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INVESTMENT LESSONS LEARNT FROM WARREN BUFFETT

BY JAMIE McINTYRE




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First published September 2012

Published by 21st Century Publishing

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www.21stcenturypublishing.com.au

National Library of Australia Cataloguing-in-Publication entry:

McIntyre, Jamie

Investment Lessons The World Can Learn From Warren Buffett

ISBN 978-1-92-458-48-4

Printed and bound in Australia by Griffin Press

For Wholesale Discounts or Reorders e-mail

enquiries@21stca.com.au

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INVESTMENT LESSONS THE WORLD CAN LEARN FROM WARREN BUFFETT

101 WAYS TO IMPROVE AUSTRALIA

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Foreword

I have had the good fortune to study, meet and learn from some amazing individuals in my 20-year search for the answer to an overriding question:

Why is it that people can grow up in the same country, have the same opportunities, even be from the same family, go to similar schools and live in the same economy- yet some excel and outperform financially, while others, often equally capable and intelligent, fail miserably in life?

The search for the answer to this question has led me to seek out outstanding role models and find extraordinary mentors that have helped shape my life and enabled me to outperform in many areas of my life including business and investing.

Modelling a billionaire won't exactly guarantee that you will become one yourself, but it could just be enough to make you a millionaire many times over if that is what you desire.

I've found that true in my own life.

My desire to always learn and improve led me to study and observe arguably the world’s most successful investor of all time- Warren Buffett, dubbed the Oracle of Omaha, an investor with an incredible and almost uncanny ability to recognize hidden value and opportunities in businesses that others often lack.

Buffett is the 81 year old Chairman and CEO of the conglomerate Berkshire Hathaway (NYSE: BRK-A, BRK-B). He’s also the third-richest person in the world, with a fortune that Forbes magazine estimated at US$44 billion in March 2012.

His success with Berkshire Hathaway, Geico, Coca Cola and American Express and countless other companies has inspired many thousands of investors to emulate his trading strategies and methods and follow his every move.

At the time of writing this, the share (stock) price of Berkshire Hathaway Inc. (BRK-A) on the New York Stock Exchange (NYSE) was an incredible $127,175.00 per share. 228 shares were traded that day and share price rose 0.03% on the previous day’s trading. That doesn’t sound much, but that small rise represented a gain of $375.00 per share.

This gave Berkshire Hathaway a market capitalization of $210.47 billion and a cash hoard that fluctuates (mostly when Buffett finds something to buy), but was estimated around $40 billion in early August 2012.

In August 1990 the Berkshire Hathaway share price was around $6,400. When Buffett started buying shares in Berkshire Hathaway in the 1960‘s they were trading at around $12.

Despite his vast wealth, Buffett is a very down to earth person with a wonderfully droll sense of humour and many examples of his humour is reflected in this book. Buffett has made most of his gains since the early 1970s by continuing to develop as an investor and embracing growth and business quality. Buffett understands and appreciates (with the help of Berkshire Hathaway vice-chairman Charlie Munger) the opportunities that growth can bring, especially when that growth requires little additional capital and is protected by a sustainable competitive advantage, something Buffett likes to call a business' 'moat'. Today, Buffet wouldn't be in the market for a lot of businesses he once singled out as examples of a 'superior business' as they are just too small. That's where small investors have an opportunity – to invest in businesses that are just too small for Buffett, but have characteristics Buffett might appreciate. Besides size and a stated asking price (for whole-company acquisitions) Buffett has previously said that he looks for businesses that have:

Demonstrated consistent earning power (future projections are of no interest to us, neither are "turnaround" situations). Businesses earning good returns on equity while employing little or no debt. Management in place (we can't supply it). Simple businesses (if there's lots of technology, we won't understand it). With this book, Investment Lessons Learnt From Warren Buffett, my goal is to educate and empower the investor and entrepreneur within you to excel to greater heights and recognize opportunities.

Warmest Regards,

Jamie McIntyre, September 2012

CEO 21st Century Education

1.

THE ORACLE

OF OMAHA

I got interested [in business] when I was seven or thereabouts. I wasted my time before that.

Warren Buffett

The Ultimate Investor?

The Oracle of Omaha - Warren Buffett

Did you ever imagine that a US$10,000 investment in Berkshire Hathaway in 1965, the year Warren Buffett took control of it, would grow to be worth nearly US$44 million, as estimated by Forbes, by early 2012?

In comparison, US$10,000 in the S&P (Standard & Poors) 500 would have grown to only about US$500,000.

Whether you like him or not, Buffett's investment strategy is arguably the most successful ever. With a sustained compound return this high for so long, there isn’t a doubt that Buffett's legend has swelled to mythical proportions. But how did he do it? Known as ‘the Oracle of Omaha’, Buffett is Chairman of Berkshire Hathaway and arguably the greatest investor of all time. His wealth fluctuates with the performance of the market, but for the last few years he has been reported to be worth between US$30 billion and $44 billion, making him the second richest man in the world. Some may think that Buffett is a lucky investor with a good touch. Even though there is some truth to that, he and his partner Charlie Munger take great care in carrying out detailed research before making any investment. Buffett is a value investor. His company Berkshire Hathaway is basically a holding company for his investments. Some of the major holdings he has had at some point or the other include Coca-Cola, American Express and Gillette. Critics predicted an end to his success when his conservative investing style meant missing out on the dotcom bull market. Of course, he had the last laugh after the dotcom crash because, once again, Buffett's time tested strategy proved successful. Value investors look for securities with prices that are unjustifiably low based on their intrinsic worth. When discussing stocks, determining intrinsic value can be a bit tricky as there is no universally accepted way to obtain that figure. Generally, intrinsic worth is estimated by analysing a company's fundamentals. Like bargain hunters, value investors seek underpriced yet beneficial and high quality products. In other words, the value investor searches for stocks that they believe are undervalued by the market. Like the bargain hunter, the value investor tries to find valuable items that are not recognized as such by the majority of other buyers.

Buffett takes this value investing approach to another level. Many value investors aren't supporters of the efficient market hypothesis, but they do trust that the market will eventually start to favour those quality stocks that were, for a time, undervalued. Buffett, however, doesn't think on these terms. He isn't concerned with the supply and demand intricacies of the stock market. In fact, he's not really concerned with the activities of the stock market at all. This implication is the paraphrase of his famous quote: "In the short term the market is a popularity contest; in the long term it is a weighing machine."He chooses stocks solely on the basis of their overall potential as a company looking at each as a whole. Holding these stocks as a long-term play, Buffett seeks ownership and not capital gain in quality companies extremely capable of generating earnings. When Buffett invests in a company, he is not concerned with whether the market will eventually recognize its worth; he is concerned with how well that company can make money as a business.

Warren Buffett is without question the most successful investor of our time (and possibly of all times). His companies employ around 260,000 people. His incredibly smart deal making abilities coupled with his creative, cheerful, down to earth and droll personality allowed him to achieve success like no other. He is a lot more than a share investor who buys, holds and sells shares in the hope of receiving regular dividends and subsequently making a profit by selling those shares when their value increases. Some of his incredibly smart and complex deals are the envy of investors and bankers all over the world, especially his deals following the global financial crisis where his investments propped up some major US businesses. These deals delivered him huge returns in just a few years with minimal risk at a time when other financiers were ducking for cover. This reminds me of - and epitomizes - one of Buffett’s well known quotes, “We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful.” His investment tastes are an affirmation of the literal value of commonsense. Rule Number One is: "Never lose money". And Rule Number

Two? "Never forget Rule Number One". He invests in companies with businesses so simple "even I can understand them", with economics and management that he likes. That means no dot coms. Buffett comes over as likable and humble: "I’m an accident of time and geography". Buffett has simple tastes. He lives in an unassuming house in unassuming Omaha. He likes steak sandwiches, hash browns and Dairy Queen ice-cream. He goes to the barber in the basement of his corporate headquarters. He drives an old car, carries a battered briefcase and doesn’t dress expensively because "expensive suits look cheap on me". Buffett is a remarkable man, a legendary investor with a moral compass and buckets of humility, who realizes that he and long-time business partner Charlie Munger are lucky men. "We were born in America, had terrific parents who saw that we got a good education, enjoyed wonderful families and great health, and came equipped with a 'business' gene that allows us to prosper in a manner hugely disproportionate to that experienced by many people who contribute as much or more to our society's well-being."

Despite (or perhaps because of) that grounded approach to life, Buffett has enjoyed stratospheric investment success. In the 47 years he has been at the helm of Berkshire Hathaway, the company has grown its assets at 21.1 percent a year, a little more than twice the 10.3 percent annual gain in the S&P 500.

The power of compounding means that while the US benchmark index has grown by 6,840 percent over that period; Berkshire's book value has soared by 400,863 percent. It has risen from $12 a share to $125,175. In 47 years, Buffett has failed to beat the market on only six occasions. It was Buffett’s interest in insurance that led to the rise and financial fame of himself and Berkshire Hathaway. The insurance industry is notoriously tough but under Buffett, the company has become not only a successful

share investor, but a leading provider of insurance.

At that time Buffett struck up a friendship with Charles T Munger, a lawyer and investor. Munger eventually joined Buffett at Berkshire Hathaway as his Vice-Chairman, alter ego, and friend. Buffett is always the first to acknowledge the contribution that Charlie Munger has made to Berkshire Hathaway.

Under Buffett and Munger, Berkshire Hathaway has become an investment giant that wholly owns a number of successful companies that include, Geico Corporation, Nebraska Furniture Mart and See’s Candy Shops. Warren Buffett, the man, is just as hard to define as Warren Buffett, the investor. He projects a homespun frugality, but one suspects that he plays his personality as close to the chest as he does with his investment secrets. He always claims that it is his partner, Charlie Munger, who keeps his feet planted firmly in the ground. Buffett was a member of President Obama's economic advisory team during the Global Financial Crisis. He has become a legend and is generally ranked first in a stellar cast of American investors along with mentor, Benjamin Graham. Buffett's biggest investments (companies he doesn't own in their entirety) include American Express, Wells Fargo, Procter & Gamble and Coca-Cola. These four businesses, he notes, were founded in 1850, 1852, 1837 and 1886 respectively. "Start-ups are not our game".

Berkshire Hathaway Share Price

On 10 August 2012 the share (stock) price of Berkshire Hathaway Inc. (BRK-A) on the New York Stock Exchange (NYSE) was an incredible $127,175.00 per share. 228 shares were traded that day and share price rose 0.03% on the previous day’s trading. Even though it doesn’t sound like much, that small rise represented a gain of $375.00 per share. This gave Berkshire Hathaway a market capitalization of $210.47 billion. In the year up until then the share price had ranged $98,952.00 - $129,040.00. In August 1990 the share price was around $6,400. When Buffett started buying shares in Berkshire Hathaway in the 1960‘s, they were trading at around $12. Based on this share price, Berkshire Hathaway had a P/E (price to earnings) of 18.03 and earnings per share of $7,054.51. Buffett hasn't paid out a dividend to Berkshire shareholders since 1967 as he believes he can reinvest the money and get higher returns. “It's not in the best interest of shareholders.”

Geico

Buffett’s involvement with Geico is a good example of his investment methodology. Geico, the overnment Employees Insurance Company, took life in 1936 when a Texan by the name of Leo Goodwin saw potential in providing low cost insurance to government employees who statistically had lower claims than the public as a whole. Goodwin correctly calculated that direct marketing to potential customers would produce more business at less cost. The venture was successful and in 1947, Benjamin Graham’s investment trust took a 50 percent share in the business. Graham subsequently floated it as a public company allocating shares to investors in his trust. He took shares for himself and retained his shareholding until his death. Buffet’s initial interest in Geico sparked in 1943 while he was still a fledgling investment consultant. Apparently, because of his mentor Graham’s involvement with Geico, Buffet decided to consider it. He visited the company’s offices only to find them closed. The night watchman told him that there was someone still working late and agreed to take Buffett in to meet him. The late worker turned out to be Lorimar Davidson, who eventually ended up running the company. Buffett interrogated Davidson for several hours and both men were impressed by each other. Because of these discussions, Buffett’s investment partnership took a small holding in Geico, which it eventually sold down.

By 1974, Geico was in trouble. The government had brought in no-liability insurance in some areas, the company had extended its clientele to higher risk categories, and there had been inadequate provisions for future claims. In 1976, it announced a loss of $126 million and the company’s shares, which had traded as high as $42, were down to just under $5. The 1976 Annual General Meeting was a near riot with angry shareholders challenging the management. By then, the shares were down to about $2. There was then a change in company management with J. J. Byrnes taking over the key role. Byrnes made drastic changes by cancelling high-risk policies, laying staff off and moving office. Despite these changes, the regulatory authorities were hovering over the company’s near carcass. Buffett had always kept his eye on the company and believed that despite its problems, the company’s core business was sound. The company’s premiums also attracted Buffett. Insurance companies receive premiums against the possibility that they may have to pay out claims in the future. Provided the company follows sound actuarial practices and makes adequate provision for claims, this gives it large amounts of cash to invest in profit making ventures. This is what Buffett calls the ‘float’. He saw this as an opportunity to provide cash resources to buy businesses and invest in shares.

Buffett arranged to meet with Byrnes through an intermediary, Katherine Graham, the proprietor of the Washington Post. Buffett was apparently impressed enough to buy 500,000 shares in the company through Berkshire Hathaway with a standing order to buy more. The company started to improve, and managed to offload a lot of its reinsurance risk. Salomon Bros came to the party with an underwritten preferred stock issue (of which Berkshire took 25 percent) and Buffett interceded with the insurance regulators to ensure that Geico kept its licenses. Six months later, the shares had risen to $8. Graham, who had by then retired, must have been happy and proud that his protégé had intervened. Over the years, Geico went from strength to strength. Buffett always seized the opportunity to increase the Berkshire shareholding. However, business started to drop off in the 1980s and by 1994; the share price had fallen again.

Buffett grabbed his chance and bought out the other shareholders for a total price of 2.3 billion dollars. Geico is now a huge and profitable insurer. Its value to Berkshire however, has not merely been its ability to make good returns from insurance activities. Instead it's been a 'float' or 'cash cow' to provide funds that enable Buffett and Berkshire to acquire good businesses and shareholdings. According to Buffett, "the Geico expense ratio runs about 17 percent, we could run as low as 11 or 12 percent if we didn't want to grow. And many companies operate at anywhere from 25 to 30 percent. And we're also very efficient because as we get scale advantages, we even get that in terms of the loss adjustment costs as well. It's a very efficient operation."

Benjamin Graham

For readers who may be unaware of Benjamin Graham (1894-1976), he was a British-born American economist and professional investor. He is considered to be the first proponent of value investing, an investment approach he began teaching at Columbia Business School in 1928 and subsequently refined with David Dodd through various editions of their famous book *Security Analysis*.

Buffett, who credits Graham as grounding him with a sound intellectual investment framework, described him as the second most influential person in his life after his own father. Benjamin Graham had a philosophy that investment policy can be reduced to three simple words: "Margin of Safety" - the price at which a share investment can be bought with minimal downside risk. The important point here is that the margin of safety price is not the same as the price that an investor calculates a share's intrinsic worth to be.

An investor may calculate the intrinsic value of a share by differing methods and will eventually come up with a price that he or she believes represents good buying value. Graham had his methods of calculating intrinsic value, Warren Buffett has his, and other successful investors have theirs. Graham acknowledges, however, that calculations can sometimes be wrong, or that external events may take place to affect the value of the share. It cannot always be predicted. For such reasons, the investor must have a margin of safety- an inbuilt factor that allows for these possibilities. For Benjamin Graham, the benchmark for calculating the margin of safety was the interest rate payable for prime quality bonds. As Graham wrote in an era when prime bonds were much more prominent, it is more practical now to adopt, the rate of return of government bonds as the benchmark. Apparently Buffet follows that too. Graham then uses a comparative approach. If the risk in two forms of investment is the same, then it must be better to take the investment with the higher return. Conversely, an investment with higher risk, such as shares, should have a higher return when calculating the margin of safety. If we modify the example Benjamin Graham uses in his book, we can take a share investment that is yielding 10 percent earnings. For example, company A is earning 90 cents per share and is selling in the market at $10. If the rate of return on government bonds is 5 percent, then the share is yielding annually an excess of 5 percent.

Over a period of ten years, the excess yield will be about 50 percent, which, in Graham’s opinion, may be enough, if the share investment is wisely chosen in the first place. Of course, the total margin of safety will fluctuate depending upon the quality of the share investment. In spite of that things can go wrong. Graham believes however, that, with a diversified portfolio of 20 or more representative share investments, the margin of error approach will, over time, produce satisfactory results.

According to Benjamin Graham, “To have a true investment, there must be a true margin of safety. And a true margin of safety is one that can be demonstrated by figures, by persuasive reasoning, and by reference to a body of actual experience".

Graham had become well known during the 1920's. At a time when the rest of the world was approaching the investment arena as a giant game of roulette, he searched for stocks that were so inexpensive that they were almost completely devoid of risk. One of his best calls was the Northern Pipe Line, an oil transportation company managed by the Rockefellers. The stock was trading at $65 a share, but after studying the balance sheet, Graham realized that the company had bond holdings worth $95 for every share. The value investor tried to convince management to sell the portfolio, but they refused. Shortly thereafter, he waged a proxy war and secured a spot on the Board of Directors. The company sold its bonds and paid a dividend in the amount of $70 per share. When he was 40-years old, Ben Graham published *Security Analysis*, one of the greatest works ever penned on the stock market. At the time, it was risky; investing in equities had become a joke. The Dow Jones had fallen from 381.17 to 41.22 over the course of three to four years following the crash of 1929. It was around this time that Graham came up with the principle of intrinsic business value - a measure of a business's true worth that was completely and totally independent of the stock price. Using intrinsic value, investors could decide what a company was worth and make investment decisions accordingly. His subsequent book, *The Intelligent Investor*, which Buffett calls "the greatest book on investing ever written", introduced the world to Mr. Market - the best investment analogy in history. Through his simple yet profound investment principles, Ben Graham became an idyllic figure and mentor to the twenty-one year old Warren Buffett.

Buy, not on optimism, but on arithmetic

In many of my books I mention the importance of having a mentor. Even the world's most successful share trader, Warren Buffett, admits having Benjamin Graham as a mentor.

In *The Intelligent Investor,* Graham sums up his investment philosophy by saying that an intelligent investor must be "business like" in approach. Investing in company shares is just like owning a share in a business enterprise. Thus, the investment must be approached as if one were buying a business or a partnership. According to Graham there are four guiding principles:

1. Know the business. The investor needs to gain knowledge about the business or businesses conducted by the company in which they propose to invest i.e. what it sells, how it operates, what is the competitive environment, what are the threats and opportunities and the strengths and weaknesses. An investor, who bought a fruit shop, or a shoe factory, without investigating the products, and just knowing them, would be foolish. The same applies to share investment. An investor who does not understand the business should not be investing in it.

2. Know who runs the business. An investor, who cannot operate the business for himself or herself, needs a manager. This is the position of the average share investor, who owns a share of an enterprise that is run by others. The owner of a business in this position would want a manager who will manage the business competently, efficiently and honestly. The share investor should not be satisfied with less. Unless the investor believes, through sound research, that the company is managed efficiently, competently and honestly, in the best interests of the shareholders, the investment should not be made.

3. Invest for pro!ts. An investor would not normally buy a business that did not, on proper research, appear to have reasonable expectations of producing good profits over time. Share investors should take the same approach and buy, as Graham says, "not on optimism, but on arithmetic".

4. Have con!dence. Graham encourages investors to properly research their investments and act on it only if they believe their investment judgment to be

sound. He cautions investors in this position against listening to others. "You are neither right nor wrong just because the crowd disagrees with you. You are right [or wrong] because your data and reasoning are right [or wrong]."

Some Buffett Wit

When asked by one shareholder, "How would you like to be remembered in 50 years?" Warren Buffett drolly replied, "For old age."

