Annual General Meeting

Company Participants

- Charles Thomas Munger, Vice Chairman
- Warren E. Buffett, Chairman, President & Chief Executive Officer

Other Participants

- Analyst
- Andrew Ross Sorkin
- Becky Quick
- Carol Loomis

Presentation

Warren E. Buffett {BIO 1387055 <GO>}

Good morning. I'm Warren. He's Charlie. I can see, he can hear. That's why we work together. Have trouble remembering each other's names from time to time.

We're going to -- we're going to introduce the directors, we're going to give you some information on the first quarter earnings. We're going to talk briefly about the David Sokol/Lubrizol situation, and then we're going to open it up for your questions.

Anything as it relates to the Lubrizol matter is going to be transcribed and will be put up on the website -- the Berkshire Hathaway website -- just as promptly as we can, maybe this evening or this afternoon, maybe tomorrow morning, but very promptly, because we want to be sure that all shareholders hear or get to read every word of what has been said here about the matter.

First thing I'd like to do is introduce the directors. And if they'd stand and remain standing, you can withhold your applause as they stand, but you can go crazy at the end, or you can continue to withhold your applause. That will be your call. Charlie and I are up here, and we don't like to stand up too often so we'll skip our standing.

The -- Howard Buffett, Stephen Burke, Susan Decker, Bill Gates, Sandy Gottesman, Charlotte Guyman, Don Keough, Tom Murphy, Ron Olson, and Walter Scott.

Now, we have a few slides that deal with the first quarter earnings. I think Marc Hamburg would like me to emphasize that these are preliminary. This is about as early as we ever have a meeting, in relation to the quarter. Normally it's always the first Saturday in May, so they had to work a little harder than usual to get these numbers together.

And I will tell you as background that basically pretty much all of our businesses, with the exception of those that are related to residential housing, are getting better, and you can almost see it with most of them quarter by quarter.

We have a wide diversity of businesses. We have more than 70 companies we list, but then Marmon itself has over a hundred businesses. So we are a cross section of not only the American economy, but to some extent we see a fair amount about what's going on internationally, too.

And in the first quarter, as has been the case, really, since the fall of 2009, both our nonresidential construction businesses, except for those nonresidential construction businesses, our other businesses have generally gotten better quarter by quarter, and there was no exception to that in the first quarter.

What was very different in the first quarter was that we had a -- probably the second worst quarter for the insurance industry, in terms of catastrophes around the globe. Normally, the third quarter of the year is the worst period because that's when hurricanes tend to hit the U.S. with most of them -- well, about 50 percent of them occurring in September and then sort of forming a normal curve on either side of September -- so the third quarter usually is the record quarter, and the third quarter was the record quarter back at the time of Katrina. But in the first quarter of this year, we had some major catastrophes in the Pacific Asian areas, and that hit the reinsurance industry particularly hard.

No one knows at this point. I mean it's a wild guess, but probably those catastrophes cost the reinsurance industry on the order of $50 billion, and we usually participate to the extent of 3% to 5%. First of all, I'll give you our overall earnings the way we normally present them. And if we'll put the first slide up.

You can see that our insurance underwriting suffered an after-tax loss of $821 million. Now, when I wrote the annual report, I postulated normal earning power of Berkshire at about $17 billion pretax and about $12 billion after tax, assuming breakeven on insurance underwriting.

Our insurance underwriting has done better than breakeven. In fact, it's made quite a bit of money for eight consecutive years. But I would say with a start of these catastrophes in the first quarter -- or the catastrophes experience we had in the first quarter -- I would say that it's unlikely that we would have an underwriting profit for 2011. If it was remarkably catastrophe-free from this point forward, including hurricanes in the United States, it's conceivable we would break even or make a tiny profit. But that's an improbable assumption, so I think for the first time in nine years we will likely have an insurance underwriting loss this year.

I think our record may very well be quite a bit better than, certainly, most other reinsurers and it does not change my expectation that over time, our insurance underwriting should at least break even. And if you have followed the -- what I've written in the annual reports

-- if insurance breaks even, we get the free use of float, and that's been enormously valuable in the past and I would expect it to be in the future.

And if you look at the other lines, insurance investment income is down a little. That will go down more because our Goldman Sachs preferred was called in April. Our General Electric preferred is almost certain to be called in October. So we have lost -- and we lost a -- we had called a note from Swiss Re that was paying us 12% and came to something over $360 million a year when the Swiss franc went above par. So we have lost, or are losing, at least three very high-yield investments, which we cannot replace with similar investments at present. So that line will go down.

On the other hand, at the end of the quarter we had $38 billion in cash, and that does not count the $5.5 billion that we were going to receive in April from our Goldman Sachs preferred. So that money is earning virtually nothing now, and I would not expect that to be part of the long-term picture, either. So there would -- just a few percent on that would be many, many hundreds of millions of dollars.

So I think over time, our insurance investment income, even though it will dip throughout this year, I would expect that if we have a similar level of investments, to actually grow from the level we show here.

We had the full ownership of BNSF in the quarter this year. We only had it, I think, from February 12th last year, so that, in a significant way, accounts for the gain in that next line of railroad, utilities and energy. But the BNSF also had a significant gain in earnings and the railroad business looks to me like it will have a very good year this year, not just our railroad but all railroads, and the competitive advantage of railroads is becoming more and more evident, almost by the day, particularly as fuel prices increase. And in the remaining lines, we also had gains in most of our businesses.

So overall, we got hit very hard in the insurance business. And if we'll move to Slide 2, we list the three major catastrophes that occurred, which in aggregate we estimate we have a total loss of a billion, 673 pretax, and that figure, as with all estimates -- early estimates about major catastrophes -- is subject to a lot of change. Nobody knows what the insured losses will be from the Japanese earthquake.

But this is our best estimate now. You'll notice that over 40% of the underwriting loss comes from a contract we have with Swiss Re where we get 20% of their business that contract is in the fourth of its five years. They have indicated that they will not be interested in renewing it. I just wish they told us that a few months ago. But we've enjoyed the relationship with Swiss Re, it's just that we enjoy it some quarters more than others.

Our estimate -- we've added a little something into their estimate because on balance we feel that most catastrophe losses develop upward. It's sort of the nature of the business. But that is incidentally, the tornadoes in April, just at GEICO, we expect -- and all we're talking about is automobiles here, cars, because we don't insure homeowners. We act as agent in placing insurance for people, but we do not take the insurance risk.

We estimate that 25,000 cars will get automobile claims. That's a lot of automobiles when you think about it, and our market share is about 9%, although it varies by state. But it's been an extraordinary tornado season, as you know. That does not hit -- I do not believe that that hits the reinsurance business particularly hard, because there are multiple, multiple events but no one event is anything like, say, the New Zealand earthquake.

The New Zealand earthquake estimated at $12 billion of insured damage. Charlie, how many people are in New Zealand?

Charles Thomas Munger {BIO 1406508 <GO>}

Well --

Warren E. Buffett {BIO 1387055 <GO>}

We don't practice these things, as will become evident here.

Charles Thomas Munger {BIO 1406508 <GO>}

I'd guess --

Warren E. Buffett {BIO 1387055 <GO>}

What, about four million? Three million?

Charles Thomas Munger {BIO 1406508 <GO>}

I'd guess a little more than that.

Warren E. Buffett {BIO 1387055 <GO>}

Four?

Charles Thomas Munger {BIO 1406508 <GO>}

Five, maybe.

Warren E. Buffett {BIO 1387055 <GO>}

Five, Okay. Five million people. So that's 1/60th of the population, we'll say, of the United States. And if you take 12 billion and multiply it by 60, you come up with 720 billion, which is 10 times Katrina, in terms of the impact on a place like that.

So those -- there's been some really extraordinary earthquakes. And as I say, the worst part of the season is, generally speaking, for reinsurers, is yet to come. So this may be a year that the reinsurers will remember, although they might prefer to forget it.

There's some good news on the insurance front. On the next slide I show the growth in policies at GEICO month by month this year versus last year. Now, if you'll remember, in the annual report I gave an explanation, in talking about goodwill value, about how the goodwill of GEICO is carried on our books at about a billion dollars.

And no matter how successful the business becomes, that goodwill value is never increased on the books, but it does grow. And as I put in the annual report, I estimate its value currently, using the same sort of yardstick we used when we purchased the second half of the company back in 1995, I estimate that value has grown, maybe to $14 billion. I mean, every policyholder at GEICO, on average, has a value to us, the way I calculate it, of something on the order of $1,500.

And when we add $318,000 -- and as of yesterday it was up to $381,000 -- when we add that, we've added something approaching $500 million to the goodwill value. That does not count the earnings from underwriting, which were substantial for GEICO. That does not count the investment income from the float, it does not count the investment income from the net worth we have attributed to it. That is added goodwill value, the same sort of goodwill value that a Coca-Cola has, or a Mars has, or any company like that.

And people think of it differently when they think of most consumer products. But a policyholder to Berkshire at GEICO has very, very significant value. There's a very significant percentage have been there for 10 years or more. And it's something that we do not realize on our balance sheet or income account, but it's an asset that's every bit as real as the numbers that we do put on the balance sheet. So there's good news at GEICO. We are gaining market share every day.

As a matter of fact, if you think about it, we have some people in the adjacent room that will be glad to sell you GEICO policies, and if only 66 of you sign up, that's a goodwill value of about $100,000, so it will take care of some of the expenses of this meeting. Not that I care whether you do it or not but --

Now, there's one more item I want to go through on the earnings picture, just because it illustrates to some extent the capriciousness of accounting and how we value our securities -- or whether we take write-downs on them, I should say. There's something called "other than temporary impairment," which is an accounting rule. It's kind of a fuzzy accounting rule, but it says that if you own a security for a while, and you paid X for it, and it's been selling at, say, 80% of X for quite a while, nobody knows exactly what quite a while means, and I'm sure they phrase it differently in the accounting textbooks, but anyway, if it sells there for quite a while, you're supposed to mark it down to that new valuation and have that markdown go through your income account, through your profit and loss account.

Now we mark it down in any event for the balance sheet, and the balance sheet is what gives you the number for book value and is our reference point. But only when it meets this other than temporary thing does the mark down actually get run through the profit and loss account.

Now, on March 31, as is shown, I believe, on the next slide, we owned some Wells Fargo stock, which had a cost of about $8 billion and the market value was $11.3 billion. But some of the Wells Fargo stock we bought had been bought at higher prices than the March 31 figure, whereas, as you can see, a lot of the stock, which had a gain in it of $3.7 billion, had been bought at lower prices.

Well, under the rules, we were required to mark down the stock we bought at a higher price by $337 million, whereas we ignored, in the income account, the $3.7 billion of gain.

Now, interestingly enough, there's two ways you can account for securities, as I understand it, both fully meeting GAAP accounting requirements. And if we had -- if we had used the average cost method, we would not have had to mark down. But we use what they call the specific identification method.

Now the specific identification method is actually useful to us from a tax standpoint, because it means whenever we sell a security we can pick out the highest priced security and attribute the sale to that. So it actually saves us money, or the time use of money, to get into specific identification. But we could just as easily use the average cost method and then we would not have a write-down like we have and that's why I -- one of the reasons I emphasize that -- the fact that you should ignore gains or losses in securities or derivatives on a quarterly basis, or even an annual basis.

The important thing is what the operating earnings of our businesses are doing and what the gain in book value, generally, has been. And then on top of that, you have to make your own estimate for what intrinsic value is, which would include things like the goodwill value that has been developed at GEICO.

