on stage (sit at one table) and after a 10 minute introduction by Warren, he simply asks, "May I have the first question please?"

The format for the shareholder meeting changed this year, so rather than *every* question being from the audience, every third question was. The first was asked by a panel of media members including Becky Quick, from CNBC and the second by a panel of analysts. Here are answers by Warren and Charlie to some of our favorite questions:

What will it take to get America growing by 4% again?

CM A lot, it's not going to be easy

WB If the US population grows by 1% a year and if the GDP grows at 4%, that would be remarkable. It's nice to have 4% growth, but while a 2.5% annual GDP growth rate might be slow in getting us out of a slump, it's a remarkable figure over a period of time. Our country is not a mess. Our politics have gotten to be a mess.

How do you compensate your Berkshire managers?

WB Obviously Charlie and I thought a few times about why we do what we do when we don't need the money, which is the same case about most of our managers. We hire people that love what they do. We get the opportunity to paint our own painting every day. We love painting that painting and that painting will never be finished.

Applause.

With our managers, we let them keep their own paint brush. If someone tells us to use more red paint, we want to tell them what to do with the paintbrush. We don't tell our managers to use more red or blue paint. We hire well and manage little.

CM We want our managers to enjoy their life.

Berkshire provides competitive salaries plus substantial performance bonuses for its managers, which can be in the millions. Berkshire Hathaway places a strong emphasis on incentive compensation. Warren and Charlie still maintain salaries of \$100,000 each.

*More than an hour into the session, Andrew Ross Sorkin of the New York Times asked Warren, **How are you feeling?***

WB I feel terrific. I love what I do and I work with people I love. It gets more fun every day. I have four doctors, and yes, they are all Berkshire shareholders. The doctors said that alternatives for my prostate cancer don't involve a single day in the hospital and wouldn't require me to miss a single day of work.

CM I resent all the sympathy and attention Warren is getting. I probably have more prostate cancer than Warren, but I've never been tested for it.

WB I'm probably more likely to be killed by a jealous husband than prostate cancer.

What about the criticism you have gotten over the "Buffett Rule" regarding the proposal to raise tax rates on the ultra-rich?

WB It was more fun to attack what I didn't say versus what I did say. People making 30, 40, 50 million dollars a year need to be paying 30% in taxes per year. I, with no tax planning and no Swiss bank accounts, have paid the lowest tax rate among all the employees (24) working at the Berkshire Omaha headquarters. That's astonishing. The top 400 earners in the United States make about \$270 million each. Under the rule, there would be a minimum rate that would restore it to what it was in 1992. The new tax rate would affect very, very few people and raise a heck of a lot of money.

What are your thoughts on the health of the banking system, both in the US and internationally?

WB US banks are in a far, far, far better position than they were three or four years ago. Since the financial system collapse, the Fed and the Treasury have handled things quite sensibly. The American banking system is in fine shape. The Euro banking system was gasping for air before the European Central bank stepped in with a trillion Euro loan at 1% for three years. Europe's biggest problem is a lack of a central bank for its 17 countries. As Henry Kissinger has said, "Who do I call if I want to speak to Europe?"

CM It's going to take a long time to fix the financial problems in Europe.

How about alternative energy? Do you prefer one over the other?

WB We're much bigger on wind than solar. Federal wind subsidies of 2.2 cents for 10 years per kilowatt hour make wind projects work. Neither solar nor wind would be working without subsidies. You cannot count on wind for your base load. If the wind's not blowing, it's a supplemental power source. Berkshire has a distinct competitive advantage in the utility and reusable energy space because 80% of the utilities in the United States can't reap the tax benefits available since they don't pay federal taxes. Berkshire can.

How about the development by China's BYD and electric cars in the US and China?

CM We need to subsidize those just like we do with wind energy and other green technologies. I recently drove a new electric car and was flabbergasted by how much it had improved from previous models. *When Warren asked Charlie what percentage of cars will be electric by the year 2030, Charlie said, Not many, but I like the idea of using the left lane for electric cars. Energy independence is one of the stupidest things I've heard adults discuss. We ought to use up the other guy's oil and save our own.*

When looking at the stable of 80 Berkshire companies, which industry has improved the most?