In May 2012 on Squawk Box TV a reporter asked Buffett, “Warren, why don't you join me and buy some cows? I mean, I like your farmland but, you know, you're in Nebraska, you love steak. I mean, we can have leather, we can have manure, we can have milk, and we can have meat, cheese. We'll employ people...” The then 81-year old Buffett drolly replied (after starting the show at 5am, the day after the Berkshire AGM) “Well, you can have the manure, I'll take the meat.” “Charlie's (Munger) pretty Old Testament.” “He (Charlie Munger) has a colourful way of expressing himself. Sometimes he does that about me, too.” “When a girl hangs up on me once, I try again. That hasn't been too successful, though, historically. I hope my batting average is better with companies.” “If McDonald's lowers the price of hamburgers today, the fact I paid more for one on Friday does not, you know, I'm even more enthused about buying a hamburger today.”

Buffett did an interview in early 2012 where he was asked with whom he had the most difficult time talking to? He came up with an interesting answer. “Well, it was Jackie Kennedy and Princess Di. I was in a room alone one time with Princess Di at a party. Somehow we found ourselves in this library and I, in 15 minutes, I don't think I could take it. I had trouble remembering my name, I couldn't think of anything to say, and it was a total disaster. “But the more interesting thing is, I only met her one other time. It was a party at Kay Graham's house, which was where the first party was, and it was very shortly before her death.

“They put me across the table after my previous disaster. But she was sitting between Barry Diller and Teddy Forstmann. And after she died a few weeks later, all these papers called and said, `What did she talk about that evening?' I didn't tell them, but I will tell you today that a comment she made, which h was absolutely true, and I can see Barry and Teddy's faces as she said it.

“She had been at the White House that day and she said that Bill Clinton was the sexiest man alive. And I didn't ask her who the least sexy guy in the world alive was. I was afraid I might get my play in there. “He has not heard this before. So he's probably having a good day today. I never told him this.”

Ethics

At one Berkshire Hathaway AGM a movie kicked off the meeting that included a clip of Buffett testifying during a scandal two decades ago at Salomon Brothers, an investment bank in which he had just become a shareholder and board member. In it, Buffett said, "Lose money for the firm, I will be understanding; lose a shred of reputation for the firm, I will be ruthless"—a rule he said is generally applied at Berkshire. This particular AGM came shortly after the fall of David Sokol, who left Berkshire abruptly, after admitting to buying shares in Lubrizol shortly before he (successfully) recommended that Buffett buy it. "Inexplicable" was Buffett's description of Sokol's behavior, especially since early in his Berkshire career Mr Sokol had selflessly given a chunk of his likely bonus to a colleague that was far bigger than he stood to gain from his Lubrizol shares.

Buffett had identified Sokol as one of his potential successors, and enthused about him recently in the latest Berkshire annual report. Buffett said he mishandled the announcement of Sokol's departure, not just by issuing a poorly worded press release that failed to sufficiently communicate his "outrage". He also predicted that the "damning facts" provided both to the public and the SEC will "cause all sorts of problems for him in years to come"—mentioning "insider trading" a few times but not making any specific allegation against Sokol, who has said he told Mr Buffett in advance that he owned some Lubrizol shares.

Personal Transportation

In 1986, Buffett bought a used Falcon aircraft for $850,000. As he had become increasingly recognizable, it was no longer comfortable for him to fly commercially. Adjusting to that idea of the luxury was hard for him, but he loved the jet immensely. Partly, his passion for jets eventually led him to purchase Executive Jet in the 90's.

Buffett and Munger on Mathematics and Theories

This what Warren Buffett and Charlie Munger made clear about their complete disdain for the use of higher-order mathematics in finance:

"There is so much that's false and nutty in modern investing practice and modern investment banking, that if you just reduced the nonsense, that's a goal you should reasonably hope for," Mr. Buffett said. Regarding complex calculations used to value purchases, he said: "If you need to use a computer or a calculator to make the calculation, you shouldn't buy it."

Munger said: "Some of the worst business decisions I've ever seen are those with future projections and discounts back. It seems like the higher mathematics with more false precision should help you, but it doesn't. They teach that in business schools because, well, they've got to do something."

Buffett said: "If you stand up in front of a business class and say a bird in the hand is worth two in the bush, you won't get tenure.... Higher mathematics may be dangerous and lead you down pathways that are better left untrod."

2.

WOODSTOCK FOR

CAPITALIST

You should invest in a business that even a fool can run, because someday a fool will.

Warren Buffett

Every year a number of Australians make their way to Omaha, Nebraska in the US in what is virtually an annual pilgrimage. People who make this trip all have a common bond- they are fund managers or people employed in the finance industry. The reason they travel to Nebraska is to listen to the Oracle of Omaha, Warren Buffett, speak at the annual general meeting of his company, Berkshire Hathaway -Woodstock for Capitalists - and enjoy his wit and wisdom.

A handful of Australians who travel there are joined by up to 45,000 other people who travel there for the same reason. A few years ago a Sydney investment broker, Ian Darling travelled there for the meeting and the production of a one-hour documentary on the trip that was later screened on ABC TV. Darling admits that Buffett is his hero: a man who invests successfully, ethically, and with a down-home folksy style.

Each year the faithful from all over the world make this pilgrimage to Omaha, Nebraska, a small mid-western town, anxious to hear the wisdom of their humble guru. It is an event surrounded by ritual, adulation and a fair degree of cult worship. But this is not a gathering of a religious sect; it is a shareholders meeting. It is a millionaire's convention - probably the largest gathering of private wealth at one time, anywhere in the world. The price of entry is a stake in Berkshire Hathaway, which costs around $127,175 for a class A share, though mere mortals are now able to buy a class B share for around $80. That deeply discounted price is thanks to the stock split Buffett has engineered of that share class to help smooth the logistics of his purchase of the Burlington Northern Santa Fe railroad a few years ago.

Their guru, Warren Buffett, is an unassuming man in his seventies. He also happens to be worth between $30 billion and $44 billion, making him one of the richest men in the world. His partner, Charlie Munger, also has a heroic status amongst thousands of devoted followers.

The meeting is held in a concert hall, and the atmosphere is somewhere between a rock concert and the Sermon on the Mount. People queue outside from 3.15 am to be sure of a good view of Buffett and his vicechairman, Charlie Munger.

At the 2012 annual meeting Buffett and Munger answered questions from attendees at the convention centre, three business analysts, and a panel of three journalists. I counted 67 questions for five and a half hours. In Australia most annual meetings are stage managed to avoid questions and I venture to say there would not be one Australian CEO who takes uncensored questions for as long as Buffett and Munger are prepared to.

Many politicians for instance will take only three questions at a press conference. There are quasi-religious overtones about much that goes on in Omaha. The audiences hang on their every word, and jostle to be photographed with their heroes. They converge on his favourite restaurant and ice-cream outlet. They buy souvenirs featuring Buffett's face, and display dollar–bills bearing Buffett's autograph as though they were holy relics. Woodstock for Capitalists provides wonderful marketing opportunities for all the companies Berkshire Hathaway has a stake in. A 28-page booklet is provided with maps and information including the times when stall holders offer discounts. These companies - around 40 of them - set up shop in the foyer to display and sell their wares. For instance, Berkshire Hathaway subsidiary Brooks Sports sells a $110 pair of running shoes that feature a cartoon image of Buffett on them.

Diamonds from Berkshire's Borsheims jeweller, food from its Dairy Queen, insurance from Geico, and Cherry Coke (one of Buffett's favourites) are just a few of the items available amongst others that include aircraft and homes.

A Message from Your Chairman

The 28-page booklet provided to those attending the AGM also contains a message from the Chairman, Warren Buffett. "Financial journalists from organizations representing newspapers, magazines and television will participate in the question-and-answer period, asking Charlie and me questions that shareholders have submitted by e-mail.

"From the questions submitted, each journalist will choose the dozen or so he or she decides are the most interesting and important. “This year we are adding a second panel of three financial analysts who follow Berkshire. This group will bring their own Berkshire specific questions and alternate with journalists and the audience. “Neither Charlie nor I will get so much as a clue about the questions to be asked.

“We know the journalists and analysts will pick some tough ones and that’s the way we like it.“We will have a drawing at 8:15 at each of the 13 microphones for those shareholders wishing to ask questions themselves. At the meeting, I will alternate the questions asked by the journalists and analysts with those from the winning shareholders.”

Shopping in Omaha

At a TV interview the morning after the 2012 Berkshire AGM, an interviewer said to Buffett, “Thirty-five thousand shareholders descended on Omaha this weekend, Warren, and they did a little bit of shopping.”

Buffett responded: “Yeah, it's interesting when you mention 35,000 because our furniture store in the one week surrounding the meeting, which will end today, will do $35 million of business. So we've done $1,000 of business for every man, woman, and child that attended the meeting. And that's almost 10 percent higher than we've done before. When a retail stores does $35 million in a week, that is a lot of business and the shareholders were out getting bargains.”

“That says an awful lot about the shareholders, the numbers who are coming in, but it says something about consumers, too,” the interviewer said. “Oh, sure. You know, they're in a different mood than they were a few years ago. And I saw that at the jewellery store, too. I sold jewelry for two and a quarter hours and I couldn't write tickets fast enough. Crazy Warren was in his element.”

“It's a special thing, though, when people are buying it from you. There's a little bit more of a clamor than maybe every day that they see that.” “They get a better price,” Buffett said with a smile.

An Insider’s Impression of the 2012 Woodstock for Capitalists by Berkshire Hathaway Director, Bill Gates.

This last weekend (the first in May 2012, I attended the Berkshire Hathaway annual meeting in Omaha. Often called Woodstock for Capitalists, this year’s meeting drew 35,000 investors and their families, who came to learn from

Warren Buffett and Charlie Munger and participate in an institution unique in the world of business. I've been on the board of Berkshire Hathaway since late 2004, this is my eighth annual meeting, and I think it was one of the best. The centrepiece of the meeting is the question-and-answer session that Charlie and Warren host. For five-and-a-half hours, they answered questions from attendees at the convention centre, three business analysts, and a panel of three journalists. I counted 67 questions. By any measure, that's amazing. The addition of the panel of industry analysts was new this year, and I thought it added a lot to the session. This year seemed to be particularly substantive in terms of the questions asked. Warren and Charlie answered questions about succession planning for Berkshire, their views on the management of risk in their insurance business, taxes and politics, and the outlook for the economy. Any time I'm lucky enough to spend time with Warren, I come away learning something, and this weekend that was certainly the case. Even though the fundamentals of his investing advice and management philosophy haven't really changed, it's inspiring to watch someone as smart, thoughtful and principled as Warren talk about the world of business. He is also a master at promoting his companies, and this year was no exception. Berkshire Hathaway recently bought the Omaha Herald newspaper, and so Warren invited me to a newspaper throwing competition just before the Saturday meeting. I was a paperboy growing up, but I didn't do as well as Warren as we lobbed Omaha Herald newspapers (in front of a large gathering of media) onto the porch of a Clayton modular home (also a Berkshire company) set up in the exhibition centre. I think Warren had been practicing.

The next day, I fared somewhat better in a Ping-Pong exhibition with Ariel Hsing. I met Ariel seven years ago, when she was 9 and was brought in to destroy Warren and me in Ping-Pong at his 75th birthday party. She's been playing ping pong at the Berkshire meetings since she was 11. Now she's 16 and will be part of the U.S. Olympic Ping-Pong team in London. I held my own for a while, but she creamed me when she brought her "real" game. I think I did a bit better than Warren. That exhibition match was placed in front of Borsheims, the Berkshire jewellery store where Warren played salesperson later in the day. A big part of the annual meeting is catching up with friends who come out to Omaha for it, and I got a chance to spend some time with Bono, who was there, as well. I also got to play some bridge along with other Berkshire shareholders and I ate at a couple of Warren's favourite restaurants in Omaha. All in all, it was a terrific trip and one I look forward to every year, no less than the thousands of other people who make the pilgrimage to Omaha to learn from this remarkable business leader and teacher.

The Chairman's Letter

The Chairman's Letter in most annual reports is as dry as dust. That is not the case with Warren Buffett's annual letter to Berkshire Hathaway shareholders. A typical Buffett letter is full of wise and pithy observations on business, investment and life in general. Here are 10 insights from the recent Buffett Chairman's Letter:

1. When you know you're the best, you can afford to tell it like it is. Buffett says: “Our insurance business had an excellent year... that party is over. It's a certainty that insurance-industry profit margins, including ours, will fall significantly in 2008. So be prepared for lower insurance earnings during the next few years."

2. Only four things really count when making an investment - "a business you understand, favourable long-term economics, able and trustworthy management, and a sensible price tag". That's investment-everything else is speculation.

3. Invest this way and you don't need to constantly look for the next "new" thing, with all the risk that it necessarily entails.

4. Businesses are run by people and the best people are not necessarily the ones with the flashiest CVs. Buffett singles out Susan Jacques, chief executive of his jewellery retailer Borsheims. "Susan came to Borsheims 25 years ago as a $4-an-hour saleswoman. She's smart, she loves the business and she loves her associates. That beats having an MBA degree any time."

5. Even for a super-long-term investor like Buffett, there's always a time to sell. Berkshire Hathaway bought 1.3 percent of PetroChina in 2002 and 2003 for $488 million, valuing the Chinese oil company at $37 billion when Buffett thought it was probably worth $100 billion. When the China share bubble took its value to $275 billion in 2007, way above its fundamental value, Buffett cashed in his holding for $4 billion, an eightfold rise in five years.

6. Buffett believes ‘incentivisation’ of managers on the basis of earnings per share encourages disingenuous, if not downright dishonest, behaviour. Take the assumptions about future investment returns in corporate pension schemes. The average in America is 8 percent, despite the fact that a quarter of pension funds are in bonds and cash (for which a 5 percent return would be a reasonable expectation) and the rest in equities, which rose by just 5.3 percent a year on average over the 20th century as a whole (a remarkable period of growth for the US economy). Managers don't really believe they'll get 8 percent, but pretending

they will means they can contribute less and boost their reported profits. "If they are wrong, the chickens won't come home to roost until long after they retire."

7. Between 2002 and 2007, Buffett notes, the euro appreciated from 95 cents to $1.37, yet the US trade deficit with Germany widened from $36 billion to $45 billion, the reverse of what should have happened. As long as these imbalances continue, foreigners will continue to buy up America on the cheap. "This is our doing, not some nefarious plot by foreign governments."

8. Buffett has an eye for witty one-liners, which make his letters a joy to read. Here he quotes John Stumpf, chief executive of Wells Fargo, on the behaviour of lenders: "It is interesting that the industry has invented new ways to lose money when the old ways seemed to work just fine."

9. He sees the joke, but Buffett also knows that there is something profoundly wrong at the heart of corporate America. "As house prices fall, a huge amount of financial folly is being exposed. You only learn who has been swimming naked when the tide goes out - and what we are witnessing at some of our largest financial institutions is an ugly sight."

10. Investors should be realists but the best are optimists too. Buffett has taken premiums worth $4.5 billion from investors buying insurance from him against four major stock markets being lower in 15 to 20 years than they are today. He is confident that he will hold on to those premiums and in the meantime he will use the cash to make another small fortune. What a man, what an investor!

Some Buffett Musings from His Chairmen’s Letters and Annual Meetings

In 1974: “Never count on making a good sale. Have the purchase price be so attractive that even a mediocre sale gives good results.”

1978: “We have tried occasionally to buy toads at bargain prices with results that have been chronicled in past reports. Clearly our kisses fell flat. We have done well with a couple of princes—but they were princes when purchased.

At least our kisses didn’t turn them into toads. And, finally, we have occasionally been quite successful in purchasing fractional interests in easilyidentifiable princes at toad-like prices.”

1981: “It’s simply to say that managers and investors alike must understand that accounting numbers are the beginning, not the end, of business valuation.”

1982: “When returns on capital are ordinary, an earn-more-by-putting-upmore record is no great managerial achievement. You can get the same result personally while operating from your rocking chair. Just quadruple the capital you commit to a savings account and you will quadruple your earnings. You would hardly expect hosannas for that particular accomplishment. Yet, retirement announcements regularly sing the praises of CEOs who have, say, quadrupled earnings of their widget company during their reign - with no one examining whether this gain was attributable simply to many years of retained earnings and the workings of compound interest.”

1985: “Ben Grahams’s Mr. Market allegory may seem out-of-date in today's investment world, in which most professionals and academicians talk of efficient markets, dynamic hedging and betas. Their interest in such matters is understandable, since techniques shrouded in mystery clearly have value to the purveyor of investment advice. After all, what witch doctor has ever achieved fame and fortune by simply advising ‘Take two aspirins?’

1987: “Over the years, Charlie (Munger, Berkshire Hathaway Vice Chairman) and I have observed many accounting-based frauds of staggering size. Few of the perpetrators have been punished; many have not even been censured. It has been far safer to steal large sums with a pen than small sums with a

gun.”

1988: “In fact, when we own portions of outstanding businesses with outstanding managements, our favourite holding period is forever. For example:

(1) As if governed by Newton's First Law of Motion, an institution will resist any change in its current direction; (2) Just as work expands to fill available time, corporate projects or acquisitions materialize to soak up available funds; (3) Any business craving the leader, however foolish, will be quickly supported by detailed rate-of-return and strategic studies prepared by his troops; and (4) The behaviour of peer companies, whether they are expanding, acquiring, setting executive compensation or whatever, will be

mindlessly imitated.”

1989: “The most common cause of low prices is pessimism - sometimespervasive, sometimes specific to a company or industry. We want to do business in such an environment, not because we like pessimism but because we like the prices it produces. Optimism is the real enemy of the rational buyer.”

1990: “Our stay-put behaviour reflects our view that the stock market serves as a relocation centre where money is moved from the active to the patient.”

1991: “We've long felt that the only value of stock forecasters is to make fortune tellers look good. Even now, Charlie and I continue to believe that short-term market forecasts are poison and should be kept locked up in a safe place, away from children and also from grown-ups who behave in the market like children.”

1992: “The strategy we've adopted precludes our following standard diversification dogma. Many pundits would therefore say the strategy must be riskier than that employed by more conventional investors. We disagree. We believe that a policy of portfolio concentration may well decrease risk if it raises, as it should, both the intensity with which an investor thinks about a business and the comfort-level he must feel with its economic characteristics before buying into it. In stating this opinion, we define risk, using dictionary terms, as "the possibility of loss or injury."

1993: “In a bull market, one must avoid the error of the preening duck that quacks boastfully after a torrential rainstorm, thinking that its paddling skills have caused it to rise in the world. A right-thinking duck would instead compare its position after the downpour to that of the other ducks on the

pond.”

1996: “Do not think of yourself as merely owning a piece of paper whose price wiggles around daily and that is a candidate for sale when some economic or political event makes you nervous. … Instead visualize yourself as a part owner of a business that you expect to stay with indefinitely, much as you might if you owned a farm or apartment house in partnership with members of your family.”

1996: “We continue to make more money when snoring than when active. … You simply want to acquire, at a sensible price, a business with excellent economics and able, honest management. Thereafter, you need only monitor whether these qualities are being preserved.”

1997: “But now for the final exam: If you expect to be a net saver during the next five years, should you hope for a higher or lower stock market during that period? Many investors get this one wrong. Even though they are going to be net buyers of stocks for many years to come, they are elated when stock prices rise and depressed when they fall. In effect, they rejoice because prices have risen for the "hamburgers" they will soon be buying. This reaction makes no sense. Only those who will be sellers of equities in the near future should be happy at seeing stocks rise. Prospective purchasers should much prefer sinking prices.”

1997: “Our future rates of gain will fall far short of those achieved in the past. Berkshire's capital base is now simply too large to allow us to earn truly outsized returns. If you believe otherwise, you should consider a career in sales but avoid one in mathematics (bearing in mind that there are really only three kinds of people in the world: those who can count and those who can't).”

1997: “If you're an investor, you're looking on what the asset is going to do, if you're a speculator, you're commonly focusing on what the price of the object is going to do, and that's not our game.”

1997: “If you understood a business perfectly and the future of the business, you would need very little in the way of a margin of safety. So, the more vulnerable the business is, assuming you still want to invest in it, the larger margin of safety you'd need. If you're driving a truck across a bridge that says it holds 10,000 pounds and you've got a 9,800 pound vehicle, if the bridge is 6 inches above the crevice it covers, you may feel okay, but if it's over the Grand Canyon, you may feel you want a little larger margin of safety...”