I apologize for taking you through the accounting lessons, but the headlines often just say what the final net income is, as if that's the all-important figure. And sometimes it's the all-deceptive figure. I mean, it really bears -- if you include gains and losses -- it bears, really, no connection to the reality of whether a quarter has been satisfactory from our standpoint. But it does get a lot of attention in the press and that's why we spend, perhaps, an inordinate amount of time trying to explain what really takes place in our financials.

Now, I think we're going to get to the questions and answers here in just a second. We'll alternate between the press group on my right and 13 stations that --microphones that have been placed. I think a dozen of them in this room and maybe one in one of the overflow rooms.

I'd like to just comment for a few minutes -- and this will be transcribed and up on the internet at our web page. I'd like to comment for just a few minutes, and I'd like to ask Charlie then to give his thoughts, on the matter of David Sokol and the purchase of Lubrizol stock.

You saw in the movie a clip from the Salomon situation, and that occurred almost 20 years ago. It will be 20 years ago this August. And at the time, it was a Sunday, Charlie was there, and I was elected the Chairman at -- what, about 3:00 in the afternoon or so I think on a Sunday at Salomon, and I went down to address a press group.

And almost the first -- somewhere in the early questions, somebody sort of asked me, what happened?

Well, A, I'd just gotten to Salomon fairly recently, so I didn't know too much about it, but the phrase that came out of my mind then -- out of my mouth then --sometimes my mind and my mouth are coordinated -- the phrase that came out of my mouth then was that what happened was inexplicable and inexcusable. Now, it's 20 years later, and looking back on Salomon, I still find what happened inexplicable and inexcusable. I will never understand exactly why some of the events that transpired did transpire.

And to some extent, in looking at what happened a few months ago with Dave Sokol's failure to notify me at all that he'd had any kind of contact with Citigroup. In fact, he directed my attention to the fact that they represented Lubrizol and never said a word about any contact with them.

And then the purchases of stock immediately prior to recommending Lubrizol to Berkshire, I think I -- for reasons that are laid out in the audit committee report, which I urge you to read and which is on our website -- I don't think there's any question about the inexcusable part that Dave violated, and that the code of ethics, he violated our insider trading rules, and he violated the principles I laid out -- I lay out -- every two years in a direct personal letter to all of our managers and which I've been doing for a long time. So I -- you can read the audit committee report about that. The inexplicable part is somewhat -- well, it's inexplicable, but I'd like to talk about it a little bit because I will tell you what goes through my mind in respect to it.

Certainly -- well, one interesting point is that Dave, to my knowledge, at least, made no attempt to disguise the fact that he was buying the stock. I mean, you read about insider trading cases and people set up trusts in Luxembourg, or they use neighbors who know neighbors, or they use third cousins -- I mean, they have various ways of trying to buy the stock so that when it's later -- the FINRA is a supervising organization looks at the trading activity in the months prior to a deal, they do not see names that jump out at them as being associated with the deal. To my knowledge, Dave did nothing like that, so he was leaving a total record as to his purchases.

Now, I think at least usually -- and maybe always, we are queried after any deal. We are asked who knew about it when, and we supply a list of whether it's people at the law firm or people that are in a secretarial position at our place or the law firm. We give them a list of everybody that might have known or did know about the deal prior to the public announcement. And I don't know whether they do that 100 percent of the time, but certainly it's my experience that you get that.

And then a while later, you get a list of names of people that FINRA, again, has picked up as trading it, and they ask you whether any of those names ring a bell with you. So they're trying to put together whether anybody did any inside trading ahead of time.

So the odds that if you're trading in your own name, and you're on that list of people who know of a deal ahead of time, the odds that it's not going to get picked up seem to me are very much against you. But, to my knowledge, Dave did not disguise the trading which that's somewhat inexplicable that if he really felt he was engaging in insider trading and knew the penalties that could be attached to it, that he essentially did it right out in the open.

The second fact, which is less -- perhaps less -- puzzling, but Dave obviously has a net worth in very high numbers. He made, I think, close to $24 million. He earned it from Berkshire last year, and we got our money's worth, but he did get $24 million, too.

So I would say that there are plenty of activities in this world that are unsavory that are committed by people with lots of money. So I don't regard that as you know, totally puzzling, but I will give you one instance that does make it puzzling. It makes it very puzzling to me.

We bought MidAmerican at the end -- Berkshire Hathaway bought MidAmerican -- at the end of 1999. Berkshire Hathaway bought about 80%. Walter Scott, who I just introduced, and his family was the second largest holder, I think something over 10%, and then two operating people, Dave Sokol the senior one, owned or had options on a big piece, and Greg Abel, a terrific partner of Dave's, also had a piece. And Walter Scott -- and I've told this story privately a few times but not -- I don't think I've done it publicly.

Walter Scott came to me a year or two after we'd bought it, and Walter said, I think we ought to have some special compensation arrangement for Dave and Greg if they perform in a really outstanding manner. And he said -- I think maybe he suggested something involving equity and he saw me turn white. So he said, "Why don't you design one and let me know." So I just scribbled something out on a yellow pad. It didn't take me five minutes.

And we call it, sort of in honor of Charlie, although he didn't know about it, we called it the Lollapalooza. And it provided for a very large cash payout, which I'll get to in a second, based on the five-year compounded gain in earnings. And we were starting from a high base, in other words this was not from any depressed level, and we set a figure that no other utility company in the United States was going to come close to.

But if that figure were achieved, we were going to give $50 million to Dave and $25 million to Greg Abel. And I had Dave come to the office and I said, "Here's what Walter and I are thinking," and, "What do you think of this plan?" And it had these figures on per share that like I say, move forward at 16% compounded per year, and then I say, "Here's the payout." And he looked at it for just a very short period of time and he said, "Warren, this is more than generous." But he said, "There's just one change you should make." And

I said, "What's that?" And he said, "You should split it equally between me and Greg, instead of being $50 million for me and $25 for Greg. It should be 37.5 apiece."

So I witnessed -- and Walter witnessed, you can talk to him about it -- we witnessed Dave voluntarily, without any -- Greg had nothing to do with it, he wasn't there -- we saw Dave transfer over $12.5 million getting no fanfare, no credit whatsoever to his, in effect, junior partner. And I thought that was rather extraordinary, and what really makes it extraordinary is that $3 million, 10 or so years later, would have led to the kind of troubles that it's led to.

I find -- that is really the fact that I find inexplicable, and I think I'll probably -- it's 20 years after Salomon -- 20 years from now Charlie will be 107 -- and we won't mention what I'll be -- but I think 20 years from now, I will not understand what causes a man to voluntarily turn away $12.5 million to an associate without getting any credit for it in the world, and then 10 or so years later, buy a significant amount of stock the week before he talked to me.

And when he talked to me about Lubrizol, it was either the 14th or 15th -- he says it was 14th, I have no reason to disagree with that. The only reason I couldn't say specifically was I had eight university groups, 160 students, in on that Friday. That's the only thing that shows, and I spent most of the day with them. And the 10K and the 10Q that got printed out on Saturday have that date on them, the 15th, when I looked at Lubrizol for the first time.

You might be interested in knowing, I've been looking up 10Ks and 10Qs for 20 or 30 years, but I don't know how to print them out. So, fortunately, Tracy Britt was in the office, and I said, "Tracy, would you print this damn thing out? I don't know how to do it yet." But that is why I don't know whether it was the 14th or the 15th. The 10Q says the 15th.

But, at that time, when Dave called me on it, he said nothing about contact with Citigroup or anything of the sort and he -- and I said, "I don't know anything, really, about the company." He said, "Well, take a look at it. It -- it might fit Berkshire." And I said, "How come?" And he said, well -- he said, "I've owned it and it's a good company. It's a Berkshire-type company." And, I obviously made a big mistake by not saying, "Well, when did you buy it?" But I think if somebody says I've owned the stock, it sounds to me like they didn't buy it the previous week.

So there we are with a situation, which is sad for Berkshire, sad for Dave, still inexplicable in my mind, and we will undoubtedly get more questions on that. We'll be glad to answer them.

Charlie, do you have any thoughts on this?

Charles Thomas Munger {BIO 1406508 <GO>}

Well, I think it's generally a mistake to assume that rationality is going to be perfect, even in very able people. We prove that pretty well, regularly.

Warren E. Buffett {BIO 1387055 <GO>}

Do you have any explanation for the irrational?

Charles Thomas Munger {BIO 1406508 <GO>}

Yes. I think hubris contributes to it.

Warren E. Buffett {BIO 1387055 <GO>}

Well, we've gotten quite a bit out of him, folks.

Okay. Let's go to work.

We'll start with Carol Loomis of Fortune Magazine. I might as well -- I should introduce our group here. We didn't go alphabetical this time. We've got Carol, and then we've got Andrew Ross Sorkin of the New York Times, and we have Becky Quick of CNBC. In terms of my check-off system, I'm still going to go to Becky. That's alphabetical. So, Andrew, it didn't do you any good to try to move over there into the center spot. Carol, you're on.

Questions And Answers

A - Warren E. Buffett {BIO 1387055 <GO>}

(Question And Answer)

Q - Carol Loomis {BIO 7137249 <GO>}

Good morning from all of us, and I will make the small preamble that I've made before. We've been getting questions for a couple of months, each of us on our e-mail. Sometimes a question will be sent to all three of us and sometimes they'll just send to one of us, therefore it becomes very hard to count how many we've had, but certainly it's in the many hundreds and probably in the -- up into a 1,000, 2,000.

And obviously we aren't going to be able to ask every question -- every good question. We have a lot of good questions we won't be able to get to. But it's just that you had to pick and choose. And the other thing I should say is that whatever we do ask, Warren and Charlie have no idea of the question. None. No hint.

A - Warren E. Buffett {BIO 1387055 <GO>}

Sometimes we have no idea of the answer either, but go ahead.

Q - Carol Loomis {BIO 7137249 <GO>}

So I will begin. I don't think that anybody will be surprised that it is a Sokol question. And actually, the -- this particular long-term shareholder believed, as Warren has believed, he says, "I do not see why he should have been expected to ask Sokol about his Lubrizol stock holdings when he said he owned the stock. That wouldn't have been a natural question. But when you found out the details of his stock purchases a short time later, I do not understand your reaction."

"Surely you realized immediately that these facts were going to become known and that they were going to damage Berkshire's reputation, something you had said repeatedly you would be ruthless in protecting. Being ruthless probably would have meant your firing Sokol on the spot, but you didn't do that. And then you put out a press release that many Berkshire shareholders that I have talked to found totally inadequate. You have always been very direct in stating things."

"You were not direct in that press release, except in praising David Sokol. Otherwise you stated some facts and behavior that you said you didn't believe was illegal. And then you ended the release, leaving us -- now maybe you thought somehow we were going to read between the lines -- without expressing any anger about what had happened. Why were you not incensed? If you were, why did you not express your anger? Why did you handle this matter in the inadequate way you did?"

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes. The -- it wasn't really immediately thereafter. I learned on March 14th, which was the day we announced it. Now bear in mind his first conversation when he said he owned the stock was January 14th.

In between January 14th and March 14th, Dave gave no indication that he'd had any contact with Citigroup of any kind, and as we learned later, I mean, he went -- they met in, maybe, October or something like that where -- and talked about possible acquisition candidates for Berkshire. But none of that -- he told me at one point, he said Evercore and Citi represent Lubrizol, one of them represents the directors and one of them represents the company, and not a word about any contact.

On March 14th, when the deal was announced in the morning, I got a call from John Freund. John Freund is probably here today. John Freund works for Citi in Chicago, and he handles -- he's handled the great majority of our business in equities for decades, and I've got a direct line to him. I talk to him frequently. And he called and said congratulations and aren't you proud of our words to the effect. You can talk to John directly, although I've been told that the Citi lawyers have told him not to talk, but that -- knowing the press, they probably can work something out of him.

