INVESTMENT PHILOSOPHY
July 2024

I view investing in common stocks as a way to build a personal holding company that owns shares in the best businesses across the globe. And in owning that share, I act not as a trader but an owner of the entire business. The construction of the portfolio, therefore, consists of a few selected holdings that ideally need not to be sold.

Limited hedging strategies, like derivatives and swaptions, may be used to protect investment capital during market downturns.

Market
Market is a tool that simplifies the price negotiations. Unlike private M&As, where customized deals allow the share price to be more efficient, the public market occasionally offers foolish prices to the buyers (1994 Berkshire Hathaway Annual Meeting). And the market permits buyers to wait until the price comes down or walk away with near zero effect on the deal. Prices may also decline during an acquisition, potentially increasing the expected return without requiring any effort from the acquirer.

> *Warren Buffett, Chairman and CEO of Berkshire Hathaway, in the 1997 Berkshire Hathaway Shareholder's Letter:*
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> *A short quiz: If you plan to eat hamburgers throughout your life and are not a cattle producer, should you wish for higher or lower prices for beef? Likewise, if you are going to buy a car from time to time but are not an auto manufacturer, should you prefer higher or lower car prices? These questions, of course, answer themselves.*
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> *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.*

Target Companies
- Understandable.
- Consistent earning power. Projections are of no interest.
- Good returns on equity with little to no debt
- Competent management with an above-average track record.

> 1*993 Berkshire Hathaway Shareholder's Letter:*
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> *We prefer instead to focus on the economic characteristics of businesses that we wish to own and the personal characteristics of managers with whom we wish to associate - and then to hope we get lucky in finding the two in combination.*

Valuation
The essence of true business analysis lies in qualitative aspects such as barriers to entry, pricing power and others that are of business fundamentals. Quantitative measures help provide a framework for the analyst to form their qualitative opinions.

> To*dd Combs, one of the two investment managers at Berkshire Hathaway, on the I Am Home Podcast:*
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> *And so when Warren and I would talk about stocks, acquisitions, whatever, we talked… it's 95, 99%, qualitative. And that comes down to all the stuff that you talked about in terms of moats, barriers to entry, all the stuff. You're not getting that necessarily in a filing or an annual report. You get a sense for it. It's a starting point, but you want to work essentially inside out. And I think that is what I mean by that is starting with the details, and then those details form the foundation from which you can build upon that.*

Risk
The correct measure of investment risk is not a stock's volatility but the performance of its underlying business relative to the price paid for its shares. The definition of risk in a business should not change simply because its shares are listed on an exchange.

> 1987 *Berkshire Hathaway Shareholder's Letter:*
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> *In our opinion, the real risk that an investor must assess is whether his aggregate after-tax receipts from an investment (including those he receives on sale) will, over his prospective holding period, give him at least as much purchasing power as he had to begin with, plus a modest rate of interest on that initial stake. Though this risk cannot be calculated with engineering precision, it can in some cases be judged with a degree of accuracy that is useful. The primary factors bearing upon this evaluation are:*
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> 1. *The certainty with which the long-term economic characteristics of the business can be evaluated;*
> 2. *The certainty with which management can be evaluated, both as to its ability to realize the full potential of the business and to wisely employ its cash flows;*
> 3. *The certainty with which management can be counted on to channel the rewards from the business to the shareholders rather than to itself;*
> 4. *The purchase price of the business;*
> 5. *The levels of taxation and inflation that will be experienced and that will determine the degree by which an investor's purchasing-power return is reduced from his gross return.*
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> *2007 Berkshire Hathaway Annual Meeting:*
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> *Volatility is not a measure of risk. And the problem is that the people who have written and taught about volatility do not know how to measure -- or, I mean, taught about risk -- do not know how to measure risk. And the nice thing about beta, which is a measure of volatility, is that it's nice and mathematical and wrong in terms of measuring risk. It's a measure of volatility, but past volatility does not determine the risk of investing*
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> *I mean, actually, take it with farmland. Here in 1980, or in the early 1980s, farms that sold for $2,000 an acre went to $600 an acre. I bought one of them when the banking and farm crash took place.*
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> *And the beta of farms shot way up. And according to standard economic theory or market theory, I was buying a much more risky asset at $600 an acre than the same farm was at $2,000 an acre. Now, people, because farmland doesn't trade often and prices don't get recorded, you know, they would regard that as nonsense, that my purchase at $600 an acre of the same farm that sold for 2,000 an acre a few years ago was riskier. But in stocks, because the prices jiggle around every minute, and because it lets the people who teach finance use the mathematics they've learned, they have -- in effect, they would explain this a way a little more technically -- but they have, in effect, translated volatility into all kinds of -- past volatility -- in terms of all kinds of measures of risk.*
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> *Risk comes from the nature of certain kinds of businesses. It can be risky to be in some businesses just by the simple economics of the type of business you're in, and it comes from not knowing what you're doing. And, you know, if you understand the economics of the business in which you are engaged, and you know the people with whom you're doing business, and you know the price you pay is sensible, you don't run any real risk.*