1998: “Intrinsic value can be defined simply: It is the discounted value of the cash that can be taken out of a business during its remaining life. The calculation of intrinsic value, though, is not so simple. As our definition suggests, intrinsic value is an estimate rather than a precise figure, and it is additionally an estimate that must be changed if interest rates move or forecasts of future cash flows are revised.”

1998: “Investors making purchases in an overheated market need to recognize that it may often take an extended period for the value of even an outstanding company to catch up with the price they paid.”

1998: “Time is the enemy of the poor business and the friend of the great business. If you have a business that's earning 20%-25% on equity, time is your friend. But time is your enemy if your money is in a low return business.”

1998: “We don't get paid for activity, just for being right. As to how long we'll wait, we'll wait indefinitely.”

1999: “We will reject interesting opportunities rather than over-leverage our balance sheet.”

1999: “The line separating investment and speculation, which is never bright and clear, becomes blurred still further when most market participants have recently enjoyed triumphs. Nothing sedates rationality like large doses of effortless money. After a heady experience of that kind, normally sensible people drift into behavior akin to that of Cinderella at the ball. They know that overstaying the festivities—that is, continuing to speculate in companies that have gigantic valuations relative to the cash they are likely to generate in the future—will eventually bring on pumpkins and mice. But they nevertheless hate to miss a single minute of what is one helluva party. Therefore, the giddy participants all plan to leave just seconds before midnight. There's a problem, though: They are dancing in a room in which the clocks have no hands."

1999: "We're more comfortable in that kind of business. It means we miss a lot of very big winners. But we wouldn't know how to pick them out anyway. It also means we have very few big losers - and that's quite helpful over time. We're perfectly willing to trade away a big payoff for a certain payoff."

1999: "The stock market is a no-called-strike game. You don't have to swing at everything—you can wait for your pitch. The problem when you're a money manager is that your fans keep yelling, 'Swing, you bum!'"

2000: "Instead, we try to apply Aesop's 2,600-year-old equation to opportunities in which we have reasonable confidence as to how many birds are in the bush and when they will emerge (a formulation that my grandsons would probably update to, 'A girl in a convertible is worth five in the phonebook.')."

2000: "But a pin lies in wait for every bubble. And when the two eventually meet, a new wave of investors learns some very old lessons: First, many in Wall Street are a community in which quality control is not prized and will sell investors anything they will buy. Second, speculation is most dangerous when it looks easiest."

2000: "After all, you only find out who is swimming naked when the tide goes out."

2001: "Investors should remember that excitement and expenses are their enemies. And if they insist on trying to time their participation in equities, they should try to be fearful when others are greedy and greedy when others are fearful."

2001: On being asked about a succession plan. "When they open that envelope, the first instruction is to take my pulse again, after mentioning that the instructions of his succession are sealed in an envelope at headquarters."

2004: “If you have a great manager, you want to pay him very well.”

2004: “Long ago, Sir Isaac Newton gave us three laws of motion, which were the work of genius. But Sir Isaac's talents didn't extend to investing: He lost a bundle in the South Sea Bubble, explaining later, ‘I can calculate the movement of the stars, but not the madness of men.’ If he had not been traumatized by this loss, Sir Isaac might well have gone on to discover the Fourth Law of Motion: For investors as a whole, returns decrease as motion increases.”

2005: “The worst sort of business is one that grows rapidly, requires significant capital to engender the growth, and then earns little or no money. Think airlines. Here a durable competitive advantage has proven elusive ever since the days of the Wright Brothers. Indeed, if a farsighted capitalist had been present at Kitty Hawk, he would have done his successors a huge favor by shooting Orville down.”

2007: “I've reluctantly discarded the notion of continuing to manage the portfolio after my death - abandoning my hope to give new meaning to the term ‘thinking outside the box.’”

2007: “Long ago, Ben Graham taught me that ‘Price is what you pay; value is what you get.’ Whether we’re talking about socks or stocks, I like buying quality merchandise when it is marked down.”

2008: “Putting people into homes, though a desirable goal, shouldn’t be our country’s primary objective. Keeping them in their homes should be the ambition.”

2008: “We never want to count on the kindness of strangers in order to meet tomorrow’s obligations. When forced to choose, I will not trade even a night’s sleep for the chance of extra profits.”

2008: “Upon leaving [the derivatives business], our feelings about the business mirrored a line in a country song: ‘I liked you better before I got to know you so well.’”

Buffett at 5am

On the Monday after the 2012 AGM which was held over the weekend, during which Buffett and Munger spent three and a half hours answering 54 questions from shareholders and financial commentators, Warren Buffett then 81-years old, spent three hours answering questions on the TV show SQUAWK BOX, in a special presentation of the show live from the Hollywood Diner just outside Omaha. Amazingly Buffett was there and ready to go at 5.00am! These are some of the things he had to say on the show. “I bought my first stock in the spring of 1942 when I was 11 years old. And, at that point, we were losing the war of the Pacific to the Japanese. And, I mean, if you read the headlines every day, it would be kind of fun to go back and look at the headlines on the day I bought my first stock because, you know, things were looking terrible until the battle of Midway, and I bought in a few months before that. So I think it's a terrible mistake. I think the worst mistake you can make in stocks is to buy or sell based on current headlines.”

Buffett was asked, “Are you talking about serious amounts of money that you put into the market?” He responded, Yeah. Well, I mean, we put as much as we can buy without disturbing the price.”

“How much did you spend on Friday?” “Well, we probably spent about 60 million. Yeah. We try to buy maybe 10 percent of what trades or something of the sort when we're buying a stock. When we were buying IBM, I used to, day by day, I would just account for 10 percent of the trading.”

“Wow. But it was done very quietly, you kind of moved your way through?”

“Yeah. I put duct tape over my mouth.”

3.

THE BUFFETT

INVESTMENT

STRATEGY

Wide diversification is only required when investors do not understand what they are doing.

Warren Buffett

Warren Buffett's Share Selection Methodology

I personally use Warren Buffett's share selection methodology - he has three basic criteria:

1. He never buys a company that's not making profit. Sounds simplistic but how many people buy a share on a hot tip and never check if it's a profitable company?

2. He never buys a company if he doesn't understand how it makes its money. Why? Well if he doesn't understand how they make money then how can he predict their likely future? For instance Buffet didn't buy Enron shares, as he couldn't understand how they were making money. Nor could anyone else for that matter, not even Enron executives. Buffet was criticized for missing out on the dot com boom before the boom turned into the dot com crash.

Critics said Buffet is old school, is losing his marbles, he simply doesn't understand the future, all because he refused to invest in dot com companies despite their share prices going from a few cents to up to $100 or more in less then a year. But he stuck by his three point criteria and as a result he couldn't understand how they were making money. Generally that's because they weren't and many never did. So he avoided the dot com crash because he stuck to fundamentals. My belief is if it works for Buffet it works for me. 3. He never buys a company that he considers over valued. This can be a more difficult assessment and becomes a judgement call. But ideally he is looking for companies the share market is under valuing so that he can get a bargain. Buffett says to look at buying a share as if you were going to buy the entire company. Some may say that's all right for Buffet as he usually is buying the entire company, nevertheless, it is still good advice.

If you were buying a newsagent, corner store or restaurant you would check if is profitable and check if the accounting is reliable and you would want to understand how it makes its money. Even if it is profitable and you understand how it makes its money and is only worth $250,000 you aren't going to buy it at $300,000. But you would want it at say $200,000 or less, being $50,000 below value. Makes sense?

Buffet sticks to this simple criteria and has consequently become a billionaire. To Buffett, management is everything. He simply won't buy a business or a stock if he doesn't have faith in the executive suite. Indeed, in terms of investment criteria, a strong management team carries a lot of weight. "At headquarters, we're not training managers, we're finding them," explains Munger, who adds that it's pretty easy to identify talent. "If you're standing on Everest, you don't have to be a genius to recognize it's a high mountain."

How Buffett Finds Low-Priced Value

We will look at how Buffett finds low-priced value with some questions relating to when he evaluates the relationship between a stock's level of excellence and its price. Keep in mind that these are not the only things he analyses but rather a brief summary of what Buffett looks for:

1. Has the company consistently performed well?

Sometimes return on equity (ROE) is referred to as "stockholder's return on investment". It reveals the rate at which shareholders are earning income on their shares. Buffett always looks at ROE to see whether or not a company has consistently performed well in comparison to other companies in the same industry. Looking at just last year’s ROE is not enough. The investor should view the ROE from the past five to 10 years to get a good idea of historical performance.

2. Has the company avoided excess debt?

The debt/equity ratio is another key characteristic Buffett considers carefully. Buffett prefers to see a small amount of debt so that earnings growth is being generated from shareholders' equity as opposed to borrowed money. This ratio shows the proportion of equity and debt the company is using to finance its assets. If the ratio is higher then debt rather than equity is financing the company. A high level of debt compared to equity can result in volatile earnings and large interest expenses. For a more stringent test, investors sometimes use only long-term debt instead of total liabilities in the calculation above.

3. Are pro"t margins high? Are they increasing?

The profitability of a company depends not only on having a good profit margin but also on consistently increasing its profit margin. This margin is calculated by dividing net income by net sales. To get a good indication of historical profit margins, investors should look back at least five years. A high profit margin indicates that the company is executing its business well, but increasing margins means management has been extremely efficient and successful at controlling expenses.

4. How long has the company been public?

Buffett typically considers only companies that have been around for at least 10 years. As a result, most of the technology companies that have had their initial public offerings (IPOs) in the past decade wouldn't get on Buffett's radar (not to mention the fact that Buffett will invest only in a business that he fully understands, and he admittedly does not understand what a lot of today's technology companies actually do). It makes sense that one of Buffet's criteria is longevity: value-investing mean looking at companies that have stood the test of time but are currently undervalued. Never underestimate the value of historical performance, which demonstrates the company's ability (or inability) to increase shareholder value. Keep in mind, however, that the past performance of a stock does not guarantee future performance - the job of the value investor is to determine how well the company can perform in the future as it did in the past. Determining this is inherently tricky, but obviously Buffett is very good at it.

5. Do the company's products rely on a commodity?

Initially you might think of this question as a radical approach to narrowing down a company. Buffett, however, sees this question as an important one. He tends to shy away (but not always) from companies whose products are indistinguishable from those of its competitors, and those that rely solely on a commodity such as oil and gas. If a company does not offer anything different than another firm within the same industry, Buffett sees little that sets the company apart. Any characteristic that is hard to replicate is what Buffett calls a company's economic moat, or competitive advantage. The wider the moat, the tougher

it is for a competitor to gain market share.

6. Is the stock selling at a 25% discount to its real value?

This is the kicker. Finding companies that meet the other five criteria is one thing, but determining whether they are undervalued is the most difficult part of value investing, and Buffett's most important skill. To check this, an investor must determine the intrinsic value of a company by analysing a number of business fundamentals, including earnings, revenues and assets. A company's intrinsic value is usually higher (and more complicated) than its liquidation value i.e. what a company would be worth if it were broken up and sold today. The liquidation value doesn't include intangibles such as the value of a brand name, which is not directly stated on financial statements. Once Buffett determines the intrinsic value of the company as a whole, he compares it to its current market capitalization - the current total worth (price). If his measurement of intrinsic value is at least 25% higher than the company's market capitalization, Buffett sees the company to have value. Sounds easy, doesn't it? Well, Buffett's success, however, depends on his unmatched skill in accurately determining this intrinsic value.While we can outline some of his criteria, we have no way of knowing exactly how he gained such precise mastery of calculating value. It is interesting to note that virtually all directors of public companies in Australia have indemnity insurance paid for by the company. By contrast, Berkshire Hathaway does not carry director’s insurance. Warren Buffett says, "If something really catastrophic happens on our directors' watch, they are exposed to losses that will far exceed yours."

Buffett On Identifying Good Companies

"We don't do due diligence or go out kicking tires. It doesn't matter. What matters is understanding the competitive dynamics of a business. We can't be taken by a guy with a sales pitch...

“What really counts is the presence of a competitive advantage. You want a business with a big castle and a moat around it, and you want that moat to widen over time. Coke and Kodak both had marvellous moats 20 or 25 years ago. Kodak's has narrowed (it has almost completely disappeared), while Coke has been building its moat. We want an economic castle."

“Retail investors should not pay any attention to the day's news. If they're paying attention to the day's news and they're trying to buy and sell stocks based on the day's news, they're never going to be successful investors.

“The idea is to buy a good business. I mean, it's the same way as if you and your, you know, your brother went out to buy a business. You'd look around for a company, some little business that had good prospects over time, had decent and honest management and where the price made sense.

“And you wouldn't read the newspaper before you do it. My partner, Charlie Munger, and I have been working together for over 50 years. In both buying a $34 billion business like Burlington Northern or buying 100 shares of stock, we have never talked about the day's news or what's going, you know, or that week's news or about month's news. We're looking at where the business is going to be 10 years from now because we're going to own it then. That's where it counts.”

Buffett on Technology Companies

Buffett says while he would "not be at all surprised" if Apple (trading at over $600 a share in mid-2012) and Google (trading at over $650 a share in mid-2012 are worth a "lot more" in ten years, he sees them as too risky for Berkshire to invest in. But, he says, "I sure as hell wouldn't short them either."

Buffett and his partner Charlie Munger told shareholders they simply don't know enough about the companies, their potential competitors, and where technology might be going, for them to see Google and Apple as "inevitable" winners.

They consider Berkshire's recently acquired $13.1 billion stake in IBM (according to Buffett “IBM is really a branded solutions provider at heart), as a much safer investment, even though it can also be characterized as a tech company. “The chances of being wrong in IBM are probably less, at least for us, than the chances of going wrong in Google and Apple."

“I'm an agnostic on a company like Facebook. Any time you get a truly extraordinary business, and it's obviously an extraordinary business, but they're the hardest ones to value because the question is, is whether five or 10 years from now they will be as extraordinary as they are now, even though they may keep doing more and more wonderful things. So it's just harder to figure out than, oh, we'll say Coca-Cola.

“I mean, Coca-Cola 10 years from now is going to be bigger and more profitable, in my view, than it is now, but there won't be some quantum change in either direction. So it's much easier for me to figure out Coca- Cola's worth than Google or Facebook or, you know, you name it.” This is what Charlie Munger had to say about the technology industry.

“Take the rapid training by the computer geniuses with the computer algorithms. Those people have all the social utility of a bunch of rats admitted to a granary. I never would have allowed the rats to get in the granary. I don't want the brilliant young men of America doting their lives at being rats in somebody else's granary. That's not my idea of the right way to run the republic. And if you let me write the laws, it wouldn't happen. But of course, nobody's going to do that.”

The Importance of Valuing A Share

Warren Buffett says that you should value a share as you would value a private business. “In the private sector, P/E (Price / Earnings) means nothing. In fact, earnings mean nothing. The only thing that matters in buying a private business is the amount of cash that it can generate-its free cash flow.

“When you buy a stock, you are buying the company’s net worth and a right to the cash that the company can generate in the future. “Earnings and revenue are numbers reported on the company’s tax return and mean nothing to a business owner or investor. You can’t spend earnings to grow the business - you can only spend the cash that makes it to the bank after all expenses are paid.

“If you know the net worth of the company (the Shareholder Equity) and can reasonably estimate the future cash of the business with a degree of confidence-you can quickly calculate the true value of a business. Once you know the value, you should insist on buying the stock at a discount to its value.

“This discount is a Margin Of Safety so that you still earn attractive returns if the company does not produce as much cash as you had expected.

“Only when the stock price is at or below your Margin Of Safety should you consider investing. Investing in this way can produce amazing results:

“It would have protected investors in the US from the Lucent, Enron, and Worldcom scams because free cash flow is hard to fake – even when earnings and other tax return numbers are growing; and, “It will allow you to invest with confidence and check in on your stocks once a year. Buying businesses as a business investor gives you the confidence and comfort to know that you own wonderful companies at attractive prices and that you do not need to concern yourself with the daily silliness of the stock markets because, over time, as your company’s value grows, its stock price will have to follow.”

Some More Buffett Wisdom

When asked about what indicator of economic activity he would watch, if he could only choose one, Buffett stated that freight car-loadings and truck tonnage moved would be the ones he would track.

“I think cash is probably as risky an asset as you can own over time. So you're not taking risk off when you go into cash. You are going into something that is sure to decline in purchasing power over time. So that is the biggest risk on trade I know is to own cash.”

“Success in investing doesn't correlate with I.Q. once you're above the level of 125. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing.”

“When you get somebody like a, Walt Disney or Steve Jobs or Mark (Zuckerberg) or Bill (Gates), what you see with those people is a passion. And to some extend they're not thinking solely about the money involved.

“I mean, they are not running their businesses to get extremely rich. They don't mind getting rich, and you know they know how to do that, too, but what really drives them is what they're creating and you saw that with Bill, you see it with Mark and when you get that, when you find that and they've got big ideas and the rest of the world doesn't necessarily understand them very well, but they're doing it. You know, you can get some amazing achievements.”

“I think equities are very attractive for the long term. They may get more attractive next week or next month. But it's the same thing I said in October of 2008. I didn't know where bottoms were going to be or where they were going to be in a year.

“But equities, producing businesses, good producing businesses are a great thing to own over time, and they've been a great thing to own, you know, for a hundred, several hundred years in this country.

“They will be a great thing to own for the next 100 years. But who knows whether they go up or down in price next week. As to the volume, though, there's still way too much volume in the market. I mean, the idea that the ownership of a company should turn over a hundred percent in a year, that is not the way people behave with apartment houses, it's not the way they behave with farmland.

“But they have this notion in stocks that they ought to do something every day. The best thing to do with stock is buy stock with a good company and don't look at the price for five years or something.”

“Whenever I read about some company undertaking a cost-cutting program, I know it's not a company that really knows what costs are about. The really good manager does not wake up in the morning and say 'This is the day I'm going to cut costs,' any more than he wakes up and decides to practice breathing.”

“My idea of a group decision is to look in the mirror.”

“You want to be with a low-cost operator. Now, that's an advantage that Wal-Mart has, that's an advantage a Costco has, and you can look throughout the field. People that are low-cost operators have an advantage.”

“When managers want to get across the facts of a business to you, it can be done with the rules of accounting. Unfortunately, when they want to play games, at least in some industries, it can also be done with the rules of accounting. If you can't recognize the differences, you shouldn't be in the equity-picking business.”

“I've often felt there might be more to be gained by studying business failures than business successes.”

“The investor of today does not profit from yesterday’s growth.”

“There are all kinds of businesses that Charlie and I don’t understand, but that doesn’t cause us to stay up at night. It just means we go on to the next one, and that’s what the individual investor should do.

1. We enjoy the process far more than the proceeds.

2. We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful.

3. We’ve long felt that the only value of stock forecasters is to make fortune tellers look good. Even now, Charlie and I continue to believe that short-term market forecasts are poison and should be kept locked up in a safe place, away from children and also from grownups who behave in the market like children.

4. When a management team with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact.”

“To be successful, you should concentrate on the world of companies, not arcane accounting mathematics.”

“We believe that according the name "investors" to institutions that trade actively is like calling someone who repeatedly engages in one-night stands a "romantic.”

“It's got to be the best intellectual exercise out there. You're seeing through new situations every ten minutes…In the stock market you don't base your decisions on what the market is doing, but on what you think is rational….”

“Bridge is about weighing gain/loss ratios. You're doing calculations all the time.

“The approach and strategies are very similar in that you gather all the information you can and then keep adding to that base of information as things develop. You do whatever the probabilities indicated based on the knowledge that you have at that time, but you are always willing to modify your behaviour or your approach as you get new information.

“In bridge, you behave in a way that gets the best from your partner. And in business, you behave in the way that gets the best from your managers and your employees.”

“Chains of habit are too light to be felt until they are too heavy to be broken.”

“The rich are always going to say that, you know, just give us more money and we'll go out and spend more and then it will all trickle down to the rest of you. But that has not worked the last 10 years, and I hope the American public is catching on.”