The -- he's -- essentially his words were that Citi's team had worked with Dave on this acquisition, and they were proud to be part of it, et cetera, et cetera. And this was all news to me, so that set up some yellow lights, at least. And the next day, I had Marc Hamburg, our CFO, call Dave, and Dave readily gave him the information about when he had bought the stock and how much.

Marc also asked him what the participation of Citi had been in reference to Berkshire's side of the transaction, and Dave said that he thought he called a fellow there to get their phone number, which turned out to be somewhat of an understatement.

Now, during the period when we announced the deal on March 14th, Lubrizol is the one that needed to prepare a proxy statement. We were not issuing shares at Berkshire. So there was no proxy statement, no -- nothing of this -- that sort -- on our part. The Lubrizol legal team, Jones Day, went to work with Lubrizol management to start preparing the proxy statement.

We eagerly awaited to see the first draft of that because I was going to be leaving for Asia on Saturday, which I guess would be the 19th, and I wanted to see what Lubrizol had to say about this whole Citi matter or anything else. The most interesting part of every proxy statement is something that says, it's basically the history of the transaction, and it's the first thing I read on any deal because it gives you a blow-by-blow of what has taken place.

And as Marc Hamburg can tell you, I kept -- and our law firm can tell you -- I kept urging them to get that to me before I took off for Asia. We got that the afternoon of Friday the 18th, and it had a fair amount of material in it about Dave's involvement with Citigroup. Then at that point -- I believe it was at that point -- our law firm got involved, Munger Tolles got involved, in their input to the Lubrizol lawyers as to what we had seen that was different or what we had seen that they didn't know about that we could add.

Ron Olson, the director of Berkshire and partner of Munger Tolles, was on the trip to Asia. So we got on the plane on Saturday the 19th and traveled over the next week until the 26th. And we knew at that point that his partners at Munger Tolles were interviewing Dave, as maybe some other people too, but certainly Dave and I believe that he was interviewed at least three times about both the stock purchases, the history of things with -- of his relationship with Citigroup, and they were assembling this information.

I don't have a BlackBerry or whatever it may be. Ron does. So he would get some information as we were over there. And he was getting some input but -- and we decided that when we got back we would need to have a prompt meeting of the Berkshire board about this matter. And we would also learn what the full details, at least of what Bob Denham, and maybe other attorneys at Munger Tolles learned from their interviews with Dave.

And we back on, I guess it would be Saturday the 26th and on the 28th we were going to bring Charlie into it before calling a board meeting. But there would have been a board meeting that week. And then about five or so in the afternoon, a letter was delivered by Dave's assistant, which really came out of the blue. And I -- he said to me he felt he was retiring on a high point and he gave the reasons why he was retiring, which I laid out and so on.

I don't know whether the questioning the previous week had affected his attitude. He would say not. But in any event, we had that resignation. That resignation as is I believe it may have been put in the audit committee report -- may have saved us some money If we'd fired him, the question would be whether it was with cause or not with cause, and we would have said it was with cause, but that might have very well gotten litigated, and a retirement did provide, in effect, the same non-level of severance payments that a firing with cause provided.

So I drafted up a press release, which has since been the subject of at least mild criticism and I laid out the good things that Dave had done, which he had done for the company. He'd done many good things, some extraordinary things. And then I laid out some actions which I said, based on what I knew then did not seem to me to be unlawful and incidentally I talked with both Charlie and Ron about that. Ron would have been more careful in that wording. I'm not sure Charlie would have been. I'll let him speak for himself on that.

And we ran it by -- I ran it by Dave Tuesday morning, just to be sure the facts were accurate, and he said -- he objected very much to something I'd put in where I said that I thought that he was in effect had his hopes dashed for succeeding me and that was part of the reason, and he said that was absolutely not true, that he had no hopes ever of succeeding me and that I -- basically he was telling me what was in his mind, and I shouldn't be trying to second-guess what was in his mind.

So I took that part out. But he affirmed all of the other facts in that letter, and then I took it out, I sent it to him a second time to make sure that he was okay with the facts, and he said they were accurate. Now, in there was included the fact that Dave had no indication that Lubrizol had any interest in an approach from Berkshire and that, at least according to the final Lubrizol proxy, is not the case.

I have not talked to anybody except John Freund at Citigroup, so I have no idea what took place with the investment bankers at Citigroup, except for what I read in the Lubrizol proxy. But the Lubrizol proxy now says that Dave did know that Lubrizol had an interest on December 17th. But, both in the two chances he had to review it, and then when he went on CNBC on a Thursday and he talked for a half an hour, he made no attempt to correct any of the facts in it.

Now, on Wednesday, when we put out the report, we had to have a board meeting first. It was news to the board. They got the release a little bit ahead of time and then we had a board meeting. We also delivered -- well, through our law firm, we phoned the head of the enforcement division of the Securities and Exchange Commission and told him exactly the facts regarding the stock purchases and anything else that they might have cared to know. So I think we acted in that case, very, very promptly, to make sure the Securities and Exchange Commission, and the top of the enforcement division, was well-versed on what had taken place, to our knowledge up to that point.

So, from our standpoint and my standpoint, Dave was gone, minimum severance costs, minimum chances for lawsuits about compensation due him, and we had turned over some very damning evidence, in my view, to both the public and to the SEC.

What I think bothers people is that there wasn't some big sense of outrage or something in the release, and I plead guilty to that. I -- this fellow had done a lot of good things for us over 10 or 11 years, and I felt that if I'm laying out a whole bunch of facts that are going to create lots of problems for him for years to come that I also list his side of the equation, in terms of what he'd done for Berkshire.

And I -- and as I said a little bit earlier,one thing I didn't even lay out was this extraordinary act where, in effect, he turned over $12.5 million to a fellow employee. So that's the history of my thinking on it.

Charlie, do you want to add anything?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Yes. Well, I think we can concede that that press release was not the cleverest press release in the history of the world. The facts were complicated, and we didn't foresee, appropriately, the natural reaction. But I would argue that you don't want to make important decisions in anger. You want to display as much ruthlessness as your duty requires, and you do not want to add one single iota because you're angry.

So, Tom Murphy, one of our best directors, always told the people at Cap Cities, you can always tell a man to go to hell tomorrow if it's such a good idea. So the anger part of it and I don't think it was wrong to remember the man's virtues as well as his error.

A - Warren E. Buffett {BIO 1387055 <GO>}

I might add as an aside, Charlie and I have worked together for 52 years, and we have disagreed on a lot of things. We've never had an argument. I need Tom Murphy's advice to remind myself of it a lot of times on other things, but with Charlie it's never even been necessary. It was long before I met Murph.

Okay. Let's go to area 1.

Q - Becky Quick {BIO 16400962 <GO>}

Mary Broderick, Berkeley, California. "Good morning, Mr.Buffett. Good morning, Mr.Munger. And a big thank you. You probably aren't aware of this, but you've been my personal financial and investment advisors for years. I would like to know what you think the effect of the government ending the POMO program mid-July this year will have on the stock market and the economy in general."

A - Warren E. Buffett {BIO 1387055 <GO>}

The government ending the -- QE2 or --

Q - Becky Quick {BIO 16400962 <GO>}

Permanent open market operation.

A - Warren E. Buffett {BIO 1387055 <GO>}

Well, you're one acronym ahead of me. The -- well, just as we're discussing it now, it's no secret what they're going to do. I mean, it's sort of the most advertised open market purchase in history, and probably in terms of defining the amount per month and when it comes to an end, what the balance sheet will look like at the end of the Fed. So I don't think -- if something is that well known by all participants in a market, I think any effect of it has been discounted by this point in time.

I mean, if you say you're going to increase tax rates in a year, we'll say, on corporations or decrease them or whatever it may be, and it's really done and locked in stone, the market doesn't wait until the date when the tax increases or decreases go through to build that into market prices. So I don't -- I see no reason -- there may be some other things that happen then -- but I see no reason why simply having that program come to an end will cause any significant change in stock or bond markets at that time.

Obviously, a huge market force will be withdrawn. I mean you buy $600 billion worth of treasurys and, you probably leave a few traces along the way that you've done it. And it has been $100 billion or so a month, and that purchasing will not be in the market but the government issuances of debt will still be at a level that are consistent with what they are now. So it will be a different market, but I think it's a different market that's already been anticipated. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

I have nothing to add.

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes.

Becky?

Q - Becky Quick {BIO 16400962 <GO>}

I'd like to ask a question that comes from Ron Taracant[ph] from Sugar Land, Texas. He says, "Good morning, Mr.Buffett and Mr.Munger. You have always put great emphasis on hiring and retaining managers that not only have exceptional talent but also adhere to the higher standards of corporate ethics and behavior."

"Recent events surrounding Mr.Sokol's actions have demonstrated that we were not very far from a situation where someone running Berkshire Hathaway had great talent, but lacked the other quality that has made Berkshire the envy of the business world."

"In some ways, we are relieved these events happened when you were still at the helm.But coming back to the succession plan that you have in place, how can you ensure that there are no more Sokols in the lineup of successional managers that you have."

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes, he made an assumption there about Sokol being the next in line, which I'm not sure was warranted. But he certainly was entitled to think that he was a candidate. And there are -- that is, one of the reasons that I think it's a good idea if my son, Howard Buffett, who would have no -- get paid nothing, and have no activities in the company, be the Chairman after I'm not around, because you can make a mistake in selecting a CEO.

I mean, I think the odds of us making a mistake are very, very low. And certainly the candidate that I think is the leading candidate now, I wouldn't -- I would lay a lot of money on the fact that he is straight as an arrow. But mistakes can be made. The Bible says "the meek shall inherit the earth", but the question is, will they stay meek?

The idea of having an independent Chairman, who would be voting a lot of stock because even at my death, because of the concentration of A stock and so on, the executors would have a very significant block of stock -- and if some mistake were made, it would be easier to change if not only a very large block of stock were available to express an opinion, but also if the chairmanship was not locked in with the CEO.

It's gotten less tough to change CEOs at companies where either their moral or their intellectual qualities are found lacking, but it's still difficult. If -- it's particularly difficult if they turn out to be a mediocre CEO. If the person is really bad, people will rise up sometimes and -- particularly if they have meetings without the CEO present. But it's not an easy job to displace a sitting CEO who also holds the chairman's position and controls the agenda and all of that.

So I think an independent chairman, particularly one that represents a very large block of stock, and has no designs himself on taking over the place, is a safety measure for the possibility, however remote, that the wrong decision is made.

But I will tell you that the directors at Berkshire will be thinking every bit as much about the quality of the person as a human being as they will be thinking about their managerial skills, because it's vital that you have somebody at Berkshire, in my view, that is running the place that really cares more about Berkshire than he does about himself, in terms of advancement. And I think we have multiple candidates that fulfill that. And the idea of an independent chairmanship is a -- is, part of the belt and suspenders. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, your idea about the Buffett family has a precedent.

The Rockefellers left the management of Standard Oil many, many decades ago, and they -- but they did intervene once, and that was to throw out, what was it, the head of Standard of Indiana, and it was on moral grounds.

So that sort of thing can happen and you have put another string in our bow.

A - Warren E. Buffett {BIO 1387055 <GO>}

Okay. We'll go to area 2.

Q - Becky Quick {BIO 16400962 <GO>}

Caroline Tile[ph] Boston, Massachusetts.

"Mr.Buffett and Mr.Munger, if you were going to live another 50 years, and we sincerely hope you do, and could add one additional sector or asset class to your circle of competence, which sector would it be and why?"

