



The Woodstock of Capitalism

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President

For the fourth consecutive year my son Jonathan and I, along with Gary Vanden Heuvel (President of the BLC Community Bank in Little Chute, WI), his two sons Casey and Sam and a few friends, embarked on our annual pilgrimage to Omaha, Nebraska. The annual Berkshire Hathaway meeting has become legendary, with over 40,000 shareholders attending this year vs. 27,000 four years ago. To buy the Burlington Northern Sante Fe Railway, Warren Buffett split the Berkshire Hathaway B shares 50-1, which I'm sure resulted in a few more attendees this year.

Warren Buffett (79) and Charlie Munger (87), once again hosted the meeting with a very simple format: One table, two chairs, two plants, two glasses of water (no Cherry Cokes this year) and a box of See's Candies (a company which he owns). On that Saturday morning as I walked to the meeting with a bounce in my step, I described the day to my son Jon as feeling like it was Christmas morning. Gary and I just loved it and we're very blessed to have sons who loved it too. To have an opportunity to witness two legends answer questions for five hours not only about the market, but also about life, is truly a precious gift that won't go on forever, but the memories and experiences will.

This year, our party had the good fortune to experience dinner at Warren Buffett's favorite restaurant in Omaha – Gorat's Steakhouse. The restaurant, which Mr. Buffett frequently dines at, (it's 10 blocks from his house) tells a lot about who he is. It is a 65 year-old supper club managed and owned by the same family for four generations. Gorat's is a very simple, yet busy supper club with wood paneled walls. They serve a no fuss salad like my mother Josephine would make on our family's dairy farm and reasonably priced meals ranging from the high teens to mid 20s for an entrée. If any of you ever get the chance to travel to Omaha, we highly recommend eating at Gorat's Steakhouse. Now on to business. Here are answers from Charlie Munger (CM) and Warren Buffett (WB) to a few of our favorite questions at the meeting:

How do you feel about the economic crisis in the last two years?

CM What our nation went through was deadly serious. We were on the edge of something that could have taken civilization as we know it to the edge of ruin. If the government hadn't stepped in, the whole damn thing could have gone down like pins in a bowling alley.

Do you agree with the bashing of Goldman Sachs by Capitol Hill for allegedly marketing securities they knew were likely to fail and adding to the 2008 global financial near-collapse?

Warren Buffett spent an unprecedented 30 minutes at this year's meeting explaining the role of Goldman Sachs, where he has bet \$5 billion of Berkshire Hathaway's money. Mr. Buffett came to the

defense of Goldman Sachs saying their practices were solid and the US Securities and Exchange Commission's civil suit against Goldman was unwarranted. He said this doesn't mean he wants financial markets to run free, but investors that lost money, primarily large European Investment banks, should bear the consequences of the risks they took. Mr. Buffett went on to say that companies that sign such bond deals, including Berkshire, don't expect to know the names of the other parties, nor would knowing the names make a difference. Both Warren Buffett & Charlie Munger said that a lack of regulation on such contracts, known as derivatives, allows more "casino-like" investing on Wall Street that has little to do with the proper role of the financial industry to allocate money toward businesses with the potential to create economic value. Charlie said that there are plenty of the nation's CEOs who should be replaced, but the CEO of Goldman Sachs is not one of them.

CM The spirit of compliance is just as important as the words of compliance. Ben Graham used to say, "It's not the bad investment ideas that fail. It's the good ideas that get pushed to excess, and that's what happened here."

How can entrepreneurs be successful?

WB Stick with what you like and keep looking until you find the thing that you love. There's nothing like following your passion and don't let anything stop you.

CM Take the high road, it's far less crowded.

What would you consider to be your best investment?

WB The best investment you can make is an investment in yourself. The more you learn, the more you earn. Never stop reading, never stop learning. It keeps you young.

How does the situation in Greece compare to the deficit situation in the United States?

CM The problems in Greece have been obvious for awhile. I'm surprised it didn't happen sooner. The issues in Greece are going to be difficult to fix.

WB There is a distinction between countries that can print their own currency (the US) and borrow in their own currency vs. countries like Greece that have to borrow in other currencies (the Euro). Borrowing in other currencies doesn't allow countries to pump out more money, like the US, to deal with their credit problem. Greece doesn't have its own currency, it has the Euro.

Mr. Buffett said that the Euro was an experiment and the world would be seeing a test case played out. As long as the United States is printing and borrowing money in its own currency, there will be no default, but having countries buy US debt is another question.

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Why invest in debt (bonds) instead of equities?