“There seems to be some perverse human characteristic that likes to make easy things difficult.”

“All kinds of things are going to happen. I'm not trying to sit around and predict which of those are going to happen, I'm trying to figure where businesses will be five or 10 years from now. And whenever we buy a stock I say am I happy owning that stock if the stock market closes for a couple of years?

“You know, if I've got a good business here and the stock market closes for a couple of years, I'm fine. And if I own part of a good business I do not need the stock market to be open for the next couple of years to do fine in investing.”

“Berkshire has been underpriced sometimes during the 45-plus years I've been there and has been overpriced. Most of the time it's been in with the range of value. In the next 50 years it'll be overpriced, sometimes it'll be underpriced, it's the nature of stocks. That's what makes stock investing so wonderful. I mean, if everything was perfectly priced all the time there would be no money in the game.”

“I would love it if they only allowed me and a whole bunch of psychotic drunks to trade in stocks and I would get very rich.”

“The real problem in stocks is that people are emotional about them. I mean, the problem isn't with the companies; the problem is with the people that call themselves investors. If you look at how American business has done over history, it's done magnificently.

“And if you just owned a cross-section of it, you didn't need to know how to run a business or read a balance sheet or anything.

“But the problem is that people get excited about getting rich very quickly or they get depressed when they thought they were going to get rich very quickly and they didn't, and people beat themselves in the stock market. The companies don't beat them, the stocks don't beat them, they beat themselves.”

“There will be bubbles in the future. I mean, people get excited about things that have gone up in price, and that very excitement becomes further proof to them and the rise in prices.

“I mean, it becomes circular, and it keeps going until it ends, and that's when bubbles pop. But we will have a lot of bubbles, and you can get very rich on bubbles if you take advantage of them rather than participate in them.”

“If you print enough money, you know, the price of everything will go up even though the value of it doesn't go up, in a sense. And if you mail out a million dollars to every American family, you know, you will not have a bubble, you'll have inflation. You'll also have a lot of activity for a while. But the printing of money results in the decline in the value of money. It's very simple.”

“What we want to have is the normal growth that comes out of an economy where people are finding more and more things to do that please you and me in terms of what we buy.”

“If you go on CNBC and say that bonds are kind of a poor investment, you know people don't get mad at you; you don't even hear from the Treasury. I mean, all right, you can knock almost any investment and people may get a little irritated, but when you talk about gold - and of course that says something about their motivations for ownership - they want people to agree with them.

“They want people - everybody - they want everybody to get so scared they run to a cave with gold. And caves might be a better investment than gold. I mean, at least they're not producing more caves all the time. So they want people to be as afraid as they are because that's what's going to produce an increase in prices.

“Incidentally, they're right to be afraid of paper money. I mean, they have a very — their basic premise that paper money around the world is going to get worth less and less and less over time is absolutely correct.”

“The one thing I can guarantee you is not safe, is the dollar in your pocket, you know. That is going to get or become worth less, not worthless, but worth less over time.”

“I don't believe in people trying to get very rich very quickly in stocks. They don't know how to do it, I don't know how to do it, nobody knows how to do it.

“And if you get convinced that you can, you know, you've made a mistake. But there are lots, there are plenty of good businesses that if you buy them, you'll have a very high probability they'll be worth more money in five or 10 or 20 years.

“And Berkshire's one of those. But it isn't the best one. I mean, the chances of getting a bad result at Berkshire is very slight, and therefore you can have, in my view, you can have a higher percentage of your money in Berkshire if you're willing to be satisfied with a modestly better than average return.

“And I have members of my family, you know, my sisters and cousins that have 80 or 90 percent of their money in Berkshire. I'm not uncomfortable with that. But they do not expect to get the kind of results out of Berkshire in the future that they've gotten in the past, and they won't.”

Berkshire vs. Gold

This is what Buffett had to say about gold as an investment in May 2012 on Squawk Box TV. “When we took over Berkshire, Berkshire was selling at $15 a share and gold was selling at $20 an ounce. Gold is now 1600 and Berkshire's 120,000. But you can take a broader example of that. If you buy an ounce of gold today and you hold it 100 years, you can go to it every day and you could coo to it and you can caress it and you can fondle it and 100 years from now you'll have one ounce of gold and it wouldn't have done anything for you in between.

“If you buy 100 acres of farmland, it will produce for you every year. You can use that money to buy more farmland; you can do all kinds of things. For 100 years it'll produce things for you and you still have 100 acres of farmland at the end of 100 years.

“You could buy the Dow Jones industrial average for 66 at the start of 1900. Gold was then $20. At the end it was 11,400. But you'd have gotten dividends for 100 years. So a productive asset of any kind, a decent productive asset, is going to kill a non-productive asset over time. Now, in any given one-year period, five-year period, any asset can outperform another asset.”

Buffett in Australia

In its report for the three months to June 2012, Berkshire Hathaway revealed that it held Australian bonds as part of the fixed interest securities backing its insurance businesses, including huge re-insurance arms, and some of its finance products. It also holds the bonds of four other AAA-rated countries including Germany and the UK. The bonds of these five countries make up 80 percent of the investment in foreign fixed-interest securities. One Australian media outlet gushingly reported, “Warren Buffett has opted to invest heavily in Australia's top-rated government bonds as he seeks a stable backstop for Berkshire Hathaway. And more purchases may be on the way.

“For the first time, one of the world's major insurers, Warren Buffett's Berkshire Hathaway, has revealed itself as a fan of Australian government bonds, especially their AAA credit rating.

“With General Re and Berkshire active in Australia, it's logical they hold Australian government bonds in their portfolios. But the importance of the AAA-rated holdings to Berkshire has increased. It seems even the legendary Warren Buffett needs to assure investors, analysts and regulators that his huge insurance business is backed by some of the best quality government debt around the world.”

Berkshire Hathaway are big global re-insurers and deal with Australian companies including Suncorp. Berkshire also has a 3 percent holding in another global re-insurer in Swiss Re. General Re has significant operations in Australia (it earned a lot of publicity following the HIH collapse in the early years of the past decade for being mixed up with HIH and FAI). If Moody's follows on with its threat to cut the credit ratings of a group of countries including Germany, Netherlands and Luxembourg later this year, then it is likely that Berkshire will be forced to expand the size of its Australian bonds holdings.

Buffett on People

“We have 270,000 people working at Berkshire, and it's a little early in the morning, but I will guarantee you that during the rest of the day, at least, some people will be doing something wrong. I mean, it's the thing that scares the dickens out of me as the CEO, because you can't have 270,000 people without somebody doing something wrong. People are just not that careful no matter what instructions you give.

“The thing I worry about at Berkshire is that with 270,000 people, somebody's doing something wrong. I'll guarantee you they're doing something wrong today. I mean, we will probably have 10 people, maybe 20 people doing something they shouldn't be doing today at Berkshire.

“What I hope is that we find out about it, that it's minor and I certainly hope that we hear about it and get it, you know, get it corrected. But you can't have a huge organization - anybody that runs a huge organization, I don't care whether it's a church or an army or a political organization, a governmental department.

“I mean, that's what haunts you is that down the line people are doing things that, you know, they're not supposed to be doing and you have various methods to try and keep that under control. You'll never— you'll never solve it 100 percent. You have to make sure when you do find out about it, you do something about it.

“We want to have people that match our principles and not principles that match our people”

4.

BUFFETT DEALS

We all are learning, modifying, or destroying ideas all the time. Rapid destruction of your ideas when the time is right is one of the most valuable qualities you can acquire. You must force yourself to consider arguments on the other side.

Charlie Munger, Berkshire Hathaway

Coca-Cola

In 1988, Buffett started buying Coca-Cola shares. His old neighbour, now the President of Coca-Cola, noticed someone was loading up on shares and became concerned. After researching the transactions, he noticed the trades were being placed from the Midwest. He immediately thought of Buffett and called him. Buffett confessed to being the culprit and requested they not speak of it until he was legally required to disclose his holdings at the 5% threshold.

Within a few months, Berkshire owned 7% of the company, or $1.02 billion dollar worth of stock. Within three years, Buffett's Coca-Cola stock would be worth more than the entire value of Berkshire when he made the investment.

In 1988, Wall Street thought Coca-Cola was an unattractive stock to buy. Conversely Warren Buffett thought it was a wonderful business to own.

In 1988 Coca-Cola was the company in the beverage industry, and in theworld. It dominated the market and had no serious competition. Even today in Australia, Coca-Cola has more shelf space than almost any other product on supermarket shelves.

During 1988 and 1989, Buffett acquired more than $1 billion worth Coca- Cola (KO) shares. At the time, Wall Street thought he was downright crazy. Wall Street scrutinized the purchase and deduced that Buffett had paid way too much for earnings and the stock price was high, having increased by 18% a year for eight years.

Wall Street thought Buffett was crazy. In 1987, Coca-Cola earnings were down nearly 2% from their 1986 peak, surely not the sign of a growing company! With a price-to-earnings (PE) ratio of 14 to 19, the company seemed fairly valued at best, if not overvalued.

Buffett showed the world, again, why Wall Street's earnings mean nothing to the business investor, how to invest like a business owner, and why you are right when your data and reasoning are right thus not depending on whether the crowd agrees or disagrees. Berkshire Hathaway has paid a total of $1.3 billion to acquire its 8.6% stake in Coke over the years. In hindsight the results speak for themselves.

Today, Buffett's stock in Coca-Cola is worth more than $10 billion. In 2011, Buffett advised, 'we (Berkshire Hathaway) will almost certainly receive $376 million from Coke in dividends.' Not bad, considering how easy it was to find the value in this "no-brainer" investment. Let's look at the reasoning behind Buffett's most famous purchase. The Cash Cow. From 1978 through 1987, Coca-Cola's Free Cash Flow grew at a median rate of 21.8% a year. Buffett himself says we should not take yearly results too seriously, so we focus on multi-year results. Then again, Coca-Cola's Free Cash Flow grew quite steadily each year - a definite plus!

The Net Worth. Coca-Cola's Shareholder Equity had been growing by around 7.8% a year. Not startling by any means, but it was consistent and predictable-imperative in the Buffett approach to investing. The growth rate of Shareholder Equity becomes critically important only when you expect your company to close up shop in the next twenty years, clearly not something Coca-Cola intends on doing.

Management and Money. Coca-Cola had a median Cash return on invested capital (CROIC) of 9.3% for ten years. For every dollar of capital invested in the company, Coca-Cola was generating $0.09 of cash. Many investors prefer to see CROIC above 13%; any lower and the numbers become fragile, though Coca-Cola was a special situation because of its brand and moat. In 1988, Coca-Cola was anything but fragile.

One of Buffett's investment dictums is for businesses to have a moat. "What really counts is the presence of a competitive advantage. You want a business with a big castle and a moat around it, and you want that moat to widen over time. Coke has been building its moat for 20 or 25 years. We want an economic castle."

In 1988, investors have been hard pressed to find a more well-known name than Coca-Cola. Now *that* is moat. The Valuation. Assuming the company could continue to grow Free Cash Flow at 21.8% a year for ten years, and then slowed to 5% thereafter. So, assuming Buffett wanted a 15% or more average annual return, you could value Coca-Cola at $22.3 billion, or $59.16 a share in 1988. The $22.3 billion is made up of $2.09 billion of Shareholder Equity and the net present value of the estimated $98.89 billion of future cash flow, discounted at 15% for a handsome return.

The Purchase. Many investors work on the theory that you shouldn't pay full price for a company, even for one as solid as Coca-Cola. If the future is a little less rosy than you projected, your returns will suffer. So, you need a discount. Being an industry leader (the industry leader), Coca-Cola could have been purchased with as little as a 25% Margin Of Safety discount. At a 25% discount to value, Coca-Cola could have been purchased at any time at or below $44.37. In 1988, the company's stock traded between $35 and $45.25, giving Buffett a discount between 24% and 41%.

Buffett on Coca-Cola.

From the 1993 Berkshire Hathaway Shareholder Letter:

"Let me add a lesson from history: Coke went public in 1919 at $40 per share. By the end of 1920 the market, coldly re-evaluating Coke's future prospects, had battered the stock down by more than 50%, to $19.50. At year end 1993, that single share, with dividends reinvested, was worth more than $2.1 million.

"As Ben Graham said: "In the short-run, the market is a voting machine - reflecting a voter-registration test that requires only money, not intelligence or emotional stability - but in the long-run, the market is a weighing machine."

Later in the letter, Buffett highlights a 1938 Fortune article. The writer of the article implies that it was already too late, back in 1938, to benefit from the ownership of Coca-Cola's stock:

"In 1938, more than 50 years after the introduction of Coke, and long after the drink was firmly established as an American icon, Fortune did an excellent story on the company. In the second paragraph the writer reported: "Several times every year a weighty and serious investor looks long and with profound respect at Coca-Cola's record, but comes regretfully to the conclusion that he is looking too late. The spectres of saturation and competition rise before him."

"Yes, competition there was in 1938 and in 1993 as well. But it's worth noting that in 1938 The Coca-Cola Co. sold 207 million cases of soft drinks (if its gallonage then is converted into the 192-ounce cases used for measurement today) and in 1993 it sold about 10.7 billion cases, a 50-fold increase in physical volume from a company that in 1938 was already dominant in its very major industry.

"Nor was the party over in 1938 for an investor: Though the $40 invested in 1919 in one share had (with dividends reinvested) turned into $3,277 by the end of 1938, a fresh $40 then invested in Coca-Cola stock would have grown to $25,000 by year end 1993." With that in mind, consider how often layers of complexity and cost are added to the investing process when a perfectly sound and straightforward option is right there in front of you.

Investment Methodology: What Questions Would Warren

Buffett Ask To Value Coca-Cola (or any other business)?

1. Does the company sell brand name products that are likely to endure?

2. Is the business of the company easily understood?

3. Does the company invest in and operate businesses within its area of expertise?

4. Does the company have the ability to maintain or increase profitability by raising prices?

5. Is the company, looking at long-term debt, and the current position, conservatively financed?

6. Does the company show consistently high returns on equity and capital?

7. Have the earnings per share and sales per share of the company shown consistent growth above market averages over a period of at least five years?

8. Has the company been buying back its shares, and if so, has it bought them responsibly?

9. Has management wisely used retained earnings to increase the rate of return to shareholders?

10. Is the company likely to require large capital sums to ensure continuing profitability?

Nebraska Furniture Mart

In 1983, according to what is now folk law, Buffett walked into Nebraska Furniture Mart, the multi-million dollar furniture retailer built from scratch by Rose Blumpkin.

Speaking to Mrs. B, as local residents called her, Buffett asked if she would be interested in selling the store to Berkshire Hathaway. Blumpkin's answer was a simple "yes", to which she responded she would part for "$60 million". The deal was sealed on a handshake and a one-page contract was drawn up. The Russian-born immigrant merely folded the cheque without looking at it when she received it days later.

Buy In Adversity

Warren Buffett has made some of his best buys when solid companies have experienced highly-publicized problems. He has correctly predicted they would work through the trouble, and they ultimately made billions when they recovered.

The first was the Great Salad-Oil Scandal. In the early 1960s, a commodities mogul was taking out big loans secured by what he claimed were giant inventories of salad oil stored in warehouses owned by American Express in Bayonne, New Jersey. As it turned out, the tanks contained mostly water, with salad oil floating on top as disguise. Shares of AmEx plummeted by 50 percent. How bad was this problem? To find out, Buffett spent an evening with the cashier at Ross's Steak House in Omaha seeing if people would stop using their Amex cards. The scandal didn't seem to give any customer indigestion, so Buffett seized the opportunity to buy 5 percent of the company for $13 million.

Buffett pounced, and multiplied his investment five-fold in five-years for a $20 million profit. Many years later, Buffett thought he saw the same pattern in a big company that many investors reviled more than any other: Bank of America (BofA).

Buffett asked his administrative assistant to find CEO Brian Moynihan's phone number. When he reached Moynihan at the environmentally-friendly Bank of America Tower in midtown Manhattan, Buffett proposed a deal that was relatively light on dividends and heavy on warrants and would produce enormous gains if BofA recovered.

Moynihan, an experienced dealmaker from his days making acquisitions for

Fleet, wanted near-total secrecy. He declined to bring in investment bankers, didn't consult with lieutenants, and initially discussed the deal only with his chairman, former DuPont CEO, Chad Holliday.

The board voted by phone early on a Thursday morning and approved the deal that had taken just 24 hours. In exchange for the Buffett brand name and $5 billion, the Charlotte, N.C. financial institution granted Warren Buffett the option to buy up to 700 million of its shares any time in the next 10 years for $7.14.

Buffett earned $357 million in paper profits that Thursday simply on warrants related to his $5 billion equity infusion into Bank of America. Not bad for a day's work. Fund managers and analysts feared that Bank of America needed to raise lots of additional capital by selling shares, at extremely low prices. They believed the bank lacked the financial strength to cover its big exposure to troubled mortgages. The TV talking heads, disappointed investors, and even investment bankers within BofA who received bonuses in shares and were watching it collapse, took a dim view of its future and Moynihan's leadership.

Buffett took a different view: Berkshire wouldn't have invested in BofA if it needed his money. The Berkshire chairman reckons that the bank would work through its current problems, and that the underlying banking business will prove highly profitable. If Moynihan's claim that BofA will earn as much as $25 billion in a few years proves correct, Berkshire's profits will exceed $10 billion.

Goldman Sachs

Buffett has a history of being a lifeline for well-known companies at time of financial stress. He made a $5 billion investment in Goldman Sachs in September 2008 at the height of the financial crisis.

Buffett’s Berkshire Hathaway took advantage of the turmoil in the markets to make a shrewd $5 billion investment with a strong 10% dividend yield in the beleaguered but best-run major Wall Street securities firm, Goldman Sachs.

Berkshire also received warrants to buy $5 billion of Goldman common stock at $115 a share, $10 below Goldman's share price when the deal was announced. Within a week Goldman issued another $5 billion in common stock. By the week's end, Goldman raised its price to around $137 a share, making Buffett's deal even more attractive. Berkshire was to receive $500 million in annual dividends on the preferred shares, which is tax-advantaged for a corporation. Preferred stock, which pays a fixed dividend but rarely fluctuates much in value, acts more like a bond than a typical common stock. Holders of preferred shares also are paid off ahead of common-stock holders if a company is liquidated. Unlike most preferred, which are callable after five years, the Goldman preferred held by Berkshire can be redeemed at any time at a 10% premium. This gives Goldman flexibility to pay off the issue if it can obtain more attractive financing later in a calmer market. If the issue is paid off, Berkshire will net a $500 million profit. Goldman probably could have done a better deal by selling $5 billion of convertible preferred stock in the open market or to a group of private-equity firms.

For Goldman, the allure of this deal was the imprimatur that comes from Warren Buffett. With Buffett saying that a preferred investment in Goldman is safe, Goldman's lenders and those with whom it trades were surely to be reassured.

This undoubtedly helped Goldman finance its $1 trillion balance sheet, even though Mr. Buffett's purchase is expected to reduce Goldman's earnings. The five-year Goldman warrants are very valuable. Berkshire gets an opportunity to buy Goldman stock at half its 2007 peak and for a small premium to the firm's book value of around $100 per share. In mid-2011 Goldman Sachs Group Inc announced that it would buy back $5 billion worth of preferred stock from Buffett, ending a costly deal that helped shore up confidence in the bank at the height of the financial crisis.

Goldman paid a 10 percent premium to buy back the shares, as well as accrued unpaid dividends, and a one-time preferred dividend of $1.64 billion. Buffett lamented the likely redemption of the shares in his 2011 annual letter to shareholders.

"Goldman Sachs has the right to call our preferred on 30 days notice, but has been held back by the Federal Reserve (bless it!), which unfortunately will likely give Goldman the green light before long."

The Buffett transaction also grants Berkshire warrants to purchase 43.5 million common shares at $115 per share through 2013. Following the announcement, Goldman shares rose 2.7 percent to close at $159.96 on the New York Stock Exchange. Berkshire's class A shares advanced 0.5 percent to $124,700 and its class B shares rose 0.9 percent to $83.48. The preferred shares carried an annual dividend of 10 percent, thus buying back the securities will save the investment bank about $500 million a year. The annual dividend to Berkshire translated into $1.4 million per day, $951.29 per minute and $15.85 per second.