A - Warren E. Buffett {BIO 1387055 <GO>}

Well, that's a very good question, and I particularly like the preamble. Well, you would certainly pick a sector that's large, because it isn't going to make any difference to Berkshire if we get to be experts on some tiny little industry or business.

I would say that, it would have to be something in the -- this isn't going to happen, but if I could really become expert -- and I mean really expert, knowing more than most -- almost anybody else about the subject in the tech field, I think that that would be terrific. It isn't going to happen, but it's going to be a huge field.

There are likely to be a few enormous winners, a lot of disappointments. So that the ability to pick the winners, is far disproportionate to the ability to pick the winners, we'll say, among integrated major oil companies where they're all equated in price. You're not going to have a big edge in trying to pick Chevron against Exxon against Continental and Occidental, and you name it.

But the degree of disparity in results among larger tech companies in the future is likely to be very, very dramatic. And if I had the skills where I could pick the winners there I would do a lot better than if I had the skills to pick the winners in the major integrated oil field. You probably will have better luck with Charlie on this one because he knows a lot more about a lot of industries than I do. Charlie, what's your answer?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, it would either be tech or energy. And I think that we're the wrong people to develop the expertise. I think if we were going to do it, it would have already happened.

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes.

A - Charles Thomas Munger {BIO 1406508 <GO>}

I do think we might identify someone else who has abilities that we lack. That's been very hard for us but --

A - Warren E. Buffett {BIO 1387055 <GO>}

We're not going to tell you.

A - Charles Thomas Munger {BIO 1406508 <GO>}

But we've done a little better lately.

A - Warren E. Buffett {BIO 1387055 <GO>}

That's a good question.

Andrew?

Q - Andrew Ross Sorkin {BIO 6340618 <GO>}

This question comes from a shareholder named Ralph Coutant[ph] who asks, "In your press release, your original press release, you noted that Dave 'brought the idea of purchasing Lubrizol to me on either January 14th or 15th." Initially you said, 'I was unimpresse, you went on to note that on January 24th you sent another note to Dave indicating your, quote, 'skepticism' about making an offer for the company. However, in a very short period of time after Dave's discussion with Lubrizol's CEO, you, quote, 'quickly warmed' to the idea.

Please clarify what caused you to, quote, 'warm' to the idea so quickly if this didn't strike you as being a great business at first glance. What changed? And what was David Sokol's role in convincing you?"

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes, the -- it wasn't that it didn't -- it struck me as a business I didn't know anything about, initially. You're talking about petroleum additives. I never would understand the chemistry of it, but I -- but that's not necessarily vital.

What is important is that I understand the economic dynamics of the industry. Is there -- are there competitive moats? Is there ease of entry? All of that sort of thing. I did not have any understanding of that at all, initially. As a matter of fact, I suggested to Dave, I said, "Charlie is a lot smarter about oil than I am. Why don't you give him a call because I don't -- I just don't know anything about that business?"

And I talked to Charlie a few days later, and I don't remember whether I asked him whether Dave had called or anything, but I mentioned it to Charlie, and Charlie says, "I don't understand it, either." So when I talked to Dave later he had not talked -- he had not gotten ahold of Charlie. I told him, "Forget it. He's as bad as I am."

What Dave passed along to me after having that dinner with James Hambrick, and which I later confirmed in a lunch when James Hambrick came out here on February 8th, but it was the same thing. I thought I -- and I still feel -- I thought I got a good understanding of industry dynamics and how the business had developed over time, what the role of oil companies was and would be, in relation to a chemical additive.

The oil companies are the biggest customers. They sell base oil to a Lubrizol, but they buy they are the big customers, and they have gotten out of the business to quite a degree, although there's two of them left in it. So this industry had consolidated over time. I looked at the question of ease of entry. Every time I look at a business -- when we bought See's Candyin 1972, I said to myself, if I had a $100 million and I wanted to go in and take on See's Candy, could I do it? And I came to the conclusion, no, so we bought See's Candy. If the answer had been yes, we wouldn't have done it. I asked myself that same question, can I start a soft drink company and take on Coca-Cola if I have $ 100 billion?

Richard Branson tried it some years ago in something called Virgin Cola. The brand is supposed to be a promise. I'm not sure that's the promise you want to get if you buy a soft drink but in any event, I felt after my conversation with Dave, subject to a second conversation with James Hambrick, but covering the same ground, that it's not impossible at all for people to enter this business. But in terms of the service that -- and the relatively low cost of what Lubrizol brings to the party, and in terms of people trying to break into a market and take them on -- and it's not a huge market, it's probably only about $10 billion market overall, I decided that there was a pretty good-sized moat around this.

They've got lots and lots of patents, but more than that, they have a connection with customers. They work with customers when new engines come along to develop the right kind of additive. So I felt that I had an understanding -- didn't understand one thing more about chemistry than when I started -- but I felt that I had an understanding of the economics of the business, the same way I felt that when the ISCAR people talked to me -- I mean, who would think you can take some tungsten out of the ground in China and put it in the little carbide tools and that you could have some durable competitive advantage? But I decided ISCAR had a durable competitive advantage after looking at it for a while.

That's the conclusion, I have come to the conclusion that -- and Charlie as well -- that the Lubrizol position is the dominant or the number one company, not dominant, but the number one company, in terms of market share, in that business -- is sustainable and that it's a very good business over time. It helps -- they are helping engines run longer, run smoother, when metal is acting on metal, the lubricants are important, and they're always going to be around. And I think Lubrizol will be the leading company for a very, very long time.

And that's the conclusion I came to. And I did not have a fix on that, nor did Charlie, prior to Dave relaying on to me what he had learned at that dinner, which incidentally, Lubrizol had been telling the world, I mean they made investor presentations and all that quite extensively over the years. I simply hadn't paid any real attention to it. And when it was explained to me, I thought I understood it, and I still think I understand it.

I think Lubrizol will be a very, very good addition to Berkshire. And I saw James Hambrick just yesterday, and despite the turmoil around this, they are very enthused about becoming part of Berkshire, that they regard it as the ideal home. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Yes, ISCAR and Lubrizol, to some extent, are sisters under the skin. You've got very small markets that aren't really too attractive to anybody with any sense to enter, and fanaticism in service. So if you have any more like that why, please give Warren a call.

A - Warren E. Buffett {BIO 1387055 <GO>}

Okay. Area 3.

Q - Analyst

This is Hsiang Hsiao Chu (PH) from Ottawa, Ontario. Warren, Charlie, I admire you guys tremendously. I want to ask a question about the valuation of your company. You said, "Price is what you pay and value is what you get." In your letter to the shareholders this year, each Class A share owns about -- investment about $95,000, and each share commands an earnings of $6,000. So in my simplistic way of calculation, each share is worth $95,000 of investment plus the earnings discounted at 7%. That's another about $90,000. So it adds up to about 185,000. Is that correct? Does that mean the complexity of your empire is a value trap?

A - Warren E. Buffett {BIO 1387055 <GO>}

We give those figures because we think they're important, both the investments per share and the operating earnings per share, excluding earnings that come from the investments, and leaving out insurance underwriting profits or losses, because we think at worst they'll break even, but they do bounce around from year to year.

Those figures are pretax on the operating earnings, so I'm not sure whether you're applying your discount factor to pretax or after-tax. But we think they're important. And I would expect -- well, the operating earnings, are almost certain to increase. How much, who knows? But that number is likely to go up. The investments are still about the same as at year-end but that they could go up or down based on whether we're able to buy more operating businesses. Our goal is to build both numbers to some extent, but our primary goal is to build the operating earnings figures.

We never -- if Charlie and I had to stick a number in an envelope in front of us as to what we thought the intrinsic value of Berkshire was, well, neither one of us would stick a figure, we'd stick a range, because it would be ridiculous to come up with a single specific number, which encompasses not only the businesses we own, but what we're going to do with the capital in the future. But even our ranges would differ modestly, and they might differ tomorrow, in terms of how I would feel versus today, but not dramatically at all.

I would say this: I think -- I certainly -- well, you've received signals once or twice when we said we would buy in our stock, we obviously thought that it was selling below the bottom of a conservative range of intrinsic value, and we did that once some years ago. And by saying so, of course, the stock went up, and so we never got any stock bought.

So there's sort of a self-defeating factor about taking the kind of approach to it that we do, in terms of really telling people that the only reason we'll buy in stock is because we think it's cheap. That is not standard practice in corporate America at all. In fact, corporate

America, to some extent, buys in their stock more aggressively when it's high than when it's low. But they may have some equation in their mind that escapes my reasoning power.

But the -- I would -- we do not regard Berkshire as overpriced. And I would say that we had, very recently, we had a very, very large international company that might well have been interested in doing something with Berkshire, and it's a very nice company, but it's bigger than we can handle unless we would use a lot of stock. And we won't use the stock. We just think our shareholders would come out behind. It would be a wonderful company and, make a lot of headlines, but in the end our shareholders would be poorer because our stock is a currency, and unless it's fully valued, it's a big mistake to use it as a currency.

Now, we used some in the Burlington deal, but we used a whole lot more cash, and, in effect, we only used 30% for stock, and it was worth doing, but it was painful. And if Lubrizol had wanted to do a deal involving stock, we would not have done it. I told James Hambrick that right off the bat. So we had absolutely no interest in buying Lubrizol -- we were perfectly willing to give close to $9 billion in cash, and in my view, we're getting our money's worth.

But we would not have given a significant portion of it in Berkshire stock, because we would be giving away part of the businesses we already own, and we like Burlington, and we like See's Candies. We like ISCAR. And to give away a portion of those, even to get another very good business, would not make financial sense for our shareholders. So you can draw your own deductions about our calculations of intrinsic value from that statement. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, he's obviously looking at two right factors. And I think that we have not permanently lost the ability to do some interesting things eventually with our enormous wealth in cash and marketable securities. We won't always be as inactive as we are now.

A - Warren E. Buffett {BIO 1387055 <GO>}

We're not that inactive, Charlie.

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, I don't know. You practically crawl out of your skin, sometimes.

A - Warren E. Buffett {BIO 1387055 <GO>}

$9 billion is, we say normal earning power is $12 billion. That uses up a good portion of one year's quota. Although we'd like to use more. I mean, there's no question.

A - Charles Thomas Munger {BIO 1406508 <GO>}

Now you're talking.

A - Warren E. Buffett {BIO 1387055 <GO>}

Can you see us using stock in the next few years?

A - Charles Thomas Munger {BIO 1406508 <GO>}

If the business were good enough, of course. Our trouble is -- it's a terrible trouble you people have -- the businesses you already own are so good it's not wise to part with them to get a business we don't own. Ordinarily.

A - Warren E. Buffett {BIO 1387055 <GO>}

Carol?

Q - Carol Loomis {BIO 7137249 <GO>}

This is for Warren -- and Charlie, too -- from your longtime Omaha friend Dick Holland. "Whenever you talk in a general way about America's economic future, your remarks are invariably positive, even glowing, despite the severe problems of growing public and private debt, the huge budget imbalances that result, and no real policies to solve these problems. Some experts believe that we may reach the point where future bond offerings to cover the rising debt might fail. Many wonder if we are not entering a time of national decline. How can a lousy long-term U.S. economy make you so happy, and why do you see gold nuggets where others see salt?"

A - Warren E. Buffett {BIO 1387055 <GO>}

That's from Charlie's good friend as well, Dick Holland, who we both have known for 60-plus years.

I don't see how anybody can be other than enthused about this country. If you look back to 1776 or 1789, whichever one you want to date it from, it has been the most extraordinary economic period in the history of the world. In fact, if you go back -- I was born on August 30th, 1930. Now, if somebody had come to me in the womb and said, "Let me tell you what it's like outside now. The stock market has just crashed, but you haven't seen anything yet. 4,000 banks are going to fail. The Dow Jones average is going to go down to 42. It was 381 back just a little bit before you were conceived, and it's going to go to 42. They're going to close the banks for a while. We're going to have 25% unemployment. We're going to have the dust bowl in the Midwest. The grasshoppers are going to take over." it would be like in that Woody Allen movie where he says, "Go back, go back."

