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The First Decade

The Partnership had its tenth anniversary during 1966. The celebration was appropriate - an all-time record (both past and future) was established for our performance margin relative to the Dow. Our advantage was 36

This pleasant but non-repeatable experience was partially due to a lackluster performance by the Dow. Virtually all investment managers outperformed it during the year. The Dow is weighted by the dollar price of the thirty

(1) Based on yearly changes in the value of the Dow plus dividends that would have been received through ownership of the Dow during that year. The table includes all complete years of partnership activity.

(2) For 1957-61 consists of combined results of all predecessor limited partnerships operating throughout the entire year after all expenses, but before distributions to partners or allocations to the general partner.

(3) For 1957-61 computed on the basis of the preceding column of partnership results allowing for allocation to the general partner based upon the present partnership agreement, but before monthly withdrawals by limited partners.

On a cumulative or compounded basis, the results are:

Year	Overall Results From Dow	Partnership Results	Limited Partners' Results
1957	- 8.4%	+ 10.4%	+ 9.3%
1957-8	+ 26.9	+ 55.6	+ 44.5
1957-9	+ 52.3	+ 95.9	+ 74.7
1957-60	+ 42.9	+ 140.6	+107.2
1957-61	+ 74.9	+ 251.0	+181.6
1957-62	+ 61.6	+ 299.8	+215.1
1957-63	+ 94.9	+ 454.5	+311.2
1957-64	+131.3	+ 608.7	+402.9
1957-65	+164.1	+ 943.2	+588.5
1957-66	+122.9	+1156.0	+704.2
Annual Compounded Rate	8.3	28.8	23.2

Investment Companies

On the following page is the usual tabulation showing the results of the two largest open-end investment companies (mutual funds) that follow a policy of being, typically, 95-100% invested in common stocks, and the two largest diversified closed-end investment companies.

Year	Mass Inv. Trust (1)	Investors Stock (1)	Lehman (2)	Tri-Cont. (2)	Dow	Limite Partner
1957	-11.4%	-12.4%	-11.4%	- 2.4%	- 8.4%	+ 9.3%
1958	+42.7	+47.5	+40.8	+33.2	+38.5	+32.2
1959	+ 9.0	+10.3	+ 8.1	+ 8.4	+20.0	+20.9
1960	- 1.0	- 0.6	+ 2.5	+ 2.8	- 6.2	+18.6
1961	+25.6	+24.9	+23.6	+22.5	+22.4	+35.9
1962	- 9.8	-13.4	-14.4	-10.0	- 7.6	+11.9
1963	+20.0	+16.5	+23.7	+18.7	+20.6	+30.5
1964	+15.9	+14.3	+14.0	+13.6	+18.7	+22.3
1965	+10.2	+ 9.8	+19.0	+11.1	+14.2	+36.9
1966	- 7.7	-10.0	- 2.6	- 6.9	-15.6	+16.8
Cumulative results	+118.6	+101.6	+138.9	+122.8	+122.9	+704.2
Annual compounded rate	8.1	7.3	9.1	8.3	8.3	23.2

(1) Computed from changes in asset value plus any distributions to holders of record during year.

(2) From 1966 Moody's Bank & Finance Manual for 1957-1965. Estimated for 1966.

These investment company performance figures have been regularly reported here to show that the Dow is no patsy as an investment standard. It should again be emphasized that the companies were not selected on the basis of comparability to Buffett Partnership, Ltd. There are important differences including: (1) investment companies operate under both internally and externally imposed restrictions on their investment actions that are not applicable to us; (2) investment companies diversify far more than we do and, in all probability, thereby have less chance for a really bad performance relative to the Dow in a single year; and (3) their managers have considerably less incentive for abnormal performance and greater incentive for conventionality.

However, the records above do reveal what well-regarded, highly paid, full-time professional investment managers have been able to accomplish while working with common stocks. These managers have been favorites of American investors (more than 600,000) making free choices among many alternatives in the investment management field. It is probable that their results are typical of the overwhelming majority of professional investment managers.

It is not true, however, that these are the best records achieved in the investment field. A few mutual funds and some private investment operations have compiled records vastly superior to the Dow and, in some cases, substantially superior to Buffett Partnership, Ltd. Their investment techniques are usually very dissimilar to ours and not within my capabilities. However, they are generally managed by very bright, motivated people and it is only fair that I mention the existence of such superior results in this general discussion of the record of professional investment management.