General Electric

A month after the Goldman Sachs deal Buffett invested $3 billion in General Electric (GE) after the stock had fallen 42 percent in the past year. The deal costs GE about $300 million each year. After announcing his investment Buffett praised General Electric. “GE is the symbol of American business to the world,” he said in a statement. “They have strong global brands and businesses ... I am confident that GE will continue to be successful in the years to come.”

Analysts said Buffett’s endorsement will mean as much or even more than Berkshire’s cash. “He’s a smart guy and he wouldn’t get involved if he doesn’t think it’s a great company,” said one analyst. “It’s a nice endorsement. He doesn’t make too many mistakes.”

Another analyst said, “I think they’re kind of a win-win situation: great deals for Berkshire and good deals for the other companies. I think in a lot of ways, Goldman and certainly GE, they’re, in effect, buying Buffett’s backing. Companies are willing to accept his capital on better terms than capital from anyone else because of the market psychology of having Warren Buffett investing in their company.”

When GE paid Buffett back, they owed him 10% more than he paid, or $300 million on top of his $3 billion payback. Plus, Buffett will have accumulated $900 million in cumulative dividends. All said and done, Buffett’s $3 billion investment in GE generated a total profit of $1.2 billion.

Swiss Reinsurance Co

Buffett made a similar investment in Swiss Reinsurance Co after it ran into financial difficulty. Buffett made the investment after Swiss Re’s strategy of trading securities such as credit-default swaps led to record write downs and losses of $8.3 billion in 2008. Swiss Re is repaying Berkshire ahead of schedule after profit almost doubled in the third quarter and the reinsurer accumulated excess capital of $10 billion by the end of June. It was announced that Buffett’s two-year return on his Swiss Reinsurance Co investment in the Zurich-based company may exceed $1.3 billion, or more than 40 percent of the funds he injected, when the reinsurer repaid Berkshire Hathaway Inc. in January 2011. Berkshire was to receive a “premium” of 600 million Swiss francs ($623 million) on the 3 billion francs injected into the world’s second-biggest reinsurer. Interest payments of 12 percent a year on the convertible notes purchased in February 2009 added up to about 700 million francs, according to Swiss Re.

A 10 to 1,000 Bet

In 2003, Pepsi paid Berkshire $10 million to insure against a contest Pepsi held which had a potential $1 billion prize. The prize had a very small chance of being won and it was not won by anyone.

The Buffett Budget

Like every regular person, when Buffet goes shopping, he has a budget. It's just that Buffett's budget is $20 billion. At the 2012 AGM, Buffett said he recently considered and then passed on a $22 billion acquisition because he didn't have the cash on hand.

Dow Chemical

Buffett's Berkshire Hathaway group emerged as a leading shareholder in Dow Chemical, after backing the global combine's near-$19 billion acquisition of a speciality chemical business, Rohm and Haas. The deal, announced in July 2008, marked a key step in the plan of Dow chief executive Andrew Liveris to move into higher-margin speciality chemicals, which are less cyclical than bulk chemicals, where Dow is among the global leaders. Berkshire Hathaway provided $3 billion towards the financing while the Kuwait Investment Authority was to put up $1 billion. The preferred shares pay an 8.5 percent annual dividend to Buffett, while the yield is about 4 percentage points higher than that on Dow's 30-year notes due in 2041.

Rohm and Haas make a range of special chemicals for construction, electronics, paper and water treatment. Dow paid $78 a share, which compared with a closing price of $44.83 on the New York Stock Exchange at the time. The offer valued Rohm and Haas' equity at $15.3 billion but also involved taking on $3.5 billion of Rohm and Haas debt. Stripping out the debt, the deal was the third largest ever in the chemicals sector.

In addition to the funding from Berkshire and Kuwait, through convertible preferred securities, Dow had also arranged $13 billion of debt finance through Citigroup, Morgan Stanley and Merrill Lynch. However, by January 2009 the deal with Kuwait had collapsed and Dow's market value was $14 billion, meaning investors thought the company was worth at least $1 billion less than the price it was to pay for Rohm.

Meanwhile, Liveris had to find $7.5 billion to replace funds that had been promised in Dow's now-collapsed joint venture with Kuwait. In July 2012 it was announced that Dow stands to receive $2.16 billion from Kuwait as penalty fees for having cancelled the agreement to buy a part of the Dow-owned plastics business in 2008.

As a result, Buffett and Berkshire Hathaway, who own around $3 billion in preferred shares and another $1 billion that was sold to Kuwait, will stand to gain substantially. While the fine print has yet to be worked out, payment is expected some time in 2013, complete with interest and other fees.

During the Rohm & Hass purchase, Dow made use of Buffett's help to the tune of some $16 million. If it wants, Berkshire Hathaway can now exchange its preferred share holdings for 72.6 million shares of Dow's common stock worth $41.32 per share.

Lubrizol Corporation

In March 2011, Berkshire Hathaway and The Lubrizol Corporation announced a definitive agreement for Berkshire Hathaway to acquire 100% of outstanding Lubrizol shares for $135 per share in an all-cash transaction. The transaction, which was unanimously approved by the board of directors of each company, is valued at approximately $9.7 billion, making it one of the largest acquisitions in Berkshire Hathaway history. This transaction was approved by Lubrizol's shareholders and finalized in September 2011.

Lubrizol supported the war effort in the 1940's, and government authorities credited Lubrizol with producing more than half of the engine oil additives and about 80% of the gear lubricant additives required in Allied military operations.

Lubrizol saw an opportunity with the 1974 petrol crisis and turned its attention to additives to improve total vehicle economy and also introduced super high performance diesel oil additives and fuel saving multigrade gear oil additives.

In the 1990s, Lubrizol began the supply of lubricant additives to China through its joint venture facilities in Tianjin and Lanzhou. Lubrizol overcame the difficulties of the GFC in 2009 to become one of the few chemical companies to produce record earnings.

Newspapers

At the 2012 AGM, Buffett said he might turn into a newspaper baron. In 2011 he bought the Omaha World-Herald, and says that acquisition has worked out well and told the audience that he is thinking of buying more newspapers.

Newspapers, according to Buffett, can be a good business as long as you don't give them away. Shortly after that AGM, Buffett's company Berkshire Hathaway announced a deal to purchase 63 newspapers from Media General -- despite Buffett recently referring to it as a "declining industry with problems." At the AGM when a member of the audience asked him how to deal with a declining industry, Buffett replied, "Generally it pays to stay away from declining businesses. [The] newspaper business is a declining business and we will pay a price to be in that. That is not where we will make real money at Berkshire." But speaking about the newspaper industry in general, Buffett also said, "I think the economics will work out OK. It's nothing like the old days, but I think it will work out OK."

Buffett also said that newspapers have "lost primacy," though he added that "they are still primary in a great many areas. They still tell me something primary that I can't find elsewhere."

Berkshire Hathaway said it will purchase most of Media General's daily and weekly newspapers for $142 million in cash. Separately, Berkshire Hathaway signed a credit agreement with Media General for a $400 million term loan and a $45 million revolving credit line. "In towns and cities where there is a strong sense of community, there is no more important institution than the local paper," said Buffett, a former paper boy. Berkshire Hathaway announced another newspaper purchase in June 2012 saying that they will acquire two Texas daily newspapers.

Buffett, Mars and Wrigleys

Buffett's role in Mars' $23 billion purchase of chewing gum company Wrigley:

In 2008 closely held Mars Inc. with $4.4 billion in debt financing from Buffett and Berkshire Hathaway acquired U.S. chewing gum icon Wm. Wrigley Jr. Company, in a deal valued at $23 billion. When the deal closed, Wrigley became a separate Mars subsidiary.

At the time Buffett said, "There's really nothing that can go wrong with something like the Wrigley and Mars brands. People are eating more and more of their products every day." Mars paid $80 per share for Wrigley in an all-cash deal, which represented a 28% premium over Wrigley's last closing price of $62.45. With the bid from Mars, Wrigley shares shot up 23%, gaining $14.46 per share on the next trading day, thus closing at $76.91.

"It's a great price. Nobody is going to pay more than that. Who is going to go up against Mars and Buffett?" commentators observed. They also noted that in typical Buffett style there was possibly a lot more to the deal. By helping Mars buy Wrigley, Buffett may actually be helping himself: As one, big privately held entity, the merged Mars-Wrigley giant would be much easier for Berkshire to buy outright should the secretive family that runs the business ever decide to sell it, sources said. The Mars-Wrigley merger bought together two all-star confectioners. Wrigley's brands include the Juicy Fruit, Orbit and Eclipse gums, Life Savers hard candies and Altoids mints. Mars is vending-machine royalty in its own right, with brands such as M&Ms, Twix and Snickers.

In addition to providing the debt financing, Buffett's Berkshire Hathaway Inc. was to make a minority investment in Wrigley valued at $2.1 billion. It was believed that Buffett got a discount on the Wrigley stake. Once the Mars buyout of Wrigley is concluded, Buffett will own a piece of the chewing-gum maker. The financing package included $4.4 billion in subordinated debt from Berkshire, and the $2.1 billion investment from Berkshire – payable at the time the deal closed.

Buffett favours companies that have a competitive advantage, offering products or services that can't easily be replicated by rivals. Businesses like Mars and Wrigley, which have strong consumer brands, fit the bill. This move by Berkshire and Buffett was just the latest in a string of deals around that time for Buffett. Others include a stake in Kraft Foods and GlaxoSmithKline PLC, Europe's largest drug maker. Buffett already owned a high-quality confectioner, See’s Candies, a specialty West Coast chocolate-and-candy maker that was founded in 1921 and acquired by Buffett in 1972. Sales were $30 million and pre-tax profit was less than $5 million that year. In 2007, the San Francisco-based See's earned $82 million on revenue of $383 million.

In his most recent letter to Berkshire shareholders, Buffett attributed "extraordinary results" down to See's "durable competitive advantage." See's is representative of the kind of companies that Buffett likes to own operations such as the Nebraska Furniture Mart, or Borsheim's Fine Jewellery, which are highly profitable and display strong growth, yet somehow manage to maintain the "feel" of the old-time sole-proprietorship shops that used to occupy the downtown "Main Street" business district in every small town. See's Candies is a really solid example of that kind of acquisition.

Boys Toys

Most young boys love playing with a train set and have a fascination with trains, but would never dream of owning a railroad. Buffett, who is known for his preference for older technologies like trains, upstaged any train enthusiast with his purchase of Burlington Northern in March 2009 when Berkshire Hathaway agreed to buy Burlington Northern Santa Fe Corp., making a $34 billion bet on the future of the U.S. economy. Burlington Northern, the nation's second-largest railroad, is the biggest hauler of food products like corn, and coal for electricity, making it an indicator of the country's economic health. The railroad also ships a large amount of consumer goods — including items imported from Asia — from big Western ports like Los Angeles and Seattle. It was the biggest acquisition ever for Berkshire Hathaway at the time. Analysts said Buffett was planting both feet in an industry that is poised to grow as the economy gets back on solid ground. Berkshire Hathaway already owned about 22 percent of Burlington Northern, and paid $100 a share in cash and stock for the rest of the company. That was a 31.5 percent premium on Burlington Northern's closing price on the day before the deal. On the day the deal was announced the stock shot up over 28 percent to $97.66 in afternoon trading. Shareholders had the option to convert their stock for a cash payment of $100 per share or receive Berkshire Class A or Class B common stock. Up to 60 percent of the deal was cash and 40 percent was in stock. "Berkshire's $34 billion investment in BNSF is a huge bet on that company, CEO Matt Rose and his team, and the railroad industry," Buffett said in a statement. "Most important of all, however, it's an all-in wager on the economic future of the United States. I love these bets," he said.

By February 2012 Buffett’s all-in wager had proved to be a very good bet on the US oil industry as well. Burlington Northern Santa Fe’s track network puts it among the best situated of its peers to meet shipping demand for fracking sand, pipe and crude oil in the northern US Bakken region, where oil production has more than tripled since 2008. Gains in mineral and chemical carloads helped Burlington Northern pay a $1 billion distribution to Buffett’s Berkshire Hathaway Inc. in early 2012. The railroad is the busiest in the U.S. in 2012 by traffic, positioning it to build on a 16 percent jump in 2011 sales that helped narrow the revenue lead of Union Pacific Corp., which lacks tracks into the Bakken area.

One analyst said, “It’s kind of like if somebody discovers gold in your backyard but not your neighbour’s. It’s just good luck.” Good luck or a typical, well researched Buffett investment?

5.

THE BUFFETT LEGEND

I’m a better businessman because I am an investor and a better investor because I am a businessman. If you have the mentality of both, it aids you in each field.

Warren Buffett

When he was only six years old, Warren Buffett purchased six-packs of Coca-Cola from his grandfather's grocery store for twenty five cents and resold each of the bottles for five cents, pocketing a five cent profit.

At eleven years old, he purchased three shares of Cities Service Preferred at $38 per share for both himself and his older sister, Doris. Shortly after buying the stock, it fell to just over $27 per share. A frightened but resilient Buffett held his shares until they rebounded to $40. He promptly sold them - a mistake he would soon come to regret. Cities Service shot up to $200. The experience taught him one of the basic lessons of investing: patience is a virtue.

In 1947, at age seventeen Buffett graduated from High School. It was never his intention to go to college; he had already made $5,000 delivering newspapers, equivalent to around $75,000 now. His father urged him to attend the Wharton Business School at the University of Pennsylvania. He stayed for two years, complaining that he knew more than his professors. When his father was defeated in the 1948 Congressional race, Warren returned home to Omaha and transferred to the University of Nebraska-Lincoln. Working full-time, he managed to graduate in only three years. Buffett approached graduate studies with the same resistance he displayed a few years earlier. He was finally persuaded to apply to Harvard Business School, which, in the worst admission decision in history, rejected him as "too young". Slighted, he applied to Columbia where famed investors Ben Graham and David Dodd taught - an experience that would forever change his life. Flying through his graduate studies at Columbia, Buffett was the only student ever to earn an A+ in one of Graham's classes. One day Ben Graham called, inviting the young stockbroker Warren Buffett to come and work for him, providing him the opportunity he had long wished for.

Buffett and his wife rented a house in the suburbs of New York and he spent his days analysing S&P reports, searching for investment opportunities. It was during this time that the differences between the Graham and Buffett philosophies began to emerge. Buffett became interested in how a company worked and what made it superior to competitors. Ben Graham simply wanted numbers whereas Buffett was predominately interested in a company's management as a major factor when deciding to invest. Graham looked only at the balance sheet and income statement; he had no interest in corporate leadership. Between 1950 and 1956, Buffett built his personal capital up to $140,000 from a mere $9,800. With this war chest, he set his sights back on Omaha and began planning his next move.

On May 1, 1956, Buffett rounded up seven limited partners including his Sister Doris and Aunt Alice, raising $105,000 in the process. He put in $100 himself, officially creating the Buffett Associates, Ltd.

Before the end of the year, he was managing around $300,000 in capital. Small, to say the least, but he had much bigger plans for that pool of money. He purchased a house for $31,500, affectionately nicknamed "Buffett's Folly", and managed his partnerships originally from the bedroom, and later, a small office. By this time, his life had begun to take shape; he had three children, a beautiful wife, and a very successful business. Over the course of the next five years, the Buffett partnerships racked up an impressive 251.0% profit, while the Dow was up only 74.3%. Somewhat of a celebrity in his hometown, Buffett never gave stock tips despite constant requests from friends and strangers alike. By 1962, the partnership had capital in excess of $7.2 million, of which $1 million was Buffett's personal stake. Buffett didn't charge a fee for the partnership, but he was entitled to 25 percent of the profits above 4 percent. He also had more than 90 limited partners across the United States. In one decisive move, he melded the partnerships into a single entity called "Buffett Partnerships Ltd.", upped the minimum investment to $100,000, and opened an office in Kiewit Plaza on Farnam street.

In 1962, a man by the name of Charlie Munger moved back from California to his childhood home in Omaha. Though somewhat snobbish, Munger was brilliant in every sense of the word, having attended Harvard Law School without a Bachelor's Degree.

Introduced by mutual friends, Buffett and Munger were immediately drawn together, providing the roots for a friendship and business collaboration that would endure for forty years and more. Ten years after its founding, the Buffett Partnership assets were up more than 1,156% compared to the Dow's 122.9%. Acting as the manager over assets that had ballooned to $44 million dollars, Buffett and his daughter Susie's personal stake was $6,849,936. As his persona of success was beginning to be firmly established, Buffett closed the partnership to new accounts. The Vietnam War was raging in full force and the stock market was being driven up by people who hadn't experienced the depression. While Buffett was voicing his concern for rising stock prices, the partnership pulled its biggest coup in 1968, recording a 59.0% gain in value, catapulting to over $104 million in assets.

Next year in May 1969, Buffett informed his partners that he was "unable to find any bargains in the current market" and liquidated the partnership. He spent the remainder of the year liquidating the portfolio, with the exception of two companies - Berkshire and Diversified Retailing. The shares of Berkshire were distributed among the partners and a letter in May 1969 informed them that he would, in some capacity, be involved in the business, but was under no obligation to them in the future. Buffett intended to hold onto his own stake in the company and by then he owned 29 percent of the Berkshire Hathaway stock.

Buffett Gains Control of Berkshire Hathaway

Buffett's role at Berkshire Hathaway had actually been somewhat defined years earlier. On May 10, 1965, after accumulating 49% of the common stock, Buffett named himself Director. Terrible management had almost run the company into the ground, and he was certain that with a bit of tweaking, it could run better. He immediately made Ken Chace President of the company, giving him complete autonomy over the organization. Although he refused to award stock options on the basis that it was unfair to shareholders, Buffett agreed to co-sign a loan for $18,000 for his new President to purchase 1,000 shares of the company's stock.

Two years later, in 1967, Buffett asked National Indemnity's founder and controlling shareholder Jack Ringwalt to his office. When asked what he thought the company was worth, Ringwalt told Buffett- at least $50 per share, a $17 premium above its then-trading price of $33. Buffett offered to buy the whole company on the spot - a move that cost him $8.6 million dollars. That same year, Berkshire paid out a dividend of 10 cents on its outstanding stock. It never happened again; Buffett said he "must have been in the bathroom when the dividend was declared".

In 1970, Buffett named himself Chairman of the Board of Berkshire Hathaway and for the first time, wrote the letter to the shareholders. That same year, the Chairman's capital allocation began to display his prudence; textile profits were a pitiful $45,000, while insurance and banking brought in $2.1 and $2.6 million dollars respectively.

A year or so later, Buffett was offered the chance to buy a company by the name of See's Candy. The gourmet chocolate maker sold its own brand of candies to its customers at a premium to regular confectionary treats. The balance sheet reflected what consumers already knew - they were more than willing to pay a bit "extra" for the special "See's" taste. Buffett decided Berkshire would be willing to purchase the company for $25 million in cash. See's owners were holding out for $30 million, but soon conceded. It was the biggest investment Berkshire or Buffett had ever made up until then. Following several investments and an SEC investigation after causing a merger to fail, Buffett and Munger offered to buy the stock of Wesco, the target company, at the inflated price simply because they thought it was "the right thing to do". Not surprisingly, the government didn't believe them. Buffett began to see Berkshire's net worth climb. From 1965 to 1975, the company's book value rose from $20 per share to around $95. It was also during this period that Buffett made his final purchases of Berkshire stock. By then he had invested more than $15.4 million dollars into the company at an average cost of $32.45 per share. This brought his ownership to over 43% of the stock with his wife holding another 3%. His entire fortune was placed into Berkshire, and with no personal holdings, the company had become his sole investment vehicle.

In 1976, Buffett once again became involved with Geico. The company had recently reported amazingly high losses and its stock was pummelled down to $2 per share. Buffett wisely realised that the basic business was still in tact; most of the problems were caused by an inept management. Over the next few years, Berkshire built up its position in this ailing insurer and reaped millions in profits. Benjamin Graham, who still held his fortune in the company, died in in September of the same year, shortly before the turnaround. Years later, the insurance giant would become a fully owned subsidiary of Berkshire.