All that's happened since August 30th, 1930, is that the standard of living of the average American has increased six-for-one. Six-for-one, that's absolutely incredible. I mean, you look at centuries where nothing happened for the average person. I mean, century after century. So we have a system that works magnificently. It gets gummed up periodically. And it always has troubles.

I mean, I -- my father was very anti-New Deal, so my sisters and I sat around a dinner table from the first we can remember hearing how things were going to go to hell. As a matter of fact, my father-in-law told my wife-to-be and her mother that he wanted to have a talk with me before we got married. And he was very much on my side, so I was not in a panic about this or anything, but I went down to his house shortly before the marriage and this wonderful man, Doc Thompson, sat in a chair for a couple of hours, and he said, "Warren," he said. "I just want to tell you that you're going to fail but it's not your fault."

And he said, "You and Susie, my daughter, if you starve, she would have starved anyway. I mean, it is not your fault. It's because the Democrats are in, and they're going to take the country down the road to Communism and just don't worry about the fact you're going to fail." And this went on for quite a while. And then he blessed me and we got married. It was a happy ending.

But ever since -- when I got out of school in 1951, the two people I admired the most in the world, my dad and Ben Graham, both said, you've got a good future but don't start in stocks now because there's never been a year when the Dow Jones average has not ended up below 200, and it's above 200 now. It's much too high, and if you start now selling stocks to people they're going to have bad experiences. So why don't you wait a while and go work in the Omaha National Bank or do something, park yourself on the sidelines.

There's always negatives. The country always faces problems. I mean, this country went through, it went through a civil war . It -- it's gone through all kinds of things. But what happens? We have a few lousy years from time to time. We've had, probably, 15 recessions since the country started. And we will always have a list of 10 or 15 things at the start of the year that will tell you why this country can't possibly work well.

But all I can tell you is that it doesn't do it in a straight line, but the power of capitalism is incredible. I mean, that's what is bringing us out of this recession. I mean, monetary and fiscal policy add some utility, and certainly in the fall of 2008 the government was needed in a huge, huge way. It could do what -- it was the only one that could do what was needed. But if you look at the history of the United States, probably half of our recessions have occurred during -- we'll say in the 19th century -- when people didn't even know what fiscal or monetary policy was.

I mean, what happened was that excesses would come in and then the resuscitative power of capitalism would set the country back on the right -- on a stronger growth pattern -- and that's happened time after time after time. And the game isn't over. I mean, it is not like the potential of America has been used up. What has happened is the rest of the world has caught on, to some extent, so you're seeing some state capitalism in places like China, and they are turning economies loose that have been dormant for centuries. But it's not because the people are smarter. It's not because they work harder. It's just because they have tapped into a system that works marvelously over time.

And I will tell you, in the next hundred years you're going to have probably 15, maybe as many as 20 lousy years, but we will be so far ahead of where we are now that it will be unrecognizable. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, I can go back a lot farther than that. Europe survived the Black Death, where about a third of the people died. The world is going to go on.

A - Warren E. Buffett {BIO 1387055 <GO>}

That's wildly optimistic for Charlie. Have you got anything more encouraging than that to say, Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

I don't know. I kind of -- I understand a little bit of Dick Holland's point of view. And by the way, I've known him a long time. He aced me out of any hope of being the chief candle snuffer at the Unitarian church. He was so damn good at it. Anyway, what was the question?

A - Warren E. Buffett {BIO 1387055 <GO>}

Can you bring yourself to say anything optimistic?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, I have a little bit of a twist on that. And so I would say that you can be cheerful even if things are slightly deteriorating, and that's a very good quality to have. I have a personal saying that has always amused me. I say, the politicians are never so bad you don't live to want them back.

A - Warren E. Buffett {BIO 1387055 <GO>}

Well, on that note of wisdom -- let's go to area 4.

Q - Analyst

Good morning. Angie Janssen[ph] of Cambridge, Massachusetts. My question is, aside from the need to put huge amounts of capital to work, do you still believe that a high return on tangible capital business, like See's or Coke, is the best asset to hold in an inflationary environment, or do you now think an irreplaceable hard asset with pricing power, like a railroad or a hydroelectric dam, is superior?

A - Warren E. Buffett {BIO 1387055 <GO>}

The first group is superior. I mean, if you can have a wonderful consumer product -- doesn't have to be a consumer product -- a product that requires very little capital to grow, and to do more dollar volume, as will happen with inflation even if you don't have unit growth, and it doesn't take much capital to support that growth, that is a wonderful asset to have in inflation.

I mean, the ultimate test of that is your own earning ability. I mean, if you're an outstanding doctor, lawyer, whatever it may be, teacher, the -- you -- as inflation goes along, your services will command more and more in dollar terms, and you don't have to make any additional investment in yourself.

People think of that with a very long-lived real estate asset or something of the sort, or a farm, or anything where additional capital is not required to finance inflationary growth. The worst kind of businesses are the businesses with tons of receivables and inventories and all of that. And in dollar terms, if their volume stays flat but the price level doubles, and they need to come up with double the amount of money to do that same volume of business, that can be a very bad asset.

Now normally, we are not enthused about businesses that require heavy capital investment, just like utilities and the railroad. We think that, on the other hand, particularly with the railroad, that where you do not have any guaranteed lower rate of return, that you should be entitled to earn returns on assets that are becoming more and more valuable to the economy as -- whether it's because of inflationary factors or because of just natural growth factors, or in the case of the United States, I think it will be both.

But the ideal business -- See's Candy is doing -- it was doing $25 million of volume when we bought it, and it sold 16 million pounds of candy -- a little more than -- well, it retails $1.90, and we had some quantity discounts, so we were doing close to $30 million worth of business. Now, we're doing well over $300 million worth of business. It took $9 million of tangible assets to run it when it was doing 30 million, and it takes about 40 million of tangible assets at 300-and-some. So we've only had to ploy back $30 million into a business which will make us -- well, it's made us, probably, $1.5 billion pretax during that period.

And if the price of candy doubles, we don't have any receivables to speak of. Our inventory turns fast. We don't store it or anything like that. We gear up seasonally and the fixed assets aren't big, so that is a much better business to own than a utility business if you're going to have a lot of inflation. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

And what's interesting about it is that we didn't always know this. And so --

A - Warren E. Buffett {BIO 1387055 <GO>}

And sometimes we forget it.

A - Charles Thomas Munger {BIO 1406508 <GO>}

That's true, too. But it shows how continuous learning is absolutely required to have any significant achievement at all in the world.

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes, and it does show --, I've said in the past that I'm a better businessman because I'm an investor and I'm a better investor because I'm a businessman. There's nothing like actually experiencing the necessity, particularly in the 1970s when inflation was gathering strength, and early '80s, you would see this absolutely required capital investment on a very big scale that really wasn't producing anything commensurate in the way of earnings. I wrote an article for Fortune called "How Inflation Swindles the Equity Investor" back in 1977.

You really want -- the ideal asset, is a royalty on somebody else's sales during inflation, where all you do is get a royalty check every month, and it's based on their sales volume. And you made -- you came up with some product originally, licensed it to them, and you never have another bit of capital investment. You have no receivables, you have no inventory, and you have no fixed assets. That kind of business is real inflation protection, assuming the product maintains its viability.

So even though we are going into some very capital-intensive businesses, part of that reflects the fact we can't deploy the amount of capital we have in a whole bunch of See's Candies. We just can't find them. We would love to find them, but we can't find them in that quantity. So we are not doing as well with capital when we have to invest many billions a year, as we would if we were investing a few millions a year. There's no question. That's true in investments. It's true in operating businesses. There is a real disadvantage to size, and we just hope that problem grows.

A - Charles Thomas Munger {BIO 1406508 <GO>}

Now you're talking.

A - Warren E. Buffett {BIO 1387055 <GO>}

Becky?

Q - Becky Quick {BIO 16400962 <GO>}

Aside from questions about Dave Sokol, the questions I've received most from shareholders have to do with dividends. And Dave Corneal[ph], who is a shareholder who couldn't be here this weekend because he's at his daughter's wedding, writes in, "I know that Berkshire is a great allocator of capital, but as an owner of stock and as I get closer to retirement, there will be a time when I will need income from my assets. Currently Berkshire does not pay dividends, yet it loves collecting on dividends on its investments. It also generates extensive cash flow in which it could pay dividends if it chooses to."

"Currently the only real option to get income from your Berkshire investment is to sell a share or two of the stock. Is there a point in the future where Berkshire shareholders may expect a dividend payment, or what conditions would be needed for Berkshire to consider paying a dividend?"

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes, we will pay dividend -- as a matter of fact, there may be an argument that when we pay dividends we should pay out almost 100%, because it does mean that we lost the ability to find ways to invest a dollar in a manner that creates more than a dollar of present value for the shareholders.

But let's assume you had a savings account, and the savings account paid 5%. And you had your choice of taking $50 a year out, or letting the $50 stay in and somebody would pay you 120% of that savings account any time you wanted to sell a piece of it. Now, would you want to take the $5 out or would you rather let it accumulate and have the ability to sell at 120 cents on the dollar, that account?

Every dollar that's been reinvested in Berkshire has created more than a dollar of market value, so it's much more intelligent, if you control the dividend policy of Berkshire, it's much more intelligent for people to leave the dollar in, have it valued at $1.20 or $1.30 or whatever it may be valued, and then sell off a little piece if they want the income, or if they want to receive some cash.

And the logic of it, I think, is unquestionable. The execution of it is a problem. I mean, the question of whether we can keep investing dollars to create more than a dollar of present market value, there's an end to that at some point. But so far, people, by leaving $160 billion at the end of third quarter in the business, have $200 billion that they can cash out for at any time they wish.

There will come a time and, who knows how soon, because the numbers are getting big -- there will come a time when we do not think we can lay out, $15 billion or $20 billion a year and get something that's immediately worth more than that for our shareholders. And like I say, when the time comes where a dollar is only buying us 90 cents of value, we'll quit spending the dollar. We'll give it to the shareholders.

But I predict that the day that Berkshire declares a dividend, the stock will go down. I mean, it will -- and it should go down -- because it's an admission, essentially, that a compounding machine has lost its ability to continue on that course. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, and there's nothing wrong with selling a little Berkshire stock to buy jewelry if you do it in the right place.

A - Warren E. Buffett {BIO 1387055 <GO>}

I would like to announce that my niece, Cynthia, visited Borsheims yesterday around -- I guess around 3:00 -- and she was there with her boyfriend, and he proposed, and they bought a ring. Congratulations. Her mother did the same thing a few years ago. And, these things become family traditions, so go out there and who knows what will happen?

Okay. Number 5.

Q - Analyst

Jeremy Pozen[ph], Newton, Massachusetts. Mr.Buffett and Mr.Munger, Berkshire Hathaway has had large investments in Wells Fargo and U.S. Bank.

What are the revenue outlooks and business prospects for these two banks, given the backdrop of slow U.S. growth, an extended U.S. consumer, a tepid rebound in the U.S. housing market with foreclosures and write-downs lessening but still at historically high levels, and the potential for greater-than-expected inflation, or worse, possibly, deflation similar to Japan? Thank you for your time and consideration.

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes, Wells Fargo and U.S. Bancorp are both among the best large banks, if not the best, in the country and they're different than what you think of in terms of some money center banks, but they're very large. Wells is four times as large as USB.