Trends in Our Business

A keen mind working diligently at interpreting the figures on page one could come to a lot of wrong conclusions.

The results of the first ten years have absolutely no chance of being duplicated or even remotely approximated during the next decade. They may well be achieved by some hungry twenty-five year old working with $105,100 initial partnership capital and operating during a ten year business and market environment which is frequently conducive to successful implementation of his investment philosophy.

They will not be achieved by a better fed thirty-six year old working with our $54,065,345 current partnership capital who presently finds perhaps one-fifth to one-tenth as many really good ideas as previously to implement his investment philosophy.

Buffett Associates, Ltd. (predecessor to Buffett Partnership, Ltd.) was founded on the west banks of the Missouri, May 5, 1956 by a hardy little band consisting of four family members, three close friends and $105,100. (I tried to find some brilliant flash of insight regarding our future or preser conditions from my first page and a half annual letter of January, 1957 to insert as a quote here. However, someone evidently doctored my file copy so as to remove the perceptive remarks I must have made.)

At that time, and for some years subsequently, there were substantial numbers of securities selling at well below the "value to a private owner" criterion we utilized for selection of general market investments. We also experienced a flow of "workout" opportunities where the percentages were very much to our liking. The problem was always which, not what. Accordingly, we were able to own fifteen to twenty-five issues and be enthusiastic about the probabilities inherent in all holdings.

In the last few years this situation has changed dramatically. We now find very few securities that are understandable to me, available in decent size and which offer the expectation of investment performance meeting our yardstick of ten percentage points per annum superior to the Dow. In the last three years we have come up with only two or three new ideas a year that have had such an expectancy of superior performance. Fortunately, in some cases, we have made the most of them. However, in earlier years, a lesser effort produced literally dozens of comparable opportunities. It is difficult to be objective about the causes for such diminution of one's own productivity. Three factors that seem apparent are: (1) a somewhat changed market environment; (2) our increased size; and (3) substantially more competition.

It is obvious that a business based upon only a trickle of fine ideas has poorer prospects than one based upon a steady flow of such ideas. To date the trickle has provided as much financial nourishment as the flow. This is true because there is only so much one can digest (million dollar ideas are of no great benefit to thousand dollar bank accounts - this was impressed on me in my early days) and because a limited number of ideas causes one to utilize those available more intensively. The latter factor has definitely been operative with us in recent years. However, a trickle has considerably more chance of drying up completely than a flow.

These conditions will not cause me to attempt investment decisions outside my sphere of understanding (I don't go for the "If you can't lick 'em, join 'em" philosophy - my own leaning is toward "If you can't join 'em, lick 'em"). We will not go into businesses where technology which is away over my head is crucial to the investment decision. I know about as much about semi-conductors or integrated circuits as I do of the mating habits of the chrzaszcz. (That's a Polish May bug, students - if you have trouble pronouncing it, rhyme it with thrzaszcz.)

Furthermore, we will not follow the frequently prevalent approach of investing in securities where an attempt to anticipate market action overrides business valuations. Such so-called "fashion" investing has frequently produced very substantial and quick profits in recent years (and currently as I write this in January). It represents an investment technique whose soundness I can neither affirm nor deny. It does not completely satisfy my intellect (or perhaps my prejudices), and most definitely does not fit my temperament. I will not invest my own money based upon such an approach - hence, I will most certainly not do so with your money.

Finally, we will not seek out activity in investment operations, even if offering splendid profit expectations, where major human problems appear to have a substantial chance of developing.

What I do promise you, as partners, is that I will work hard to maintain the trickle of ideas and try to get the most out of it that is possible - but if it should dry up completely, you will be informed honestly and promptly so that we may all take alternative action.