By late 1970s, Buffett’s reputation had grown to the point where a rumour that Warren Buffett was buying a stock was enough to shoot its price up by 10 percent. Berkshire Hathaway's stock was trading at more than $290 a share, and Buffett's personal wealth was almost $140 million. The irony was that Buffett never sold a single share of his company, meaning his entire available cash was the $50,000 salary he received. During this time, he made a comment to a broker, "Everything I’ve got is tied up in Berkshire. I'd like a few nickels outside."

This prompted Buffett to start investing for his personal life. According to Roger Lowenstein's "Buffett", he was far more speculative with his own investments. At one point he bought copper futures, which was an unadulterated speculation. In a short time, he had made $3 million dollars. When prompted to invest in real estate by a friend, he responded "Why should I buy real estate when the stock market is so easy?"

By 1989, Berkshire Hathaway was trading at $8,000 a share. Buffett was now, personally, worth more than $3.8 billion dollars. Within the next ten years, he would be worth ten times that amount. During the remainder of the 1990's, Berkshire Hathaway stock catapulted as high as $80,000 per share. Even with this astronomical feat, as the dot-com frenzy began to take hold, Buffett was accused of "losing his touch".

In 1999, when Berkshire reported a net increase of 0.5% per share, several newspapers ran stories about the demise of the Oracle. Confident that the technology bubble would burst, Warren Buffett continued to do what he did best: allocate capital into great businesses that were selling below intrinsic value. His efforts did not go unrewarded. When the markets finally did come to their senses, Warren Buffett was once again a star. Berkshire's stock recovered to its previous levels after falling to around $45,000 per share, and Buffett was once again seen as an investment icon.

The Wit and Wisdom of Warren Buffett

“Take me as an example. I happen to have a talent for allocating capital. But my ability to use that talent is completely dependent on the society I was born into. If I'd been born into a tribe of hunters, this talent of mine would be pretty worthless. I can't run very fast. I'm not particularly strong. I'd probably end up as some wild animal's dinner.”

To Barack Obama, quoted in The Audacity of Hope: Thoughts on Reclaiming

the American Dream (2006)

If people want to give me ties, I accept

Buffett was asked by a reporter on a TV show, “Didn't you get a tie from Obama, too? You stole one from him, too. I remember this story. Didn't you ask him for one, too?"

Buffett responded, "I didn't ask him. I just wore this tie that looked like it has been through a washing machine and he noticed that threads were hanging out and everything and he said, `I can't let you leave the White House looking like that.' So he gave me another tie. A rich guy never has to pay for anything."

More Buffett comments

"If I was running $1 million today, or $10 million for that matter, I'd be fully invested. Anyone who says that size does not hurt investment performance is selling. The highest rates of return I've ever achieved were in the 1950s. I killed the Dow. You ought to see the numbers. But I was investing peanuts then. It's a huge structural advantage not to have a lot of money. I think I could make you 50% a year on $1 million. No, I know I could. I guarantee that."

"Someone's sitting in the shade today because someone planted a tree a long time ago."

"The business schools reward difficult complex behaviour more than simple behaviour, but simple behaviour is more effective."

"Americans are in a cycle of fear which leads to people not wanting to spend and not wanting to make investments, and that leads to more fear. We'll break out of it. It takes time."

"Beware of geeks bearing formulas."

"Chains of habit are too light to be felt until they are too heavy to be broken."

"Derivatives are financial weapons of mass destruction."

"Economic medicine that was previously meted out by the cupful has recently been dispensed by the barrel. These once unthinkable dosages will almost certainly bring on unwelcome after-effects. Their precise nature is anyone's guess, though one likely consequence is an onslaught of inflation."

"I am a huge bull on this country. We will not have a double-dip recession at all. I see our businesses coming back almost across the board."

"I am quite serious when I say that I do not believe there are, on the whole earth besides, so many intensified bores as in these United States. No man can form an adequate idea of the real meaning of the word, without coming here."

“I don’t buy expensive suits. They just look cheap on me.”

“I don't look to jump over 7-foot bars: I look around for 1-foot bars that I can step over.”

“I just think that - when a country needs more income and we do, we're only taking in 15 percent of GDP, I mean, that - that - when a country needs more income, they should get it from the people that have it.“

“I never attempt to make money on the stock market. I buy on the assumption that they could close the market the next day and not reopen it for five years.”

“I think the most important factor in getting out of the recession actually is just the regenerative capacity of - of American capitalism.”

“If a business does well, the stock eventually follows.”

“If anything, taxes for the lower and middle class and maybe even the upper middle class should even probably be cut further. But I think that people at the high end - people like myself - should be paying a lot more in taxes. We have it better than we've ever had it.”

“If past history was all there was to the game, the richest people would be librarians.”

“In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a flu epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to 11,497.”

“It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently.”

“It's better to hang out with people better than you. Pick out associates whose behaviour is better than yours and you'll drift in that direction.”

“It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price.”

“It's never paid to bet against America. We come through things, but it’s not always a smooth ride.”

“Let blockheads read what blockheads wrote.”

“Look at market fluctuations as your friend rather than your enemy; profit from folly rather than participate in it.”

“Of the billionaires I have known, money just brings out the basic traits in them. If they were jerks before they had money, they are simply jerks with a billion dollars.”

“Only buy something that you'd be perfectly happy to hold if the market shut down for 10 years.”

“Only when the tide goes out do you discover who's been swimming naked.”

“Our favourite holding period is forever.”

“Price is what you pay. Value is what you get.”

“Risk comes from not knowing what you're doing. Risk is a part of God's game, alike for men and nations.”

“Rule No.1: Never lose money. Rule No.2: Never forget rule No.1.”

“The first rule is not to lose. The second rule is not to forget the first rule.”

“Should you find yourself in a chronically leaking boat, energy devoted to changing vessels is likely to be more productive than energy devoted to patching leaks.”

“The business schools reward difficult complex behaviour more than simple behaviour, but simple behaviour is more effective.”

“The investor of today does not profit from yesterday's growth.”

“The only time to buy these is on a day with no "y" in it.”

“There's class warfare, all right, but it's my class, the rich class, that's making war, and we're winning.”

“The 400 of us pay a lower part of our income in taxes than our receptionists do, or our cleaning ladies, for that matter. If you're in the luckiest 1 per cent of humanity, you owe it to the rest of humanity to think about the other 99 percent.”

“I've got a lot of letters from various promoters around the country saying, you know, join my fund and we'll do it in the fund. But if you look at the cost of doing it and everything, it's going to work out fine for the fund manager and how it works out for the investor is a different thing. You know, Wall Street has a way of creating products that work out better for it than it does for the investor.”

“There aren't lots of big companies that you can make a deal on and there are lots of big companies that I don't understand. So they're outside my circle of competence. And then there are others that have no intention of selling, and then there are others that are, that were, they may have some intention, but you can't come together with them on price. So big deals are not going to happen very often, but occasionally they will.”

Don't try to get in touch with me by cellphone

Could a lost voicemail have changed the course of financial history? It's conceivable, in the case of Lehman Brothers and Warren Buffett. He has revealed that on the weekend of Lehman's spectacular collapse in 2008, Barclays' president, Bob Diamond, rang him to ask if he'd be willing to help with a rescue of Lehman. When Buffett took the call he was hurrying out to an engagement in Edmonton, Alberta. So he asked Diamond to get back to him with details later. Diamond did call back and left a message on the voicemail on Buffet's cellphone. But the notoriously tech-unsavvy Buffett was unfamiliar with the workings of his handset and didn't notice that there was a message on it. With no offer forthcoming, Lehman proceeded to declare it bankrupt. And we all know the consequences to that fiasco. Full 10-months later Buffett asked his daughter, Susie, about a funny little symbol on the screen of his phone. It turned out to be Diamond with the lowdown on Lehman. There's a simple lesson to the story, Buffett told a conference: "Don't try to get in touch with me by cellphone."

6.

THE INVESTMENT

PROCESS

You couldn't advance in a finance department in this country unless you thought that the world was flat. Why not invest your assets in the companies you really like? As Mae West said, "Too much of a good thing can be wonderful".

Warren Buffett

The Share Market

The market, which is made up of hundreds of thousands of "independent experts" is constantly placing a value on every company. While the market is certainly not always correct, it serves as a useful and independent proxy as to the value of a company. It is clear here that the market and the independent expert are not of one mind.

Some General Rules for Successful Share Trading

The first and most important thing a trader must have is a trading plan. This is a written plan, which you can refer to from time to time. The reason for this is that it will keep you on track and on the right path to becoming a successful share trader. It should comprise of several steps which will become a constant guide to each trade that you make.

1. Objective. The main idea is to make a Profit. This is regardless of whether you are a long-term or short-term trader. Surprisingly enough quite a few traders do not make a profit. This usually is brought about by not planning in the first instance. They are actually trading blindfolded. Not a very desirable state to be in. But funny enough Traders are doing it all the time.

2. Risk. There are several types of risks to be alert for. Firstly there is overall market risk. What is the current mood of the market right now? Is it a bear or bull market? Depending on what type of market it is, this should/could influence

you on whether or not to enter the market now or later. If everything is heading downwards, a little delay might mean that you purchased that stock a little cheaper. A bit of advice here, never try to pick the very bottom or the very top of the market. If you happen to it is luck and nothing else. Even the so-called experts cannot predict the top or bottom. As much as they would have us believe they can. Another risk is speculative risk; this can be found particularly in the mining or oil sector. Sure the stock price can go skywards, but it can go the other way just as quick if not quicker. Only put a small proportion of your capital in this area. Unless of course you are willing to accept the risk involved. Only you can decide what level of risk you are comfortable with.

3. Entry. This where you have decided what price you are going to pay for your share. Whatever you do, do not leave an order in overnight, particularly if the stock is volatile that is to say that the stock is going up and down like a yo-yo. You could pay more than you bargained for. If you must leave in overnight put a limit to what price you want to pay. Not a ‘at market order.’ At least you won’t get any nasty surprises that way.

4. Timing. A very important part of your trading success will be your timing. If the market is going downwards a little patience could mean a better entry price, which will reflect on your profits. Don’t try to pick the exact bottom or the top. Waiting to long might mean the difference between a small profit and a larger more desirable one. The best advice is to get the best price possible at the time you decide to trade.

5. Exit. Not enough attention is paid to this area. Timing is important, but a good tip is “have a pre-set exit figure already prepared. This has the advantage of you knowing already how much profit you are going to make. Don’t be greedy. This is a trap that many traders fall into very regularly. More than I care to mention, small profits taken on a regular basis build very quickly into quite large amounts.

6. Stop/loss. This can mean the difference between success and failure. A stop loss is a price that is set either above or below your share price. This has the effect of stopping a substantial loss or a big one. A good guide is to have no more than 2 percent of your total portfolio at risk. You can decide what percentage you are comfortable with. A trailing stop/loss is what you place just behind your rising share price; this effectively locks in those profits so near and dear to you and me.

7. Paper trading. This is a wonderful idea to practice, learn and fine-tune your trading skills without endangering your hard earned cash; plus it is free which is

another advantage. There are websites where you can try for yourself and you might pick up a prize, depending on your trading skill.

Value Investing

Warren Buffett has made himself into one of the richest men in the world, with a value investing philosophy that millions of investors follow. Let's have a look at the theory of value investing as well as the theory behind some other forms of investing. Many different types of stock trading exist including day trading, swing trading, market making, scalping, charting, momentum trading, trading the news, arbitrage, technical and fundamental analysis, Dow Theory, Elliott Wave Theory, Mark Twain effect, January effect, efficient market hypothesis, arbitrage pricing theory and many others, some of which are outlined in this chapter. Value investing is an investment paradigm that derives from the ideas on investment and speculation set out by Ben Graham (regarded by many to be the father of value investing) and David Dodd in their 1934 text *Security Analysis*. Although value investing has taken many forms since its inception, it generally involves buying securities whose shares appear under-priced by some form(s) of fundamental analysis. For example, such securities may be shares in public companies that trade at discounts to book value or tangible book value, have high dividend yields, have low price-to-earning multiples or have low price-to-book ratios. Notable proponents of value investing, including Buffett, have argued that the essence of value investing is buying stocks at less than their intrinsic value. The discount of the market price to the intrinsic value is what Benjamin Graham called the "margin of safety". The intrinsic value is the discounted value of all future distributions. However, the future distributions and the appropriate discount rate can only be assumptions. Buffett has taken the value investing concept even further as his thinking has evolved to a point, where over last 30 years or so his focus has been on "finding an outstanding company at a sensible price" rather than generic companies at a bargain price. This concept is important when you are actually buying into a business.

The people who established value investing, Benjamin Graham and David Dodd, were both professors at Columbia University and teachers of many famous investors. In Graham's book *The Intelligent Investor*; he advocated the important concept of margin of safety, first introduced in *Security Analysis*, the 1934 book he co-authored with David Dodd, which calls for a cautious approach to investing. In terms of picking stocks, he recommended defensive investment in stocks trading below their tangible book value as a safeguard to adverse future developments often encountered in the stock market. However, the concept of value (as well as "book value") has evolved significantly since the 1970s. Book value is most useful in industries where most assets are tangible. Intangible assets such as patents, software, brands, or goodwill are difficult to quantify, and may not survive the break-up of a company. When an industry is going through fast technological advancements, the value of its assets is not easily estimated. Sometimes, the production power of an asset can be significantly reduced due to competitive disruptive innovation and therefore its value can suffer permanent impairment. One good example of decreasing asset value is a personal computer. An example of where book value does not mean much is the service and retail sectors. One modern model of calculating value is the discounted cash flow model (DCF). The value of an asset is the sum of its future cash flows, discounted back to the present.Value investing has proven to be a successful investment strategy. There are several ways to evaluate its success. One way is to examine the performance of simple value strategies, such as buying low PE ratio stocks, low price-to-cash-flow ratio stocks, or low price-to-book ratio stocks. Numerous academics have published studies investigating the effects of buying value stocks. These studies have consistently found that value stocks outperform growth stocks and the market as a whole. Another way to examine the performance of value investing strategies is to examine the investing performance of well-known value investors. Simply examining the performance of the best known-value investors would not be instructive, because investors do not become well known unless they are successful. This introduces a selection bias. A better way to investigate the performance of a group of value investors was suggested by Buffett, in a speech in May 1984 that was published as *The Superinvestors of Graham-and-Doddsville.*In this speech, Buffett examined the performance of those investors who worked at Graham-Newman Corporation and were thus most influenced by Benjamin Graham. Buffett's conclusion is identical to that of the academic research on simple value investing strategies - value investing is, on average, successful in the long run. During a 25-year period (1965-90), published research and articles in leading journals of the value ilk were few. The most lasting contribution of *Security Analysis,* first published in 1934 by Graham and Dodd to the field of security analysis was to emphasize the quantifiable aspects of security analysis (such as the evaluations of earnings and book value) while minimizing the importance of more qualitative factors such as the quality of a company's management. Graham's most famous student was Warren Buffett, who ran successful investing partnerships before closing them in 1969 to focus on running Berkshire Hathaway. Charlie Munger joined Buffett at Berkshire Hathaway in the 1970s and has since worked as the Vice Chairman of the company. Buffett has credited Munger for encouraging him to focus on long-term sustainable growth rather than on simply the valuation of current cash flows or assets. Another famous value investor is John Templeton, who first achieved investing success by buying shares of a number of companies in the aftermath of the stock market crash of 1929. Martin J. Whitman is another well-regarded value investor. His approach is called safe-and-cheap, which was hitherto referred to as financial-integrity approach. Whitman focuses on acquiring common shares of companies with an extremely strong financial position at a price reflecting meaningful discount to the estimated NAV of the company concerned. Whitman believes it is ill-advised for investors to pay much attention to the trend of macro-factors (like employment, movement of interest rate, GDP, etc.) not because they are not important but because attempts to predict their movement are almost always futile. Joel Greenblatt achieved annual returns at the hedge fund Gotham Capital of over 50 percent per year for 10 years from 1985 to 1995 before closing the fund and returning his investors' money. He is known for investing in special situations such as spin-offs, mergers, and divestitures. Edward Lampert, the chief of ESL Investments, is best known for buying large stakes in Sears and Kmart and then merging the two companies.

Market trends

In investing, financial markets are commonly believed to have market trends that can be classified as primary trends, secondary trends (short-term), and secular trends (long-term). This belief is generally consistent with the practice of technical analysis and broadly inconsistent with the standard academic view of financial markets, the efficient market hypothesis. That market prices move in trends is one of the major assumptions of technical analysis, and the description of market trends is common to share traders. Market trends are described as periods when bulls (buyers) consistently outnumber bears (sellers), or vice versa. A bull or bear market describes the trend and sentiment driving it, but can also refer to specific securities and sectors ("bullish on BHP Billiton", "bullish on technology stocks," or "bearish on gold", etc.).

Bull Markets

Bull Markets are a financial market of a certain group of securities in which prices are rising or are expected to rise. The term "bull market" is most often used in respect to the stock market, but really can be applied to anything that is traded, such as bonds, currencies, commodities, etc.

Bull markets are characterized by optimism, investor confidence and expectations that strong results will continue. No bull market can last forever of course, and sooner or later a bear market (in which prices fall) will come. It is tough if not impossible to predict consistently when the trends in the market will change. Part of the difficulty is that psychological effects and speculation can sometimes play a large (if not dominant) role in the markets. The extreme on the high end is a stock-market bubble, and on the low end- acrash. The use of "bull" and "bear" to describe markets comes from the way in which each animal attacks its opponents. That is, a bull thrusts its horns up into the air, and a bear swipes its paws down. These actions are metaphors for the movement of a market: if the trend is up, it is considered a bull market. And if the trend is down, it is considered a bear market. A bull market tends to be associated with increasing investor confidence, motivating investors to buy in anticipation of further capital gains. The longest and most famous bull market was in the 1990s when the U.S. and many other global financial markets grew at their fastest pace ever. In describing financial market behaviour, the largest group of market participants is often referred to, metaphorically, as a herd. This is especially relevant to participants in bull markets since bulls are herding animals. A bull market is also described as a bull run. Dow Theory attempts to describe the character of these market movements.

Bear Markets

A bear market is described as being accompanied by widespread pessimism. Investors anticipating further losses are motivated to sell, with negative sentiments feeding on itself in a vicious circle. The most famous bear market in history was 1930 to 1932, marking the start of the Great Depression. A milder, low-level long-term bear market occurred from about 1967 to 1983, encompassing the stagflation economy, energy crises in the 1970s, and high unemployment in the early 1980s. Prices fluctuate constantly in the open market. A bear market is not a simple decline, but a substantial drop in the prices of a range of issues over a defined period of time. By one common definition, a bear market is marked by a price decline of 20 percent or more in a key stock market index from a recent peak over a 12-month period. However, no consensual definition of a bear market exists to clearly differentiate a primary market trend from a secondary market trend. Investors frequently confuse bear markets with corrections. Corrections are much shorter lived, whereas bear markets occur over a longer period with typically a greater magnitude of loss from top to bottom.

Bear market historic examples

The Crash of 1929 was an end to the bull market that existed throughout the 1920's. The Black Monday crash of 1987 did not push the markets into a bear market. It was a sharp, dramatic correction within an upward trend. The October 27, 1997 mini-crash is considered a somewhat more minor stock market correction when compared to Black Monday, but, like the 1987 crash, it was a correction during an upward trend. The stock market downturn of 2002 saw a sharp drop in stock prices in stock exchanges across the United States, Canada, Asia, and Europe. After recovering from lows reached following the September 11 attacks, indices slid steadily starting in March 2002, with dramatic declines in July and September leading to lows last reached in 1997 and 1998. The US dollar declined steadily against the euro, reaching a 1-to-1 valuation not seen since the euro's introduction. In May 2006, emerging markets including India witnessed a correction. Indices fell as much as 20 percent before resuming the secular Bull Run.