Banking as a whole -- U.S. banking -- profitability will be considerably less, in my view, in the period ahead than it was, say, in the early part of this century. And a very important reason is that the leverage will be reduced. And that's probably a good thing for society. It's -- it may be a bad thing for individual banks that could use leverage intelligently, but the trouble was that they all thought they could use leverage intelligently, and the actions of one, or more, that were unintelligent about it, had consequences for everybody, which you can see if you view HBO on whatever it is -- is it May 26?

The -- so I would say that return on assets -- even if return on assets were as good as it was some years ago, there will be less assets per dollar of common equity than before which means returns on common equity will be less. We still think that Wells Fargo and U.S. Bank are very good operations. We think they're very decent businesses. They're not as attractive as when leverage ratios could be higher.

In terms of the troubles in banking, I think you've seen, by far, the worst in the past. And loan losses have been trending downward now for several quarters, and I think the expectation is that will continue, and I think banking is a very fundamental business. But as John Stumpf said a few years ago at Wells Fargo, he said, "I don't know why we keep thinking of new ways to lose money when the old ones were working so well."

And banks periodically go crazy. It's always on the asset side. I mean, here you've got cheap money. You've got the federal government behind, although the federal government has never had to pay out anything on -- in terms of the FDIC. The FDIC has handled 3800 since it was established on January 1, 1934. The FDIC has paid out probably 3800, 3900 by now, institutions, 250 of them or so in the last couple years. And that has not cost the U.S. taxpayer a penny. I mean, that has all come from FDIC assessments on other banks. It's been a mutual insurance company.

The banking, if you just keep out of trouble on the asset side, is a very good business because you get your money so cheap and, because of the implicit federal guarantee, and you do get to leverage up to a fair extent, and America's been a pretty good place to lend money.

So I like our positions in there. You will see that -- if you looked at those totals -- you'll see we've added to Wells Fargo. And both those companies are very well run institutions, but they will not be able to earn -- I don't know what the figures were, but I think they were up

25% or -- to 30% on tangible equity -- and that's not going to get repeated in the future, and it shouldn't be. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, yes, we might add that M&T Bank, which most people --

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes.

A - Charles Thomas Munger {BIO 1406508 <GO>}

-- never talk about, is headed by a really sensible fellow, and it's been a wonderful investment for us.

A - Warren E. Buffett {BIO 1387055 <GO>}

Yeah, as a matter of fact, if you get the M&T annual report, it's written by Bob Wilmers, the letter, the first part of it is about M&T specifically, but the second part is about particularly the American financial economy, and I would really recommend you read that. Bob is a very smart guy and he has a lot of good observations.

And, frankly, the other one I recommend you read is Jamie Dimon's letter, at JPMorgan, is a tour de force, in terms of describing the banking scene, the economic scene. He has some real insights in there about some very important subjects. We don't own that stock, but it's a letter that I think everybody could learn a lot from reading, as they could from reading Bob Wilmer's letter at M&T.

A - Charles Thomas Munger {BIO 1406508 <GO>}

And those people who like an element of morality in business, Wilmer sounds like an Old Testament prophet. I mean, he really doesn't like it that all the really big banks are making so much money out of trading, because he says you're really trying to outsmart your own customers, and he'd rather serve them in a culture of deserved trust in both directions. It's hard to think he's totally wrong.

A - Warren E. Buffett {BIO 1387055 <GO>}

He also expresses quite a dislike for the fact that a market system creates a reward system where money sort of disproportionally flows to people who work with money, and that tends to attract a disproportional number of people that -- of lots of ability that he thinks might be -- at least some of them -- might be better deployed elsewhere. It's an interesting read.

A - Charles Thomas Munger {BIO 1406508 <GO>}

It's one of the best annual reports that's ever came out of banking. Right out of Buffalo.

A - Warren E. Buffett {BIO 1387055 <GO>}

Okay. Andrew?

Q - Andrew Ross Sorkin {BIO 6340618 <GO>}

This question who comes from Neil Steinhoff[ph] who writes, "The commodity market, and particularly gold, have appreciated astronomically over the last few years. My Berkshire Hathaway stock is only slightly better -- doing better -- than it was in 2006. It's barely kept up with inflation," he says. "Please explain why you have not invested more heavily in commodities. As long as Ben Bernanke continues to print money and there's no indication he's going to stop any time soon, isn't it right that commodities, and particularly gold, will continue to appreciate?"

A - Warren E. Buffett {BIO 1387055 <GO>}

Well, I would point out that when we started with Berkshire, it was about 3/4 of an ounce of gold, and gold was $20 an ounce then, and it was 15. So gold, even at 1500, has a ways to go, and the -- I think he's right about inflation. But if you think about it, there are three major categories of investment. And you ought to think very hard about which category you want to be in before you start thinking about the choices available within that category.

Now, the first category is anything denominated in a currency. It could be bonds, it could be deposits in a bank, it can be a money market fund, it can be cash in your pocket. And the -- if you will reach in your pocket -- I don't like to do this, but -- and pull out your wallet -- you're watching an historic event. If you look at this -- and I might point out this is a one. Charlie carries a -- on the back of it, it says, "In God We Trust." And that's really false advertising.

The -- if Elizabeth Warren were here, she would say, quite properly, it should say, "In Government We Trust," because God isn't going to do anything about that dollar bill, if government does the wrong things, in terms of keeping it as valuable as it was when you parted with it to buy a bond or put it in a bank. Any currency-related investment is a bet on how government now, and in the future, will behave. And if you happen to be unfortunate to live -- fortunate to live in Zimbabwe and you decided to make currency-related investments, you -- family would have left you by now, and it was not a good decision.

Almost all currencies have declined in value over time. I mean, it may be built into almost any economic system that it will be easier to work with a value of currency that declines in value than a currency that appreciates in value, and the Japanese might reaffirm that here with their experience. So as a class, currency-related investments, whether they are in the UK, or the United States, or anyplace else, unless we're getting paid extremely well for having them, we do not think make much sense.

The second category of investments regard items that you buy that don't produce anything but that you hope someone will pay you more for later on. And the classic case of that is gold. And I've used this illustration before, but if you take all of the gold in the world -- don't get too excited now -- and put it into a cube, it will be a cube that's about 67 feet on a side. That would be 165,000 or 170,000 metric tons.

So you could have a cube -- if you owned all the gold in the world -- you could have a cube that would be 67 or 68 feet on a side, and you could get a ladder and you could climb up on top of it, and you could say, I'm sitting on top of the world, and think you're king of the world. You could fondle it, you could polish it, you could do all these things with it. Stare at it. But it isn't going to do anything.

All you are doing when you buy that is that you're hoping that somebody else a year from now, or five years from now, will pay you more to own something that, again, can't do anything, but you're hoping that the person then thinks that somebody else will buy something five years later from him. In other words, you're betting on not just how scared people are now of paper money, you're betting on how much they think a year from now people will be scared two years from then on.

Keynes described all of this. I think it was in Chapter 12 of "The General Theory," when he talked about this famous beauty contest where the game was not to pick out the most beautiful woman among the group, but the one that other people would think was the most beautiful woman, and then he carried it on to second and third degrees of reasoning.Any time you buy an asset that can't do anything, produce anything, you're simply betting on whether somebody else will pay more for, again, an asset that can't do anything.

And actually, we did that with silver, but silver had an industrial use, and we -- about 13 years ago I bought a whole lot of silver. And if you'll notice, silver has moved recently, so my timing was only about 13 years off, but, who's perfect?

The third category of asset is something that you value based on its -- what it will produce, what it will deliver. You buy a farm because you expect a certain amount of corn or soybeans or cotton or whatever it may be, to come your way every year. And you decide how much you pay based on how much you think the asset itself will deliver over time. And those are the assets that appeal to me and Charlie.

Now, there's some logical follow-on to that. If you buy that farm, and you really think about how many bushels of corn, how much bushels of soybeans will it produce, how much do I have to pay the tenant farmer, how much do I have to pay in taxes and so on, you can make a rational calculation, and the success of that investment will be determined in your own mind by whether it meets your expectations as to what it delivers. Logically, you should not care whether you get a quote on that farm a day later, or a week later, or a month later, or a year later. We feel the same way about businesses.

When we buy ISCAR, or we buy Lubrizol, or whatever, we don't run around getting a quote on it every week and say, "Is it up or down or anything like that?" We look to the business. We feel the same way about securities. When we buy a marketable security, we don't care if the stock exchange closes for a few years.

So when we look at Berkshire, we are looking at what we think can be delivered from the productive assets that we own, and how we can utilize that capital in acquiring more productive assets. And there will be times, cotton doubled in price, much to our chagrin at

Fruit of the Loom, but, if you own cotton for the right six or eight months in the past year, you came close to doubling your money. But if you go back a century and try to make money owning cotton over time, it has not been a very good investment. So to pick a product, crude oil, cotton, gold, silver, anything that -- and, of course, cotton has utility. Gold really doesn't have utility. I would bet on good-producing businesses to outperform something that doesn't do anything over any period of time.

But there's no question that rising prices create their own excitement. So when people see gold go up a lot -- I mean, if your neighbor owns some gold, and you think you're smarter than he is, and you didn't own any, and your wife says to you, "How come that jerk next door is making money, and you're just sitting here?" It can start affecting behavior. And people like to get in on things that have been rising in price and all of that. But over time, that has not been the way to get rich. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, I certainly agree with that. And besides, something peculiar to buy an asset which only will really go up if the world really goes to hell. It doesn't strike to me as an entirely rational thing to do. I think you can figure on leaving the country because the country is going to kill you. And all the countries you might go to will also be thoroughly screwed up.

I think all those people should buy a little gold, but I think the rest of us would be better off with Berkshire Hathaway stock. And, of course, there's another class of people that think they can protect themselves by buying paintings of soup cans. I don't recommend that, either.

A - Warren E. Buffett {BIO 1387055 <GO>}

One thing about gold, also, is that in addition to this 67-foot cube, more gold is being produced every year. So you have to have buyers not only to offset sellers in the natural course of events, but you have to absorb something like $100 billion dollars worth of added items of no utility. I mean, it's really interesting. I mean, they dig it up out of the ground in South Africa, and then they ship it to the Federal Reserve in New York and they put it back in the ground.

I mean, if you were watching this from Mars you might think it was a little peculiar. But think of how many people it makes happy. I might mention that the value of that cube, all the gold in the world, is now about -- valued at 1500-plus -- it's about $8 trillion. And there are a billion acres, roughly, of farmland in the United States. That's a little a million-and-a-half square miles. And that's valued at something over 2 trillion.

And if you take ten Exxon Mobils, you get up, maybe, another 4 trillion and -- maybe not that much even -- and so you could own all the farmland in the United States, every bit of it, and you could own ten Exxon Mobiles and you could stick a trillion or so in your pocket for walking around money, and you could have your choice of that or this 67-foot piece of gold that you could fondle and -- that may seem like a close choice to some people, but not to me.

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, you would also need an army to defend the gold. And it's really not a very good spot.

A - Warren E. Buffett {BIO 1387055 <GO>}

Okay. Number 6.

Q - Analyst

-- Millard, Dallas, Texas. Mr.Buffett and Mr.Munger, when you were raising your first investment funds, how did you go about attracting investors, and once you had your first funds and your first investors, how did you go about growing them?

A - Warren E. Buffett {BIO 1387055 <GO>}

Sounds to me like a man that's about ready to start a hedge fund. The -- in my case, I'd moved back here from New York in March or so of 1956, and a few members of my family said we'd like you to manage our investments just like I did when I was selling securities out here before I went to New York. And I didn't like being in the securities selling business, partly because if I sold somebody a stock at 20 and it went down to 10, I wanted to buy more, but I couldn't face the idea of people that had bought at 20 and, based only on confidence in me not because they understood it, and now they were feeling depressed, and it was -- it just wasn't -- it wasn't very satisfactory. I could not do as well managing money if people were watching every decision as I could if I did it in a room all by myself.