Mr. Buffett explained that there are different risk profiles. For example, he doesn't know what Harley Davidson stock is worth but he does believe the company isn't going out of business, which means he believes he can make money investing in Harley Davidson debt.

What kind of risk does inflation pose with the US?

WB I worry about inflation. The prospects of significant inflation have increased not only here, but around the world. Big spending to solve the economic crisis might be the right thing for us, but the country might find it hard to wean itself from the medicine. A bet on high inflation in the future probably will win.

How can children be taught financial responsibility so we avoid the financial mayhem of the last three years?

WB What happened in the last year occurred, in part, because of conventional wisdom coming out of business schools. Good financial habits early in life are incredibly important. The early grade school years of a child's education will be far more important to a child's future than the type of business school they attend for an advanced education.

CM It starts with universities like the Harvard Business School, and how they teach the history of business. There's not enough emphasis on the history of markets. Show why GM rose to power and how it failed. Teach why railroads rose, then failed and why they're now good investments. Today's business schools teach from the perspective of a career in business and not as an investor in business. There are great benefits in thinking like an investor.

How does Berkshire compensate its managers?

WB We never use a compensation consultant. Determining compensation requires some interaction with Berkshire managers, sharing ideas about what they are contributing to the company. Charlie Munger says managers need to "**widen their moats**" compared to companies in other industries. I don't have managers submit budgets to me. We attempt to create the proper structure and culture, which minimizes bad behavior.

Will some of our nation's municipalities default in the next few years?

WB It would be very difficult for the Federal Government to say no to a municipality, such as a large state or city, when they're saying yes to a General Motors bailout.

Would Berkshire intervene if managers behave unethically or illegally?

WB Yes. If the reason a manager is doing something is because the next guy is doing it, it is not good enough.

Each year at the meeting a video is shown when Warren Buffett testified in front of the Department of Justice Committee regarding Salomon Brothers in 1992. His famous quote to the committee about his employees states, "Lose me money and I will be understanding. Lose a shred of reputation for the firm and I will be ruthless."

Can you talk about current investment opportunities and how to overcome the fear of losing money?

WB Equities will make more money over the next 10 to 20 years than cash or bonds. Returns in general won't be as high as they

have been in the past. If you are fearful over time, you won't make a lot of money. If a stock goes down, it's a great time to buy more, **but if you can't get into that mental attitude, you'll be scared when everyone else is scared.** Think of buying securities like owning a farm. You don't check the price of the farm every day.

CM Scared people are a broker's best friend. What counts is buying a good business with a **durable competitive advantage** at a decent price and then forgetting about it for a long, long time. Focusing on quarterly earnings or quarterly returns is bad for investors and a terrible idea for managers because managers are tempted to fudge the numbers.

Why did you buy Burlington Northern Santa Fe Railway?

WB Railroads have a high barrier to entry, which eliminates competition, especially foreign competition. *Mr. Buffett didn't say it, but buying a railroad, which hauls things like coal and commodities, is a bet on hard assets in the future and the potential of inflation.*

Does our country need high speed passenger rail?

WB Light rail doesn't work in our country because we don't have enough density (like Tokyo in Japan). The US has three million square miles. If it's going to be high speed it can't stop very often. Light rail is competing with a system that people prefer (autos). Light rail will be a bottomless pit of government subsidies.

Do our children have a chance in the future to succeed with all of our nation's issues?

WB If there is a time in history to be born into our land of opportunity, I would pick today for our nation's children as long as they are willing to continue to learn. To children – read as much as you can as often as you can. We go to sleep smarter than we wake up. People that keep learning almost never fail in life, with few exceptions. *Warren and Charlie both read five newspapers a day.*

What's your secret to investment success?

CM I'll take this one. **Avoiding dumb mistakes.** You always have a lot of people pushing you hard with dumb ideas. **When any guy offers you a chance to earn lots of money without risk, don't listen to the end of the sentence.** Follow this and you will save a lot of money.

What type of employees and business associates do you look for?

WB Find people that love what they do. People that love what they do are usually in it for the long haul and will generally have more integrity than someone who's simply in it for a quick buck. At Berkshire, we don't buy companies to liquidate them or spin them. We build them for the next generation.

Once again we enjoyed our trip to Omaha. A theme that stands out with Warren Buffett and Charlie Munger and the 21 employees at their home office in Omaha is not only their passion, but their integrity and their ability to keep things simple. As Charlie says, when it comes to looking at investments, **if you can't understand an investment in 30 minutes, you won't understand it in 30 days so don't do it.** Warren and Charlie provide a wonderful gift of wisdom each year to their shareholders. We wanted to share that gift with you. A day well spent.

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