Stock Trader versus Stock Investor

A stock trader or a stock investor is an individual or firm who buys and sells stocks or bonds (and possibly other financial assets) in the financial markets. Individuals or firms trading equity (stock) markets as their principal capacity are called stock traders. Stock traders usually try to profit from short-term price volatility with trades lasting anywhere from several seconds to several weeks. The stock trader is usually a professional. A person can call himself a full or part-time stock trader/investor while maintaining other professions. On the other hand, stock investors purchase stocks with the intention of holding for an extended period of time, usually several months to years. They rely primarily on fundamental analysis for their investment decisions and fully recognize stock shares as part-ownership in the company. Many investors believe in the buy and hold strategy, which as the name suggests, implies that investors will hold stocks for a very long term, generally measured in years. This strategy was made popular in the equity bull market of the 1980s and 90s where buy-and-hold investors rode out short-term market declines and continued to hold as the market returned to its previous highs and beyond. However, during the 2001-2003 equity bear market, the buy-andhold strategy lost some followers as broader market indexes like the NASDAQ saw their values decline by over 60%. Trading activities are not free. They have a considerably high level of risk, uncertainty and complexity, especially for unwise and inexperienced stock traders/investors seeking for an easy way to make money quickly. In addition, stock traders/investors face several costs such as commissions, taxes and fees to be paid for the brokerage and other services, such as the buying/selling orders placed at the stock exchange. Beyond these costs, the opportunity costs of money and time, currency risk, financial risk, Internet Service Provider, data and other expenses must be added. Although many companies offer courses in stock picking, and numerous experts report success through Technical Analysis and Fundamental Analysis, many economists and academics state that because of Efficient Market Theory it is unlikely that any amount of analysis can help an investor make any gains above the stock market itself. In a normal distribution of investors, many academics believe that the richest are simply outliers in such a distribution (i.e. in a game of chance, they have flipped heads twenty years in a row). For this reason most academics and economists recommend that investors invest in funds that follow an index in the market, i.e. long-term and welldiversified investments.

Index Funds

An index fund or index tracker is a collective investment scheme (usually a mutual fund) that aims to replicate the movements of an index of a specific financial market, or a set of rules of ownership that are held constant, regardless of market conditions. Tracking can be achieved by trying to hold all of the securities in the index, in the same proportions as the index. Other methods include statistically sampling the market and holding "representative" securities. Many index funds rely on a computer model with little or no human input in the decision as to which securities to purchase and are therefore a form of passive management. The lack of active management (stock picking and market timing) gives the advantage of lower fees and lower taxes in taxable accounts. However, the fees will always reduce the return to the investor relative to the index. In addition it is impossible to precisely mirror the index as the models for sampling and mirroring, by their nature, cannot be 100% accurate. The difference between the index performance and the fund performance is known as the 'tracking error' or informally 'jitter'. Index funds are available from many investment managers. Some common indices include the All Ordinaries, the S&P 500, the FTSE 100 and the FTSE All-Share Index. In 1973, Burton Malkiel published his book *A Random Walk Down Wall Street*, which presented academic findings for the lay public. It was becoming well known in the lay financial press that most mutual funds were not beating the market indices, to which the standard reply was made "of course, you can't buy an index." Malkiel said, "It's time the public can." The investment objectives of index funds are easy to understand. Once an investor knows the target index of an index fund, what securities the index fund will hold can be determined directly. Managing one's index fund holdings may be as easy as rebalancing every six months or every year. Diversification refers to the number of different securities in a fund. A fund with more securities is said to be better diversified than a fund with smaller securities. Owning many securities reduces volatility by decreasing the impact of large price swings above or below the average return in a single security. Since some indices, such as the All Ordinaries, the S&P 500 and FTSE 100 are dominated by large company stocks, an index fund may have a high percentage of the fund concentrated in a few large companies. This position represents a reduction of diversity and can lead to increased volatility and investment risk for an investor who seeks a diversified fund. Asset allocation is the process of determining the mix of stocks, bonds and other classes of investable assets to match the investor's risk capacity, which includes attitude towards risk, net income, net worth, knowledge about investing concepts, and time horizon. Index funds capture asset classes in a low cost and tax efficient manner and are used to design balanced portfolios.

Growth Investing

Growth investing is a style of investment strategy. Those who follow this style are known as growth investors. They invest in companies that exhibit signs of above-average growth, even if the share price appears expensive in terms of metrics such as price-to-earning or price-to-book ratios. In typical usage, the term "growth investing" contrasts with the strategy known as value investing. Some notable investors such as Warren Buffett have stated that there is no theoretical difference between the concepts of value and growth ("Growth and Value Investing are joined at the hip"), in consideration of the concept of an asset's intrinsic value. In addition, when just investing in one style of stocks, diversification can be negatively impacted. After the busting of the dotcom bubble, "growth at any price" has fallen from favour. Attaching a high price to a security in the hope of high growth may be risky because if the growth rate fails to live up to expectations, the price of the security can plummet. It is often more fashionable now to seek out stocks with high growth rates that are trading at reasonable valuations. There are many ways to execute a growth investment strategy. Some growth investment vehicles include: emerging markets, recovery shares, blue chips, Internet and technology stock, smaller companies and special situations.

Socially Responsible Investing

Socially responsible investing (SRI) describes an investment strategy which combines the intentions to maximize both financial return and social good. In general, socially responsible investors favour corporate practices which are environmentally responsible, support workplace diversity, and increase product safety and quality. Some (not all) also avoid businesses involved in alcohol, tobacco, gambling, weapons and other military industries, and/or abortion. Modern SRI movement began during the Vietnam War. Many people living during the era remember a picture from June of 1972 of a naked nine yearold girl, Phan Thu Kim Phúc, running towards a photographer screaming, her back burning from the napalm dropped on her village. That photograph channelled outrage against Dow Chemical, the manufacturer of napalm, and prompted protests across the country against Dow Chemical and other companies profiting from the Vietnam War. In the late 1970s, SRI activism turned its attention to nuclear power and automobile emissions control.

Socially responsible investing (SRI) is a booming market in both the US and Europe. One outstanding endorsement of (SRI) policies is the Norwegian Government Pension Fund, which is mandated to avoid "investments which constitute an unacceptable risk that the Fund may contribute to unethical acts or omissions, such as violations of fundamental humanitarian principles, serious violations of human rights, gross corruption or severe environmental damages." Social investors use four basic strategies to maximize financial return and attempt to maximize social good. Screening excludes certain securities from investment consideration based on social and/or environmental criteria. For example, many socially responsible investors screen out tobacco company investments. This is an example of a social screen at work. Divesting is the act of removing stocks from a portfolio based on mainly ethical, non-financial objections to certain business activities of a corporation. Shareholder activism efforts attempt to positively influence corporate behaviour. These efforts include initiating conversations with corporate management on issues of concern, and submitting and voting proxy resolutions. These activities are undertaken with the belief that social investors, working co-operatively, can steer management on a course that will improve financial performance over time and enhance the well being of the stockholders, customers, employees, vendors, and communities. Positive investing involves making investments in activities and companies believed to have a high and positive social impact. Positive investing activities tend to target under served communities. These efforts may support activities designed to provide mortgage and small business credit to minority and low-income communities. At least one U.S. mutual fund, the Vice Fund (VICEX), was created specifically to contrast with the trend in socially responsible investing. VICEX specializes in investing in the defence, alcohol, tobacco, and gambling industries, and has greatly outperformed both the S&P 500 and most socially responsible mutual funds.

Magic Formula Investing

Magic Formula Investing is a term that refers to an investment technique outlined by Joel Greenblatt. Magic Formula Investing is firmly rooted in the principles of value investing. For the lay investor, it is claimed that it offers market-beating returns without the complexity associated with a discounted cash flow analysis. Greenblatt suggests purchasing 30 good companies: cheap stocks with a high earnings yield and a high return on capital. He touts the success of his magic formula in his book The Little Book that Beats the Market, citing that it does in fact beat the market 96% of the time, and has averaged a 17-year annual return of 30.8%. The comparison index used for "the market" in Greenblatt's research is the S&P 500. The Formula: Establish a minimum market capitalization (usually greater than $50 million).

• Exclude utility and financial stocks

• Exclude foreign companies

• Determine company's earnings yield = EBIT / enterprise value.

• Determine company's return on capital = EBIT / (Net fixed assets +working capital)

• Rank all companies above chosen market capitalization by highest earnings yield and highest return on capital (ranked as percentages).

• Invest in 20-30 highest ranked companies, accumulating 2-3 positions per month over a 12-month period.

• Rebalance portfolio once per year, selling losers one day before the year-mark and winners one day after the year mark.

• Continue over long-term (3-5 year) period.

Dart Board Method

Financial journals and newspapers such as the Wall Street Journal have carried articles on stock picking in the past. One famous article involved a stock picking contest between a panel of Wall Street experts, the public and a dart board. One member was elected to throw darts at the Journal's stock page in order to select a portfolio. At the end of the experiment, the public and the dart board both beat the board of Wall Street experts. Was the dart board more savvy?

The dart board's triumph over Wall Street experts can be attributed to chance (one can also attribute the dart board losing to the experts as a coincidence as well).

Arbitrage Pricing Theory (APT)

Arbitrage pricing theory in finance, is a general theory of asset pricing that has become influential in the pricing of shares. APT holds that the expected return of a financial asset can be modelled as a linear function of various macro-economic factors or theoretical market indices, where sensitivity to changes in each factor is represented by a factorspecific beta coefficient. The model-derived rate of return will then be used to price the asset correctly - the asset price should equal the expected end of period price discounted at the rate implied by model. If the price diverges, arbitrage should bring it back into line. The theory was initiated by economist Stephen Ross in 1976. In economics and finance, arbitrage is the practice of taking advantage of a price differential between two or more markets: a combination of matching deals is struck that capitalize upon the imbalance, the profit being the difference between the market prices. When used by academics, an arbitrage is a transaction that involves no negative cash flow at any probabilistic or temporal state and a positive cash flow in at least one state; in simple terms- a risk-free profit. A person who engages in arbitrage is called an arbitrageur. The term is mainly applied to trading in financial instruments, such as bonds, stocks, derivatives, commodities and currencies. If the market prices do not allow for profitable arbitrage, the prices are said to constitute an arbitrage equilibrium or arbitrage-free market. Arbitrage equilibrium is a precondition for a general economic equilibrium. The assumption that there is no arbitrage is used in quantitative finance to calculate a unique risk neutral price for derivatives. Statistical arbitrage is an imbalance in expected values. A casino has a statistical arbitrage in almost every game of chance that it offers. Conditions for Arbitrage: Arbitrage is possible when one of three conditions is met:

The same asset does not trade at the same price on all markets ("the law of one price").

Two assets with identical cash flows do not trade at the same price.

An asset with a known price in the future does not today trade at its future price discounted at the risk-free interest rate (or, the asset does not have negligible costs of storage; as such, for example, this condition holds for gain but not for securities).

Arbitrage is not simply the act of buying a product in one market and selling it in another for a higher price at some later time. The transactions must occur simultaneously to avoid exposure to market risk, or the risk that prices may change on one market before both transactions are complete. In practical terms, this is generally only possible with securities and financial products which can be traded electronically.

In the simplest example, any good sold in one market should sell for the same price in another. Traders may, for example, find that the price of wheat is lower in agricultural regions than in cities thus they purchase the good, and transport it to another region to sell at a higher price.

This type of price arbitrage is the most common, but this simple example ignores the cost of transport, storage, risk, and other factors. "True" arbitrage requires that there be no market risk involved. Where securities are traded on more than one exchange, arbitrage occurs by simultaneously buying in one and selling on the other.

Scalping

Scalping, when used in reference to trading in securities, commodities and foreign exchange, may refer to, a fraudulent form of market manipulation, or, a legitimate method of arbitrage of small price gaps created by the bid-ask spread. Scalping in this sense is the practice of purchasing a security for one's own account shortly before recommending that security for a long-term investment and then immediately selling the security at a profit upon the rise in the market price following the recommendation.

Swing Trading

Swing trading sits in the middle of the continuum between day trading and trend following. Swing traders hold a particular stock for a period of time, generally between a few days and two or three weeks, and trade the stock on the basis of its intra-week or intra-month oscillations between optimism and pessimism. The first key to successful swing trading is picking the right stocks. The best candidates are large-cap stocks that are among the most actively traded stocks on the major exchanges, for example in the U.S., Intel, Microsoft, and Cisco

Systems. In active markets, these stocks will swing between broadlydefined high and low extremes, and the swing trader will ride the wave in one direction for a couple of days or weeks, only to switch to the opposite side of the trade when the stock reverses direction. It should be noted that in either of the two market extremes, the bearmarket environment or bull market, swing trading proves to be a ratherdifferent challenge than in a market that is between these two extremes. In these extremes, even the most active stocks will not exhibit the same upand-down oscillations that they would when indices are relatively stable for a few weeks or months. In a bear market or a bull market, momentum will generally carry stocks for a long period of time in one direction only, thereby ensuring that the best strategy will be to trade on the basis of the longerterm directional trend.

The swing trader, therefore, is best positioned when markets are going nowhere - when indices rise for a couple of days and then decline for the next few days, only to repeat the same general pattern again and again. A couple of months might pass with major stocks and indices roughly the same as their original levels, but the swing trader has had many opportunities to catch the short terms movements up and down (sometimes within a channel).

Contrarian Investing

In finance, a contrarian is one who attempts to profit by investing in a manner that differs from the conventional wisdom, when the consensus opinion appears to be wrong. A contrarian believes that certain crowd behaviour among investors can lead to exploitable mispricing in securities markets. For example, widespread pessimism about a stock can drive a price so low that it overstates the company's risks, and understates its prospects for returning to profitability. Identifying and purchasing such distressed stocks, and selling them after the company recovers, can lead to above-average gains. Similarly, widespread optimism can result in unjustifiably high valuations that will eventually lead to drops, when those high expectations don't pan out. Avoiding investments in over-hyped investments reduces the risk of such drops. These general principles can apply whether the investment in question is an individual stock, an industry sector, or an entire market or asset class. Contrarians are sometimes thought of as perma-bears - market participants who are permanently biased to a bear market view. However, a contrarian does not necessarily have a negative view of the overall stock market, nor does he believe that it is always overvalued, or that the conventional wisdom is always wrong. Rather, a contrarian seeks opportunities to buy or sell specific investments when the majority of investors appear to be doing the opposite, to the point where that investment becomes mispriced. While more "buy" candidates are likely to be identified during market declines (and vice versa), these opportunities can occur during periods when the overall market is generally rising or falling.

Dow Theory

Dow Theory is a theory on stock price movements that provides a basis for technical analysis. The theory was derived from 255 Wall Street Journal editorials written by Charles H. Dow (1851–1902), journalist, founder and first editor of the Wall Street Journal and co-founder of Dow Jones and Company. Following Dow's death, William P. Hamilton, Robert Rhea and E. George Schaefer organized and collectively represented "Dow Theory," based on Dow's editorials. However, Dow himself never used the term "Dow Theory”. The six basic tenets of Dow Theory as summarized by Hamilton, Rhea, and Schaefer are described below.

Six Basic Tenets of Dow Theory

1. Markets Have Three Trends.

Dow defined an uptrend (trend 1) as a time when successive rallies in a security price close at levels higher than those achieved in previous rallies and when lows occur at levels higher than previous lows. Downtrends (trend 2) occur when markets make lower lows and lower highs. It is this concept of Dow Theory that provides the basis of technical analysis' definition of a price trend. Dow described what he saw as a recurring theme in the market: prices would move sharply in one direction, recede briefly in the opposite direction, and then continue in their original direction (trend 3).

2. Trends Have Three Phases.

Dow Theory asserts that major market trends are composed of three phases: an accumulation phase, a public participation phase, and a distribution phase. The accumulation phase (phase 1) is when investors "in the know" are actively buying (selling) stock against the general opinion of the market. During this phase, the stock price does not change much because these investors are in the minority absorbing (releasing) stock that the market at large is supplying (demanding). Eventually, the market catches on to these astute investors and a rapid price change occurs (phase 2). This is when trend followers and other technically oriented investors participate. This phase continues until rampant speculation occurs. At this point, the astute investors begin to distribute their holdings to the market (phase 3).

3. The Stock Market Discounts All News.

Stock prices quickly incorporate new information as soon as it becomes available. Once news is released, stock prices will change to reflect this new information. On this point, Dow Theory agrees with one of the premises of the efficient market hypothesis.

4. Stock Market Averages Must Con"rm Each Other

In Dow's time, the US was a growing industrial power. The US had population centres but factories were scattered throughout the country. Factories had to ship their goods to market, usually by rail. Dow's first stock averages were an index of industrial (manufacturing) companies and rail companies. To Dow, a bull market in industrials could not occur unless the railway average rallied as well (usually first). According to this logic, if manufacturers' profits are rising, it follows that they are producing more. If they produce more, then they have to ship more goods to consumers. Hence, if an investor is looking for signs of health in manufacturers, he or she should look at the performance of the companies that ship the output tomarket, the railroads. The two averages should be moving in the same direction. When the performances of the averages diverge, it is a warning that change is in the air. Both Barron's Magazine and the Wall Street Journal still publish the daily performance of the Dow Jones Transportation Index in chart form. The index contains major railroads, shipping companies, and air freight carriers in the US.

5. Trends Are Con"rmed By Volume

Dow believed that volume confirmed price trends. When prices move on low volume, there could be many different explanations. For example, an overly aggressive seller could be present. But when price movements are accompanied by high volume, Dow believed this represented the "true" market view. If many participants are active in a particular security, and the price moves significantly in one direction, Dow maintained that this was the direction in which the market anticipated continued movement. To him, it was a signal that a trend is developing.

6. Trends Exist Until De"nitive Signals Prove That They Have Ended

Dow believed that trends existed despite "market noise". Markets might temporarily move in the direction opposite the trend, but they will soon resume the prior move. The trend should be given the benefit of the doubt during these reversals. Determining whether a reversal is the start of a new trend or a temporary movement in the current trend is not easy. Dow Theorists often disagree in this determination. Technical analysis tools attempt to clarify this but they can be interpreted differently by different investors.

Charting

A point and !gure chart is used for technical analysis of securities. Unlike most other investment charts, point and figure charts do not present a linear representation of time. Instead, they show trends in price. The aim of point and figure charting is to filter out the "noise" (unimportant price movement) and focus on the main direction of the price trend. Point and figure charts are usually used for longer-term price movements. However, they can be used to day trade by clearly identifying the key points of supply and demand. They are very effective at keeping you on the right side of the market. Point and figure charts can do a really good job to spot very good trading opportunities on a trade and trend market. Point and figure charts are close relatives to three line break, renko and kagi charts all of which do not have a fixed timeframe. This makes you trade only the important moves of the market. Minor moves are discarded because of the limited gain potential. There are two typical ways to plot point and figure charts - using closing prices, or with high/low prices. The most common method nowadays is high/low prices of a specific timeframe, normally daily prices. Point and figure charting is said to have had its origins in the US during the early 1900s with the first book appearing by deVilliers in 1933. The Point & Figure Method of Anticipating Stock Price Movements showed that this charting technique was already known by insiders and stock traders. Point and figure charts where already there in the trading rooms for the purpose to record daily tick movements of stocks when Charles Dow was beginning to create his famous index.

Elliott Wave Principle

The Elliott Wave Principle is a form of technical analysis that attempts to forecast trends in the financial markets and other collective activities. It is named after Ralph Nelson Elliott (1871–1948), an accountant who developed the concept in the 1930s: he proposed that market prices unfold in specific patterns, which practitioners today call Elliott waves. Elliott argued that because humans are themselves rhythmical, their activities and decisions could be predicted in rhythms, too. Critics argue the theory is unprovable and inconsistent with the efficient market hypothesis. The wave principle posits that collective investor psychology (or crowd psychology) moves from optimism to pessimism and back again. These swings create patterns, as evidenced in the price movements of a market at every degree of trend. Elliott's model says that market prices alternate between five waves and three waves at all degrees of trend, as the illustration shows. As these waves develop, the larger price patterns unfold in self-similar fractal geometry.