Analysis of 1966 Results

All four main categories of our investment operation worked out well in 1966. Specifically, we had a total overall gain of $8,906,701 derived as follows:

Category	Average Investment	Overall Gain
Controls	$ 17,259,342	$ 1,566,302
Generals - Private Owner	1,359,340	1,004,362
Generals - Relatively Undervalued	21,847,045	5,124,254
Workouts	7,666,314	1,714,181
Miscellaneous, including U. S. Treasury Bills	1,332,609	(18,422)
Total Income		$ 9,390,677
Less: General Expense		483,976
Overall Gain		$ 8,906,701

A few caveats are necessary before we get on with the main discussion:

1. An explanation of the various categories listed above was made in the January 18, 1965 letter. If your memory needs refreshing and your favorite newsstand does not have the pocketbook edition, we'll be glad to give you a copy.

2. The classifications are not iron-clad. Nothing is changed retroactively but the initial decision as to category is sometimes arbitrary.

investment operations, such as dividends paid on short stock, are deducted by category. When securities are borrowed directly and sold short, the net investment (longs minus shorts) is shown for the applicable average investment category.

5. The above table has only limited use. The results applicable to each category are dominated by one or two investments. They do not represent a collection of great quantities of stable data (mortality rates of all American males or something of the sort) from which conclusions can be drawn and projections made. Instead, they represent infrequent, non-homogeneous phenomena leading to very tentative suggestions regarding various courses of action and are so used by us.

6. Finally, these calculations are not made with the same loving care we apply to counting the money and are subject to possible clerical or mathematical error since they are not entirely self-checking.

Controls

There were three main sources of gain during 1966 in respect to controlled companies. These arose through: (1) retained business earnings applicable to our holdings in 1966; (2) open market purchases of additional stock below our controlling interest valuation and; (3) unrealized appreciation in marketable securities held by the controlled companies. The total of all positive items came to $2,600,838 in 1966.

However, due to factors mentioned in my November 1, 1966 letter, specific industry conditions, and other relevant valuation items, this gain was reduced by $1,034,780 in arriving at our fair valuation applicable to controlling interests as of December 31, 1966. Thus the overall gain in the control category was reduced to $1,566,058 for the year.

We were undoubtedly fortunate that we had a relatively high percentage of net assets invested in businesses and not stocks during 1966. The same money in general market holdings would probably have produced a loss, perhaps substantial, during the year. This was not planned and if the stock market had advanced substantially during the year, this category would have widely held security which was selling far below its value to a private owner. Our hope was that over a two or three year period we could get $10 million or more invested at the favorable prices prevailing. The various businesses that the company operated were understandable and we could check out competitive strengths and weaknesses thoroughly with competitors, distributors, customers, suppliers, ex-employees, etc. Market conditions peculiar to the stock gave us hope that, with patience, we could buy substantial quantities of the stock without disturbing the price.

At yearend 1965 we had invested $1,956,980 and the market value of our holding was $2,358,412 so that $401,432 was contributed to performance during 1965. We would have preferred, of course, to have seen the market below cost since our interest was in additional buying, not in selling. This would have dampened Buffett Partnership, Ltd.'s 1965 performance and perhaps reduced the euphoria experienced by limited partners (psychically, the net result to all partners would have been a standoff since the general partner would have been floating) but would have enhanced long term performance. The fact that the stock had risen somewhat above our cost had already slowed down our buying program and thereby reduced ultimate profit.

An even more dramatic example of the conflict between short term performance and the maximization of long term results occurred in 1966. Another party, previously completely unknown to me, issued a tender offer which foreclosed opportunities for future advantageous buying. I made the decision that the wisest course (it may not have been) for us to follow was to dispose of our holdings and we thus realized a total profit of $1,269,181 in February, of which $867,749 was applicable to 1966.

While any gains looked particularly good in the market environment that ultimately developed in 1966, you can be sure I don't delight in going around making molehills out of mountains. The molehill, of course, was reflected in 1966 results. However, we would have been much better off from a long range standpoint if 1966 results had been five percentage points worse and we were continuing to buy substantial quantities of the stock at the depressed prices that might have been expected to prevail in last year's market environment.

If good ideas were a dime a dozen, such a premature ending would not be so unpleasant. There is something to be said, of course, for a business operation where some of the failures produce moderate profits. However, you can see how hard it is to develop replacement ideas by examining our average investment in the Private Owner category - we came up with nothing during the remainder of the year despite lower stock prices, which should have been conducive to finding such opportunities.