So I just told these seven members of the family -- one of them, actually, was my roommate in college and his mother, they came in also -- I said, if you'd like to join up in a partnership, I'm not going to tell you what's going on, but I will tell you that I will be doing with my own money what I'm doing with yours. Later on, I put all my own money in. And it just was very slow.

A few months later, Graham-Newman, that I'd worked for, was liquidating, and a fellow named Homer Dodge asked Ben Graham what he should do with the money he was getting out of Graham-Newman. He said, "This kid used to work for me and he's okay." And so he came out and went in with me. And another fellow, late in the fall, had seen the notice of partnership formed in some legal paper and he said, "What's this?" and came in with me. It's just -- we just stumbled along. And for almost six years, I operated out of my house, no employee. I kept all the books, I filed the tax returns, I went out and picked up the stocks personally and stuck them in a safe deposit box.

When Charlie came along, I kept chiding him about the fact -- I met him in 1959 -- and I said, "Law is okay as a hobby, but it's no place for a man with your intellect to spend his time." And, well, I'll let Charlie take it over from there.

A - Charles Thomas Munger {BIO 1406508 <GO>}

It actually took me a long time to leave what was a family business. And so any of you who are having a slow time accepting good ideas, why, you should be cheered by my example, because it was some years after you started working on me, and you pounded on me, and I slowly got the point.

A - Warren E. Buffett {BIO 1387055 <GO>}

And he was actually asking about attracting money.

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, of course, it helps if you conducted yourself in life so that other people trust you. And then it helps even more if --

A - Warren E. Buffett {BIO 1387055 <GO>}

You can see why I was so slow and he was so fast.

A - Charles Thomas Munger {BIO 1406508 <GO>}

And then it helps even more if other people are right to trust you. So the formula is quite simple. First one, then the other.

A - Warren E. Buffett {BIO 1387055 <GO>}

Unfortunately, with the present fee structure, just attracting money, rather than performing with it, can be enormously lucrative. So the skill of attracting money may be -- at least in the short run, and maybe the intermediate run -- it may be a more important quality than the ability to manage money. But we, neither one of us, ever charged any fixed fee of any kind. Am I right on that, Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, we stopped taking any significant overrides on other people's money at very young ages and at very small amounts of net worth. I wish our example were more common. But I like our compensation practices, too, and they're spreading slowly. We get a new company every, what, five years?

A - Warren E. Buffett {BIO 1387055 <GO>}

Yeah.

Okay. Carol?

Q - Carol Loomis {BIO 7137249 <GO>}

This is from Jeff -- sorry, Jeff Cunningham of Directorship. "Berkshire's corporate strategy resembles that of the go-go conglomerates of the 1960s: Geneen's ITT, Teledyne, Textron. Small corporate team, tight financial controls, sector neutrality, and little involvement in subsidiary operations, and ultimately not fully valued for the sum of their parts. If you disagree with this, how does Berkshire differ?"

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes it -- we are a conglomerate and, people shy from that name, but that's exactly what we are. And I think I laid out in the annual report at least one of the advantages of being a conglomerate, namely the tax-efficient transfer of money from businesses that do not have good ways of using it to businesses that have better ways of using it, which is, if it's carried out intelligently, is a very significant plus.

The conglomerates you mentioned -- and I'm familiar with all of them -- really became sort of stock issuance machines, where the idea was to get your stock to sell at a very high multiple, and then trade it for something else that was selling at a lower multiple, and voila, earnings per share went up, and then people said you'll do it again.

So it was -- it was really accepted and endorsed by Wall Street that if you had this sort of semi-Ponzi scheme of issuing shares constantly for things that had lower P/E ratios, everybody knew what the game was, but they thought the game would continue to succeed. And for a while it did. And the Gulf and Westerns of the world, and the Littons of the world, and there were numbers of them, it was almost like an unspoken conspiracy that nobody will point out that this is kind of a perpetual motion machine, and if they don't it will keep working. But if something says anything about it, somebody says, "The emperor has no clothes," it will all collapse.

The interesting thing, of course, you mentioned Teledyne in there. Teledyne played that game, and then it ended, and all of this stuff came back to Earth, but then Teledyne went into reverse and bought in stock like crazy when their stock got underpriced. So they issued stock like crazy when it was overpriced, and they bought it in to an extraordinary degree when it was underpriced, and it created a sensational record.

Most of those companies, though, I think have very little relationship to Berkshire. It's true that, I think, some of them were pretty decentralized, although I remember -- didn't Harold Geneen have some famous room that he brought everybody in --

A - Charles Thomas Munger {BIO 1406508 <GO>}

Yes.

A - Warren E. Buffett {BIO 1387055 <GO>}

--chewed them out, monthly for not making their projections, so they learned to make them whether they were actually really making them or not.

The managers were -- if you took Charlie Bluhdorn at Gulf and Western, or, take the group, they were primarily thinking about how -- Jimmy Ling at LTV -- they were primarily thinking about how they could pump the stock up to a level where they could buy big established businesses that were selling at lower PE ratios and sort of have this perpetual motion game going. And it came to an end.

I don't think there's at Berkshire we are not in that game. We are in the game of trying to buy very good businesses that we're going to keep forever and having them grow their earnings and have them also throw off cash that we can use to buy more similar businesses. It is a conglomerate. Conglomerates, generally, are unpopular, and I don't disagree with why they are. But I think it's a very rational way of running the business as long as you keep it focused on running businesses and not as a stock-issuance machine. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, yes, and some of those companies got into really pretty heavy manipulation of the numbers. One of them said, "I know what I'm going to report, I just don't know how I'm going to do it." That's not the attitude around this place.

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes, we don't know what we're going to report.

A - Charles Thomas Munger {BIO 1406508 <GO>}

No, no. And sometimes we don't know how to do it, either.

A - Warren E. Buffett {BIO 1387055 <GO>}

Okay. Number 7.

Q - Analyst

Good morning, Warren and Charlie. John Norwood from West Des Moines, Iowa. I have a question on legacy. A hundred years from now, Warren and Charlie, what would each of you like to be remembered for?

A - Warren E. Buffett {BIO 1387055 <GO>}

Old age.

A - Charles Thomas Munger {BIO 1406508 <GO>}

I've heard Warren say that what he wants said at his funeral is that's the oldest looking corpse I ever saw. I have a different saying that came down from one of my great grandfathers. And I think it -- he wanted to be remembered for a fortune fairly won and wisely used. That's a pretty good system.

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes, I would -- if you really ask me, I'd probably like "teacher." I enjoy teaching a lot. Some people think I do a little too much of the didactic stuff, but I like students coming. And I've benefited by some fabulous teachers, starting with my dad, but going on to Ben Graham, going on to Tom Murphy, I mean, lots of great teachers. So I would say that. So I might point out that on Wilt Chamberlain's gravestone, I think it says, "At last, I sleep alone." Well, we have some people from Kansas here, anyway.

Okay. Becky?

Q - Becky Quick {BIO 16400962 <GO>}

This question comes from Pierre Sorel. He's a portfolio manager at Fidelity and he says that "The U.S. dollar has been depreciating against major currencies. The Federal Reserve continues to run a zero interest rate policy in contrast to other major economies that are raising rates or have stepped back from quantitative easing. A few years ago, Berkshire had a short U.S. dollar position to preserve the company's value from the devaluating dollar. So what's the company's management doing about the risk of further U.S. dollar weakness, given that most of the company's assets and operating businesses are denominated in the U.S. dollar?"

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes, we had a significance short position some years ago. Last year we had a small short position in two currencies, and we made about $100 million in them, but we have not been really active in the foreign exchange market.

We think -- shouldn't speak for Charlie here on this -- but I think that there's no question that the purchasing power of the U.S. dollar will decline over time. The only question is at what rate. But I also think that the purchasing power of most currencies around the world -- almost most currencies around the world -- will decline. And, of course, a short position is just a bet on which one declines at the faster rate, and I don't have a strong conviction on that. I've got some mild feelings about it but not enough to where I want to back it up with a lot of money.

We do own some businesses -- I mean, l take Coca-Cola. Coca-Cola -- I don't have the exact figures -- but my guess is that 80% or thereabouts of the earnings will be non-dollar. And we've got exposure in various other ways. But we are not -- we're unlikely to make another big currency bet, although, I do think that the purchasing power of the U.S. dollar is destined to decrease. And I have fears, but I've long had some unwarranted fears, of it declining at a rapid rate.

Now, Charlie has pointed out to me that the dollar of 1930, when I was born, is worth 6 cents now. 16-to-1 in terms of depreciation. And as he points out, we've both done pretty well. So inflation has not destroyed us. If somebody had said to me in 1930, In addition to this Great Depression you're facing, and a World War where it looks like we're even losing for a little while, and all these terrible things, on top of that dollar that, your grandfather is going to hand you when you're born, is only going to be worth six cents in purchasing power, that might have been discouraging. But overall, we've still done pretty well.

So, I hate inflation, but we've adapted pretty well to it over the years, and we have not had the total runaway-type inflation that really can be upsetting to a society, yet, but I think it's something you always have to guard against. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

No, but God knows where the world is headed. I just think that one way or another, the world muddles through. Take a really god-awful culture, which is Greece, modern Greece. I don't mean there's anything wrong with the Greeks, but -- in their family life -- but the way they manage their money and pay their taxes. The main industry in Greece -- or one of the main industries -- is tourist attractions, and they closed right -- most of the time -- during the tourist season. It's a pretty dysfunctional government. And, of course, people don't want to pay any taxes or do much work, and yet there it is. It's -- the people of Greece are surviving.

A - Warren E. Buffett {BIO 1387055 <GO>}

It's lasted a long time.

A - Charles Thomas Munger {BIO 1406508 <GO>}

Yes. Adam Smith said it very well. He said, "A great civilization has a lot of ruin in it." It takes a long time, and there's a lot left after you've been through a good deal of ruin. In fact, it's an easier game than the ordinary process of living and then dying.

A - Warren E. Buffett {BIO 1387055 <GO>}

Well, I think we'll see a lot of inflation, but if I had a choice, I would rather be born in the United States today than any other place, any other time in history, so --

Okay. Area 8.

Q - Analyst

Good morning, Mr.Munger and Mr.Buffett. This is Mary Bundrick[ph] from Rochester, Minnesota. I was wondering, what factors would you consider in deciding between investment in Berkshire Hathaway versus a no-load mutual fund?

A - Warren E. Buffett {BIO 1387055 <GO>}

Well, I advise people to buy index funds, actually, if they're not going to be active in investments. I mean, if you just are going -- if you've got a day job, and you want to just put money aside over time, I think the average individual will do better buying an index fund consistently over time than almost anything else available to them.

I think it will be a perfectly satisfactory investment. It won't be -- it'll never be regarded as a great investment, but it will be a perfectly satisfactory investment. If I personally had a choice between an index fund and Berkshire at present prices, I would rather own Berkshire. But I wouldn't be unhappy if you told me I had to leave all my money in an index fund for the rest of my life and then -- but I like Berkshire better. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, I like it a lot better, and I'd be very unhappy if I had to own an index fund. My ambitions are larger. I don't think the average return of a skilled investor over the next 50 years is going to be as good after all factors as it was over the last 50 years. So I think reduced expectations are the best defense any investor has, and after that, I think Berkshire is a pretty good bet.

A - Warren E. Buffett {BIO 1387055 <GO>}

Charlie's big on lowering expectations.