Speculation

Speculation, in the narrow sense of using it as financial speculation, involves the buying, holding, selling, and short-selling of stocks, bonds, commodities, currencies, collectibles, real estate, derivatives, or any valuable financial instrument to profit from fluctuations in its price as opposed to buying it for use or for income via methods such as dividends or interest. Speculation or agiotage represents one of four market roles in Western financial markets, distinct from hedging, long- or short-term investing, and arbitrage. Convention and especially satire sometimes portray speculators comically as speculating in pork bellies (in which a real market and real speculators exist) and often "losing their shirts" or making a fortune on small market changes. Speculation exists in many such commodities, but, if measured by value, the most important markets deal in futures contracts and other derivatives involving leverage that can transform a small market movement into a huge gain or loss. Most non-professional traders lose money on speculation, while those who do make money tend to become professionals. Occasionally some dramatic event will occur, such as the effort of the Hunt brothers to corner the silver market or the currency speculations of George Soros or the speculative trading of Nick Leeson, which caused the collapse of Barings Bank. By some definitions, most long-term investors, even those who buy and hold for decades may be classified as speculators, excepting only the rare few who are not primarily motivated by eventually selling at a good profit. Some dedicated speculators are distinguished by shorter holding times, the use of leverage, by being willing to take short positions as well as long positions (in markets where the distinction can be reasonably made). A degree of speculation exists in a wide range of financial decisions, from the purchase of a house to a bet on a horse; this is what modern market economists call "ubiquitous speculation.

" In *Security Analysis*, Benjamin Graham gave a definition of speculation in relation to investment: "An investment operation is one which, upon thorough analysis, promises safety of principal and a satisfactory return. Operations not meeting these requirements are speculative."

Mark Twain Effect

In some U.S. stock markets, the Mark Twain effect is the phenomenon of stock returns in October being lower than in other months. The name comes from the following quotation attributed to Mark Twain: "October. This is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August, and February." It is interesting to note both the 1929 and 1987 stock market crashes occurred in October.

The Trader's Worst Enemy - a one legged chair

Think of a three legged chair with one leg representing:

1. Emotional health (family, friends, spiritual needs and personal goals),

2. Physical health (our diets, nutrition, exercise and activities),

3. Financial health (investing, savings, business decisions).

If any one of these legs is broken, you are going to fall flat on your butt, so try and take the time to keep the weight spread out evenly over them all, and keep them all in good shape. In the long run, it is the only way any of us will ever reach a state of "wellbeing" and "happiness" thus developing the state of true wealth intelligence.

Buffett and Short Selling

"You'll see way more stocks that are dramatically overvalued than dramatically undervalued. It's common for promoters to cause a stock to become valued at 5-10 times its true value, but rare to find a stock trading at 10-20% of its true value. So you might think short selling is easy, but it's not. Often stocks are overvalued because there is a promoter or a crook behind it. They can often bootstrap into value by using the shares of their overvalued stock. For example, it it's worth $10 and is trading at $100, they might be able to build value to $50. Then, Wall Street says, "Hey! Look at all that value creation!" and the game goes on. [As a short seller,] you could run out of money before the promoter runs out of ideas. "Everything we've ever thought about shorting worked out eventually, but it's very painful. It's a whole lot easier to make money on the long side. You can't make big money shorting because the risk of big losses means you can't make big bets."

Personality and the Investment Process

Personality is a huge factor in the investment process. At the Australian Investors Association Conference on the Gold Coast in 2012, the founder of Relate Empower Deliver, David Chia, spoke on the subject. Give 10 people exactly the same data, he said, and ask them what they think and they will give you 10 different answers. The data is the same but our personalities conspire to divine 10 unique interpretations. Personalities dictate investment success or failure, not the data. The data is not the determining factor of success or failure, "You" are. It is well understood in the texts that humans are not geared to the investment process because they are geared to emotion, likes, dislikes, even their tax status, none of which have any bearing on where a share price is going to go next but all of which find their way into the investment process. For instance, if you find yourself saying "I hate XYZ" or "I like ABC" about a particular stock, you have a bias that is preventing a clinical decision. Net effect, you should be on the lookout for your own bias and for other people's bias. The more bias, the less effective their advice. Having a predisposition to a particular stock is a dangerous failing. Having a predisposition to optimism in a market that has gone down 9.6 per cent a year for five years is a costly emotional bias. Being predisposed to pessimism is the same. Pride is a bias - the desire not to be wrong - and there are many "experts" whose objectivity has been sacrificed to bias based on their earlier calls. The moment they care about being right or wrong, they have lost value. When it comes to investment, you need to be cold, dispassionate and unaffected. On that basis, who do you trust more: yourself, a guru, or maths, science and a computer chip?

Source: Marcus Padley, author of stock market Newsletter *Marcus Today*

7.

BUFFETT BETS BIG

ON HOUSING

We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful.

Warren Buffett

What does Warren Buffett see that no one else does? In June 2012 he made an outsize bid on bankrupt mortgage lender ResCap loans-the latest example of his bet that the housing market represents a great investment opportunity.

Buffett's Berkshire Hathaway placed bids on a bankrupt mortgage lender that it may not want, in what some investors and observers view as an effort to make more money on Berkshire's stake in the company's bonds. Berkshire has made two bids for Residential Capital, the bankrupt unit of Ally Financial that makes loans and collects payments on them. Both bids were topped by Nationstar Mortgage Holdings, which also makes and services loans. An auction for the unit was due to start later in the year. ResCap's parent, Ally Financial, was previously known as General Motors Acceptance Corp and was once the auto lending arm of what is now General Motors Co.

ResCap was a major subprime lender that became an albatross for GMAC when losses ballooned during the financial crisis. Ally wants to shed ResCap's mortgage liabilities as it seeks to repay government bailouts. Many believe Buffett will buy ResCap if he has to, but would rather drive the price higher for Nationstar. For one thing, Berkshire Hathaway lacks the licenses needed to make mortgage loans. For another, Buffett often shies away from acquiring financial companies outside of the insurance business. But Berkshire Hathaway has much to gain from pushing Nationstar to bid more. Berkshire owned more than $900 million of ResCap junior secured debt as of June, representing more than 40 percent of the total outstanding for that class. Going into the bankruptcy, when Nationstar was bidding $2.4 billion, media reports suggested the secured holders could get 93 cents on the dollar. But the more Nationstar pays the more money Berkshire Hathaway gets. In fact, with the higher offer from Nationstar, secured bondholders were expected to be paid back in full, according to one person involved in the restructuring. Even unsecured creditors were likely to make some recovery. To outsiders, Buffett's strategy makes perfect sense.

"The worst-case scenario is he owns it and he'll just hold onto it," according to one asset manager who has more than $12 million in Berkshire Hathaway stock.

"The best-case scenario is he extracts a higher bid and that helps him on the debt side," he said. "I think it's one of his brighter moves."

Did you know the U.S. housing market has suffered its biggest crash ever, causing a major fall in demand and prices?

More than 7 million homes have been foreclosed - equivalent to the combined Sydney and Melbourne metropolitan areas. The U.S. economy and housing market are at their absolute lowest point in 30 years. Some properties have plummeted from $300,000 to just $40,000. In many instances Americans are literally walking away from their mortgages. American banks are now extremely cautious about lending money for houses, while international buyers are snapping up incredible bargains. But surprisingly the rental returns on these properties has stayed the same. This presents a unique, possibly once in a lifetime opportunity for investors - an opportunity that hasn’t been seen since the great depression of the 1930’s according to some commentators. This has brought on a dramatic swing towards rentals and, in many cases, increased rental returns. The Aussie dollar is at an all time high - at the time of writing it is almost at par with the U.S. dollar. Many readers will painfully recall overseas trips in years gone by when the Aussie dollar was worth around 50 cents!

Recent research shows that U.S. property prices have risen for the third month running!

Where else can you invest approximately $50,000 and immediately star collecting positive cash flow of 15-20% net returns?

Due to the potential of capital growth, low entry point and high rental returns we have established that there is a large demand for United States property amongst Australian and New Zealand Investors yet there are limited services and resources that can assist you in this goal.

For the price the Channel 9 show, ‘The Block’, paid for just one Melbourne property, you could buy almost fifty cash flow positive properties in the U.S. with only 5% deposit!

As a consequence of the U.S. credit crisis combined with these conditions international investors are swooping in now before the U.S. market bounces back up.

Like Warren Buffet, I am bullish about the US Housing market and I have been an active buyer in the market for several years now. No one has a crystal ball when it comes to investing but one savvy investor, American hedge fund manager John Paulson, was prepared to bet on the U.S. property market crashing and as a consequence he made billions of dollars. Paulson became a billionaire by short-selling sub-prime mortgages in 2007, and made $3.5 billion that year. In 2010, he beat a hedge-fund record by making nearly $5 billion. He was ranked 39 on the 2011 *Forbes* list of the world's wealthiest people with a net worth of almost $16 billion. At the time of writing Warren Buffet, arguably the most famous and respected investor of all time was taking a contrarian investor stance by investing in U.S. housing. Australians are well known and respected for their love of owning and investing in real estate and many people have done very well from real estate in the last twenty to thirty years, though at the time of writing, growth prospects have slowed down a little but should still provide stable growth. One of the key points I like to constantly remind people attending my seminars is that the less financial education you have, the more money you will need in order to retire. People with a financial education are often able to do deals with a minimum deposit. Because of the slow down in Australian real estate, as an investor I started looking at other areas of potential growth that might provide a higher return than Australian real estate. As a fan of Buffett's investment strategy when I heard he was bullish on the U.S. housing market recovery I researched the market extensively including exploring many streets and suburbs of U.S. cities to discover how to best profit from U.S. housing and established an entire team to acquire me U.S. properties on mass.

8.

FINAL WORDS FROM

THE SAGE OF OMAHA

In the business world, the rear-view mirror is always clearer than the windshield.

Warren Buffett

Personally, I am now comfortable and happy to be investing in the U.S. real estate market. I have travelled to the U.S. a number of times to study and educate myself and carry out due diligence on potential opportunities in the real estate market there. As a result, my initial fears, scepticism and misconceptions are overcome. Personally I am now excited and driven by the opportunities I found there, and have purchased more U.S. property. Despite it sounding like a tired cliché, I firmly believe the U.S. real estate market currently presents a once in a lifetime opportunity for investors. One of the reasons I am excited about these opportunities is because what would take millions of dollars in Australian real estate to achieve a comfortable retirement position, can be achieved in the U.S. for a fraction of that amount. As an example of the current opportunities at the top end of the U.S. property market, former politician Sarah Palin recently purchased a large house in Phoenix for $1.7 million. Just a few months back an investor had purchased it for $800,000. I personally inspected a huge mansion being offered for $960,000 that would sell for at least $5 million in Australia.

Warren Buffett, the ‘Sage of Omaha', is generally considered to be the world’s most successful investor and has inspired countless copycats and hangerson. His investment vehicle, Berkshire Hathaway, is legendary. Investors would love to know the secret of his success - to know how he became America’s second or third richest man, and a living legend. For most shareholders, Buffet can do no wrong. And the evidence is in the share price. Recently each Class A share in Berkshire Hathaway was worth almost US$130,000. In the last 40 years, Buffett has increased the book value of the company by around 300,000 percent. Buffett has made some brilliant moves in his career, such as turning a $1 billion investment in Wells Fargo into $4 billion; making 500% profits on a massive investment in Geico and in one of his best known and most talked about plays-turning $1 billion into $8 billion with Coca-Cola. Buffett is famous for droll quotes such as

• “I got interested (in business) when I was seven or thereabouts. I wasted my time before that.”

• “Buy businesses that an idiot could run, because one day one will.”

• “We really want to buy from someone who doesn't want to sell.”

As Buffett’s assistant Charlie Munger tells it, Berkshire is totally out of step with modern corporate practice. It buys firms whose management it admires, keeps that management and leaves the companies alone. It is worth more than US$100 billion and has only 16 people in its head office. "The interesting thing is how well it has worked for a great many decades, and how few people copy it," Munger says. Buffett says Berkshire has no incentives to meet profit targets, believing it might encourage people to do something they wouldn't otherwise do to meet those targets. "Businesses don't need quarterly expectations, quarter after quarter," he says. Berkshire does not believe in asset allocation, a basic tenet of most investment companies, where investments are divided between different classes. It just looks for good companies at low prices. Berkshire does not believe in "gin rummy" management either, where one company is discarded and another bought. It doesn't sell companies just because they are losing money.

Buffett remarks that there is no exit from a financial meltdown. "Think about a burning theatre. The only way to leave your seat in a burning financial market is to find someone to take your seat, which isn't easy." Buffett does not give stock tips, and why should he? He does however, from time to time, sound out investment principles in his annual letters to Berkshire Hathaway stockholders, in reports to annual meetings and, from time to time, in the media. His investment secrets can be gleaned from these comments and I have researched some of them for this book. Not surprisingly, they invariably seem to spell out good, common sense, investment principles.

1. The company should be soundly managed. Tests of good management include: share buybacks, good use of retained earnings, sticking to what you know.

2. The company has demonstrated earning capacity with a likelihood of continuation. Tests of earning capacity include: company growth, dealing with inflation, capital expenditure, look through earnings, brand names.

3. The company should have consistently high returns. Warren Buffett would look at both: Returns on equity and Returns on capital.

4. The company should have a prudent approach to debt.

5. The businesses of the company should be simple and the investor should have an understanding of the company.

6. Assuming that all these thresholds are satisfied, the investment should only be made at a reasonable price, with a margin of safety. This is always a matter of independent judgement by the investor but it is relevant to consider: price/earnings ratios, earnings and dividend yields, book value, comparative rates of return

7. Investors need to take a long term approach. Buffett believes, as did Benjamin Graham, that investors should look upon share investment as buying a part of a business. Investors should take the same approach to buying shares as they would if they were buying a business. The only difference is that instead of buying the whole business or a partnership in the business, they are only buying a tiny share.

A prudent investor never buys a business that they do not understand. Similarly, a prudent share investor should never buy shares in a company, whose business they do not understand.

In 1977, Buffett told shareholders in Berkshire Hathaway that their company would only invest in a business that the directors could understand. He has repeated this message many times since and expanded on this theme: ‘We try to stick with businesses we believe we understand. That means they must be relatively simple and stable in character. If a business is complex or subject to constant change we’re not smart enough to predict future cash flows. Incidentally that shortcoming doesn’t bother us.’

Succession Plans

In May 2010, Buffett, months away from his 80th birthday, said he would be succeeded at Berkshire Hathaway by a team consisting of a CEO and three or four investment managers; each of the latter would be responsible for a "significant portion of Berkshire's investment portfolio."

Five months later, Berkshire announced that Todd Combs, manager of the Castle Point Capital hedge fund, would join them as an investment manager. In

September 2011, Berkshire Hathaway announced that 50-year-old Ted Weschler, founder of Peninsula Capital Advisors, will join Berkshire in early 2012 as a second investment manager. In Berkshire Hathaway's annual February 2012 shareholder letter, Buffett said that his successor as CEO had been chosen internally but not named publicly. While the intent of this message was to bolster confidence in the leadership of a "Buffett-less Berkshire", critics have noted that this strategy of choosing a successor without a concrete exit strategy for the sitting CEO often leaves an organization with fewer long-term options, while doing little to calm shareholder fear in reaction to the announcement. One leadership consultant who specializes in CEO succession, noted, "You see this more often with successful founder CEOs. Because they're so good, they want to take the lead in choosing their replacement, [but] most boards try to avoid what Buffett did." “The safest thing, well, greatest asset to own is your own abilities. I mean, no matter what happens in the economy or with currency, if you develop your own talents, I tell the college students that the best thing to have is your chance to develop your own talents. The second best thing is to buy into other people's talents. You know, here's Coca-Cola, and people are going to be drinking it 10 years or 50 years from now, and they're going to be drinking more of it, and they'll make more money. So I don't have any idea what Coca-Cola stock is going to do next week or next month or next year, but I'm pretty darn sure where the company will be in 10 or 20 years. And people beat themselves in the stock market. The stock market, literally, in the 20th century, went from 66 on the Dow to 11,400. And you'd said, ‘How could anybody not have a good experience?’ But millions of people don't because they get excited at the wrong time, and they get depressed at the wrong time. So you've got to put your emotions aside, you've got to give up the idea that you can decide when to buy stocks and when to sell stocks. The time to buy stocks is consistently over time.”

Prostate Cancer

In April 2012 Warren Buffett announced that he has early-stage prostate cancer, and indicated he had no intention of stepping down as head of his investment firm Berkshire Hathaway. In a letter to Berkshire shareholders, Buffett said he had been diagnosed with Stage I prostate cancer and would undergo radiation treatment beginning in mid-July. Imaging tests revealed he had no cancer in any other part of his body, he said. "The good news is that I've been told by my doctors that my condition is not remotely life-threatening or even debilitating in any meaningful way." Buffett said he and his doctors had decided on a two-month treatment of daily radiation, which would restrict his travel "but will not otherwise change my daily routine." "I feel great - as if I were in my normal excellent health - and my energy level is 100 percent," said Buffett. The cancer was discovered during a routine medical check-up that showed an unusually large jump in his blood level of PSA -- a protein that is a prostate-specific antigen produced by the cells of the prostate gland. "I will let shareholders know immediately should my health situation change. Eventually, of course, it will; but I believe that day is a long way off," he said.

In conclusion I trust you have gained not only an incredible insight into arguably the worlds greatest investor of all time but also his detailed specific strategy of investment rules. I am a big believer in the power of education especially what I call a '21st Century Education'. That is one taught by those with a PhD in results as opposed to the education of schools or universities taught by those generally with a PhD in theory. There is no PhD in theory that can make you a millionaire investor only one learnt by modelling successful people like Warren Buffett. As I mentioned at the start of the book, and on numerous radio interviews, modelling billionaires won't guarantee you will become one. However it can certainly help you become a millionaire modelling people like Warren Buffett and entrepreneurs such as Richard Branson, Steve Jobs, Mark Zuckerberg and others.

For many though just learning how to make enough for a comfortable retirement or a nicer lifestyle is more then enough reward for learning and applying the secrets of billionaire investors and entrepreneurs. I wish you well on your investment journey and I hope you have also taken some great life lessons, as well as investment lessons, from Warren Buffet as I have. And importantly I hope that you have a strong understanding that success can be remarkably simple just like Buffett's investment strategy is. However simple doesn't come easy. It takes courage to act and time and patience for results to occur. I would be happy to hear your feedback, your ideas and thoughts or even questions you might have at amie@21stca.com.au . Or visit my blog for more thoughts and life lessons: jamiemcintyre.com

I wish you well,

Jamie McIntyre

CEO of 21st Century Education

September 2012

JAMIE McINTYRE

Co-Founder of 21st Century Education

Jamie McIntyre is the founder of over 12 companies that turn over in excess of $40 million dollars annually. With reach in industries such as education, trading, accounting, finance broking, stock broking, financial services, recruitment, media, publishing and TV, the 21st Century Group has grown to be the largest financial education resource in Australia. 17 years ago Jamie realised the world needed a 21st Century Modern day education rather than the current out-dated education system created in the industrialisation era of the 19th Century. A "21st Century" education that was better than school or university and taught by those with a PhD in Results, not just theory. An Education – For Life! Only 5 years from being almost bankrupt, he had succeeded - Jamie had become a selfmade millionaire. This incredible turnaround can be credited to Jamie's extensive research and to the knowledge he gained from his somewhat unconventional approach of modeling multi-millionaires, entrepreneurs, investors and success coaches. After producing such outstanding results in so many areas of his life, Jamie decided to fulfill a promise he made to one of his personal mentors and pass on what he had learnt to others. From this, the 21st Century Education and the 21st Century Group was born. Today, Jamie has educated more than 450,000 people worldwide and helped thousands achieve financial abundance and long-term success. Nominated for 'Young Australian of the Year' in 1999 for his achievements, Jamie is a successful entrepreneur, investor, sought after success coach, internationally renowned speaker and worldleading educator, sharing the stage with some of the world's most successful entrepreneurs (such as Sir Richard Branson, Harry Dent, Tim Ferriss, and more). He is also the author of numerous globally applauded publications such as the best-selling books 'What I Didn't Learn At School But Wish I Had' and "Think & Grow Rich For The 21st Century".

http://www.JamieMcIntyre.com

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Conclusion

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