WB Our railroad business has improved its position dramatically over the last 15 to 20 years. It's a whole lot better business than it was five to 10 years ago. The railroad industry in the US had 1,700,000 employees after World War II. Today, the industry is far more efficient with 200,000 employees. A 120-car train is a mile long. The industry is averaging moving a ton of freight 500 miles on a single gallon of diesel fuel; that's three times more fuel efficient than trucking is. Nobody is going to build another railroad. We spend \$3.9 billion a year on railroad expansion and improvements without help from the Federal government.

What are your thoughts on investing in gold?

WB Over a 50 year period, Berkshire stock will outperform gold. If you own an ounce of gold now and you caress it for 100 years, you'll have an ounce of gold 100 years from now. When Berkshire started, gold was \$20 and Berkshire stock was \$15. Now gold is at \$1600 and Berkshire is at \$120,000.

What is the future of newspapers in this country?

WB Newspapers have three problems, two of which are difficult to overcome; distribution costs and giving away content for free online, while charging for the print product. The third problem is, becoming a secondary source for information. If you go back 50 years, newspapers contained dozens of areas of interest to people where it was the primary source; apartment listings, jobs, sports. Today, those things are all on the Internet. *The Omaha World Herald* tells me every day things that I can't find elsewhere. Most of those things are local. They tell me about my city, about local sports, my neighbors and about things I want to know. It's a balance between people caring about a sense of community and wanting to know what's going on. You don't give away the product in local news. Newspapers still fill an important function. We like newspapers in small and mid-sized communities with a lot of penetration and significant interest through local news. *Berkshire*

announced last week that it plans to buy 63 newspapers from Media General (Associated Press, 5/25/12).

What are your thoughts on investing in IPOs?

WB We haven't bought a new issue (IPO) in the last 30 years. New issues carry a 7% commission. We have no interest in new issues. If you call us with a new issue, don't bother finishing the sentence to sell us one.

CM We would rather buy a strong brand with strong barriers to entry, than try and build one by purchasing a new issue.

What are your thoughts on the risk of investing in today's market?

WB I'm fascinated by reading about other people's disasters. I'm absolutely absorbed by it. We have copies of the front pages of seven newspapers framed in our office about past investment disasters to remind us of what can happen. To guard against risk, we always keep a margin of safety. At Berkshire, we always keep \$20 billion in short-term government securities in case we need cash tomorrow morning. BH currently has \$38 billion in cash.

Warren said that the price of Berkshire stock has been cut in half four times in the last 53 years; or about once every 10 to 14 years. Those are the times you want a margin of safety and cash for those occasional great buying opportunities. For example, Warren Buffett was quoted in the New York Times in October 17, 2008 to "Buy American, I am." In hindsight, he didn't hit the bottom of the market, but he was close. Warren has nerves of steel. As he often says, be fearful when others are greedy and greedy when others are fearful. It's why in most cases at Spectrum we suggest balanced portfolios to keep a margin of safety.

CM We would rather learn from other people's mistakes, than make our own mistakes. It's why we like studying history. It's what business schools need to spend more time on versus learning more about options.

Long-term, what do you see as our nation's biggest problem?

WB Medical costs, which today make up 17% of the GDP. The biggest tape worm in the US economy is medical costs.

CM Eventually our country will need to add a value added (sales) tax to pay for it.

Listening to answers from Warren and Charlie, the time just flew by. We couldn't take notes fast enough as we listened to them speak. Warren is an optimist, but also a realist. So what have we learned from listening to Warren and Charlie for the past six years?

1. Always keep a **margin of safety**. Doing so provides a cash reserve for those buying opportunities that historically occur every 4-5 years, and those great buying opportunities that occur usually every 10-14 years. **For the average investor, having a margin of safety in your portfolio (moderate asset allocations) is important during volatile market periods.** 2. When investing or running a business, think **durable competitive advantage**. 3. Keep your sense of humor to laugh and enjoy life, and appreciate what a remarkable country we live in. As Ben Stein says, **"The best thing that happened to me today is I woke up in the United States of America."**

We loved our trip to Omaha and can't wait for next year. Check out our website at www.spectruminvestor.com and look for Warren Buffett's wisdom, found in our previous five **Woodstock of Capitalism** newsletters.