Generals - Relatively Undervalued

Our relative performance in this category was the best we have ever had - due to one holding which was our largest investment at yearend 1965 and also yearend 1966. This investment has substantially out-performed the general market for us during each year (1964, 1965, 1966) that we have held it. While any single year's performance can be quite erratic, we think the probabilities are highly favorable for superior future performance over a three or four year period. The attractiveness and relative certainty of this particular security are what caused me to introduce Ground Rule 7 in November, 1965 to allow individual holdings of up to 40% of our net assets. We spend considerable effort continuously evaluating every facet of the company and constantly testing our hypothesis that this security is superior to alternative investment choices. Such constant evaluation and comparison at shifting prices is absolutely essential to our investment operation.

It would be much more pleasant (and indicate a more favorable future) to report that our results in the Generals - Relatively Undervalued category represented fifteen securities in ten industries, practically all of which outperformed the market. We simply don't have that many good ideas. As mentioned above, new ideas are continually measured against present ideas and we will not make shifts if the effect is to downgrade expectable performance. This policy has resulted in limited activity in recent years when we have felt so strongly about the relative merits of our largest holding. Such a condition has meant that realized gains have been a much smaller portion of total performance than in earlier years when the flow of good ideas was more substantial.

The sort of concentration we have in this category is bound to produce wide swings in short term performance - some, most certainly, unpleasant. There have already been some of these applicable to shorter time spans than I use in reporting to partners. This is one reason I think frequent reporting to be foolish and potentially misleading in a long term oriented business such as ours.

Personally, within the limits expressed in last year's letter on diversification, I am willing to trade the pains (forget about the pleasures) of substantial short term variance in exchange for maximization of long term performance. However, I am not willing to incur risk of substantial permanent capital loss in seeking to better long term performance. To be perfectly clear - under our policy of concentration of holdings, partners should be completely prepared for periods of substantial underperformance (far more likely in sharply rising markets) to offset the occasional over-performance such as we have experienced in 1965 and 1966, and as a price we pay for hoped-for good long term performance.

All this talk about the long pull has caused one partner to observe that "even five minutes is a long time if one's head is being held under water." This is the reason, of course, that we use borrowed money very sparingly in our operation. Average bank borrowings during 1966 were well under 10% of average net worth.

One final word about the Generals - Relatively Undervalued category. In this section we also had an experience which helped results in 1966 but hurt our long term prospects. We had just one really important new idea in this category in 1966. Our purchasing started in late spring but had only come to about $1.6 million (it could be bought steadily but at only a moderate pace) when outside conditions drove the stock price up to a point where it was not relatively attractive. Though our overall gain was $728,141 on an average holding period of six and a half months in 1966, it would have been much more desirable had the stock done nothing for a long period of time while we accumulated a really substantial position.

Workouts

In last year's letter I forecast reduced importance for workouts. While they were not of the importance of some past years, I was pleasantly surprised by our experience in 1966 during which we kept an average of $7,666,314 employed in this category. Furthermore, we tend to ascribe borrowings to the workout section so that our net equity capital employed was really something under this figure and our return was somewhat better than the 22.4% indicated on page six. Here, too, we ran into substantial variation. At June 30, our overall profit on this category was $16,112 on an average investment of $7,870,151, so that we really had a case of an extraordinarily good second half offsetting a poor first half.

In past years, sometimes as much as 30-40% of our net worth has been invested in workouts, but it is highly unlikely that this condition will prevail in the future. Nevertheless, they may continue to produce some decent returns on the moderate amount of capital employed.

Miscellaneous

Operationally, we continue to function well above rated capacity with Bill, John, Elizabeth and Donna all contributing excellent performances. At Buffett Partnership, Ltd. we have never had to divert investment effort to offset organizational shortcomings and this has been an important ingredient in the performance over the years.

Peat, Marwick, Mitchell & Co., aided for the second year by their computer, turned in the usual speedy, efficient and comprehensive job.

We all continue to maintain more than an academic interest in the Partnership. The employees and I, our spouses and children, have a total of over $10 million invested at January 1, 1967. In the case of my family, our Buffett Partnership, Ltd. investment represents well over 90% of our net worth.

Within the coming two weeks you will receive:

1. A tax letter giving you all BPL information needed for your 1966 federal income tax return. This letter is the only item that counts for tax purposes.