A - Charles Thomas Munger {BIO 1406508 <GO>}

Absolutely. That's the way I got married. My wife lowered her expectations.

A - Warren E. Buffett {BIO 1387055 <GO>}

And he lived up to them.

Okay. Andrew?

Q - Andrew Ross Sorkin {BIO 6340618 <GO>}

The question is, "Can you explain the company's policy for your own personal investing outside of Berkshire and that of your other managers, and why aren't all trades in investments first cleared through a compliance department like that of most other companies?"

A - Warren E. Buffett {BIO 1387055 <GO>}

Well, I don't think it is true of most other companies. We have 260,000 employees, and we have one company that's a subsidiary of General Re called New England Asset Management, but that's the only company that advises other people on investments or operates in the investment field.

At Berkshire, there are presently three people that can execute trades, and then there are a few other clerical people that would see what was done.But we are not an investment advisory firm. We're not a mutual fund or anything of the sort. So if we -- we have some, I think, pretty clear rules that are going to be looked at, again, I can assure you, by the audit committee. But in terms of the Code of Conduct, Code of Ethics, and insider trading rules, which go to the managers, I don't think there's anything ambiguous in those.

Now, to extend those beyond -- I don't know, Marc, how many people those go to but -- whether 60 or 70 or something, I'm not sure of the number -- but the problem with rules, is, I mean, you've got to have them and we emphasize not only the letter of them, but the spirit. That's why I write that letter every couple years. I was on the audit committee, for example, of Coca-Cola. And Coca-Cola has about one-fifth as many employees -- or did then -- had about 50,000 -- had about one-fifth as many employees as Berkshire. And each time the audit committee met we had 8 or 10 code violations.

I mean, people -- if you take Berkshire at 260,000 people that's about the number of households in the greater metropolitan Omaha. And perfect as we like to think we are in

Omaha, I will tell you there's a lot of things going on in Omaha right as we sit here that do not match the rules. So it's a real problem. The problem, obviously, with the Sokol thing is it hit very, very high up.

But we had a case sometime back where a fellow that was a friend of mine, vice president of one of our subsidiaries, and, like I say, a personal friend, and we supplied the evidence that sent him to jail. It has happened. We had a -- as I remember some years ago, I think it was in Woodbury, New York, we may have had a woman arrested in the offices just because we want to make very clear, what -- that we mean business and as the -- as the audit committee said that this is not public relations, this is reality.

Here's a letter that went out from Johns Manville. I didn't know anything about it until Todd Raba gave it to me the other day, but it describes what -- dated April 27, and it said, "The audit committee clearly found that Mr.Sokol compromised the integrity-related values of both Berkshire and JM have worked so hard to ingrain in the fabric of both companies. "This should serve as a tragic lesson learned for every employee in JM." And then in boldface, "There are no gray areas when it comes to integrity." And it goes on.

So we hope to get some value out of this experience that will help us reinforce, with not only the 60 or 70 managers, but with 260,000 people that we do mean business on this, and we've showed them we mean business when we have sent more than one person to jail. But there will be, we can have all the records in the world and if somebody wants to trade outside them or something, I -- they're not going to tell us they're trading in their cousin's name. I mean, it just doesn't work that way.

We will have occasions in the future when people do wrong things. Usually they get handled at the subsidiary level. I mean, it's somebody doing something, whether it's getting a kickback from a vendor or stealing out of a cash register, whatever it may be, and then, we get the occasional mega one, which is very painful. But we will -- if there's anything we can do in the rules that will make it even more explicit or get across further the idea that rules are not made to be danced around but rather that the spirit of them extends beyond them, we want to be sure we do it. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Yeah, all that said, if you look at the greatest institutions in the world, they select very trustworthy people, and they trust them a lot. And it's so much fun to be trusted. And there's so much self-respect you get from it when you are trusted and are worthy of the trust, that I think your best compliance cultures are the ones which have this attitude of trust, and some of the ones with the biggest compliance departments, like Wall Street, have the most scandals.

So it's not so simple that you can make your behavior better automatically just by making the compliance department bigger and bigger and bigger. This general culture of trust is what works. And, Berkshire hasn't had that many scandals of consequence, and I don't think we're going to get huge numbers, either.

A - Warren E. Buffett {BIO 1387055 <GO>}

Okay. Number 9.

Q - Analyst

Hi, Charlie and Warren. I'm Michelle from Decatur, Illinois. Half the U.S. economy seems to be in a sluggish recovery while most foreign economies are showing solid growth numbers. Are there any significant changes that you think can be made to either current U.S. economic policy or Federal Reserve policy or tax laws to get the economy healthy and growing in the U.S.?

A - Warren E. Buffett {BIO 1387055 <GO>}

Yes, we've really had our foot to the floor in both monetary and fiscal policy. You've seen it, obviously, on the monetary side, with extended period of effectively zero interest rates and actually with the Chairman, just the other day saying this is going to go on for an extended period. And then they asked him what an extended period meant, and he was -- he said an extended period.

The -- but we -- it's hard to imagine pushing harder on monetary policy than has occurred. The interesting thing is people think of fiscal policy and they think, well, we had a stimulus bill. Well, if you think about what stimulus really is, it's not whether you call something a stimulus bill. If you had something that was called a stimulus bill and you didn't run a deficit, it would not be, it would not be a stimulus. You'd be -- And if you don't have anything you call a stimulus bill at all, but you're spending 10% more of your GDP than you're taking in, you are applying an incredible stimulus -- fiscal stimulus -- to the economy.

We have a huge fiscal stimulus program going on now, and it's called taking in 15% of GDP and spending 25% of GDP. That's extraordinary. So, I think that we have used those levers in a way that's almost unprecedented. And I think it's been wise, in general, to do what's done, and I think it was particularly wise what was done in the fall of 2008. But I think, generally, we have followed the right policies. I think they're less important than most people think they are.

I think if you did the wrong policies it would really screw things up. But I don't -- I think the natural resuscitative powers of capitalism are -- will be the biggest factor in taking us out. And I think you've seen that over the last two years and we're seeing it month by month. I would say this: residential construction is flatlined at, 500,000 or so units per year. I think when it comes back, and it will, but it will take -- it takes working off a crazy excess inventory we had, and there's no way to do that except through creating fewer residential units than you create households. That's how you reduce the oversupply.

When that ends -- when part comes back -- I think you're going to see much more of a pick-up in employment than you might think just by looking at construction workers. I mean, we have Shaw Carpets. I'm sure they're not counted as construction jobs, but we have thousands fewer people working there because residential construction is where it is.

And we have people at the Furniture Mart and how much carpet they're selling or houses, so I think there's a lot of indirect, as well as direct, reservoir of jobs that will be drawn upon, or utilized, when residential construction comes back. I don't think I'd measure it just by the number of construction workers that are being employed currently versus, say, four or five years ago. It will come back. I don't know when. I said in the annual report I thought you'd be seeing it by the end of the year. I may or may not be right on that, but that would be my best guess, still. We are creating households faster than we're creating housing units. And, we lose housing units just you look at the -- with the tornadoes recently.

So there are -- that problem will get cured. And I don't think, when you mention we're progressing more slowly than other places, certainly in terms of Asia, there's no question about it, or Brazil, but actually, I think our pace of coming out of this, while it's been slow compared to the hit we took in 2008 -- the American economy was paralyzed -- it's come back quite a distance, and we see that in our businesses.

Now, our peak on railcar loadings were 219,000 one week, I believe, in 2006, but -- and our bottom was 150,000 or 151,000. We'll probably run 190,000, or thereabouts, currently, and that will pick up more as the year goes along. So it's come back a significant way. We have certain companies that are setting records that serve basic industries. If you look at TTI, which makes -- which distributes -- electronic components, has thousands and thousands of customers all over the world -- it's setting new records, and it's way up in the first quarter and it set a record last year.

If you look at ISCAR, which supplies nothing but basic industry, I mean, nobody buys little carbon cutting tools, to put in their recreation room or anything. This stuff is use for making big things, and their business is going up and up and up month by month. So, the economy is coming back, and when residential construction finally gets this huge overhang largely eliminated I think -- I think you'll see a lot of improvement in the employment picture. Charlie?

A - Charles Thomas Munger {BIO 1406508 <GO>}

Yes, the one place that I feel we're making a huge mistake is not learning enough from the big mess that came from wretched excess in our financial system.

I don't think we throttled the sin and folly out of that aspect of the economy nearly enough. And I think -- if you look at all the panics and depressions in the United States, they all came from financial collapses, usually preceded by perfectly asinine and greedy behavior. And I think that would be a lot to be said for taking an ax to our financial sector and whittling it down to a more constructive size.

A - Warren E. Buffett {BIO 1387055 <GO>}

Tell us more about how you use that ax.

A - Charles Thomas Munger {BIO 1406508 <GO>}

Well, Warren, I'll make myself ridiculous, but I guess I'm so old I'm entitled to do that.

The -- I would have the tax system discourage trading. I would have various kinds of Tobin taxes. I would have securities trading more with the frequency of real estate than the trading by computer algorithms where one person's computers outwit another person's computers in what amounts to sort of legalized front running. I don't think we need any of that stuff. And I think making heroes out of the people who succeed at it is not good for the fiber of the country, either. I hate the idea that 25% of our best engineers are going into the financial sector.

So, I think it's crazy what we've allowed. And I think the lack of contrition in our financial sector, after the disgraceful stuff they got us into, is perfectly awesome. It makes Dave Sokol look like a hero.

A - Warren E. Buffett {BIO 1387055 <GO>}

He's getting warmed up.

Just as a sidelight, how many of that if you trade an S&P future contract -- 500 -- S&P 500 contract -- and you hold it for 10 seconds and you have a profit, that 60% of the gain is long-term gain and 40% is short-term gain. So, essentially, our Congress has said that this activity should be more lightly taxed than cleaning washrooms or doing all the things that you people do every day. You get a special tax treatment.

Now that illustrates one of the problems with the tax code, in that there's a few people that care intensely about having that in there, and the cost of it, in terms of less revenue for the U.S. government, is diffused among a large group, none of whom have enough interest to want to go out and write their Congressman or hire a lobbyist to fight the other way. But it's pretty extraordinary that we have decided that particular form of activity should get 60% taxed at 15% maximum rate, even though it may only take 10 or 20 seconds and be just a little flicker on a screen.

A - Charles Thomas Munger {BIO 1406508 <GO>}

And the hedge fund operators of America get a much lower tax rate than the professors of physics or the drivers of taxis. This is demented.

A - Warren E. Buffett {BIO 1387055 <GO>}

Well, with that, we're getting to our break at noon, and I promised -- I made a bet three years ago with some fellows that run a fund of funds, and I promised to put the figures up every year as to how we're doing. It's a 10-year deal, and if we can put up the slide -- what number would that be? Probably five.

As you can see, these funds of funds -- these are five funds of funds groups chosen by these people who I like, Ted Seides and his friends, and Ted couldn't be with us today, but we will put these figures up annually. He got off to a very good start with his group. Obviously, hedge funds should do better in a down market. And we haven't caught them yet with the S&P 500, but it will give you all a reason to keep coming back over the next seven years as I report regularly on how we are doing in the S&P 500 versus the five funds of funds.

As Carol Loomis pointed out in an article recently or a -- maybe it was on the web -- in reporting on this, she looked at the bottom line where the investors in the S&P 500 are behind for the three years, and the investors in the funds of funds are behind, and the only people that are ahead so far are the investment managers. They're doing very well at this point. So we'll keep you up to date on that. We're going to take a break for close to an hour for lunch. We'll be back here, and we'll take up the questioning where we left off. Thank you.