Allocation
To mitigate the risk of one or more businesses failing within a portfolio, diversification is essential. However, diversification is meaningful only when it considers the correlations between sectors to avoid merely replicating a market index. Over-diversification allows for an average (indexed) performance, for which itself loses the purpose of investing in individual companies.

My conviction is that any portfolio allocation less than ~5% is meaningless (given that the capital one manages is less than tens of billions of dollars). Owning a select few—between 3 to 10—exceptional businesses across sufficiently uncorrelated sectors is enough to manage exposure risks while achieving superior results.

> Ma*rk Sellers of Sellers Capital during his speech So You Want To Be The Next Warren Buffett? How is Your Writing?:*
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> *…Personally, I'm amazed at how little conviction most investors have in the stocks they buy. Instead of putting 20% of their portfolio into a stock, as the Kelly Formula might say to do it, they'll put 2% into it. Mathematically, using the Kelly Formula, it can be shown that a 2% position is the equivalent of betting on a stock that has only a 51% chance of going up, and a 49% chance of going down. Why would you waste your time even making that bet?*
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> *Charlie Munger, the former Vice-Chairman of Berkshire Hathaway, at the 2019 Daily Journal Annual Meeting:*
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> *I had a grandfather who was very useful to me. My mother's grandfather. He was a pioneer. He came out to Iowa with no money but youth and health and took it away from the Indians. He was a captain in the Blackhawk Wars and he stayed there and he bought cheap land and he was aggressive and intelligent and so forth. Eventually he was the richest man in the town and owned the bank. Highly regarded. Huge family. Very happy life.*
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> *He had the attitude, having come out to Iowa when the land was not much more than a dollar an acre and having stayed there until that black topsoil created the modern rich civilization and some of the best land in the world. His attitude was that a favored life like his, when you're located in the right place, he just got a few opportunities if you lived to be about ninety, and the trick in coming out well was seizing a few opportunities that were your fair share that came along when they did.*
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> *He told that story over and over again to the grandchildren around him all summer and my mother, who had no interest in money, remembered the story and told it to me.*
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> *But I'm not my mother's natural imitator and I knew grandpa was right and so I always knew from the very first… When I was a little boy, the opportunities that were important, that were gonna come to me were few. and that the trick was to prepare myself for seizing the few that came. This is not the attitude they have at a big investment counseling thing. They think that if they study a million things, they can know a million things. And of course, the result is almost nobody can outperform an index.*
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> *Whereas I sit here with my Daily Journal stock, my Berkshire Hathaway stock, my holdings in Li Lu's Asian fund, my Costco stock and, of course, I am outperforming everybody. And I'm 95 years old. And I probably may never have a transaction.*
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> *And the answer is I'm right and they're wrong. And that's why it's worked for me and not for them. And now the question is do you want to be more like me or more like them?*
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> *The idea of diversification makes sense to a point. If you don't know what you're doing and you want the standard result and not be embarrassed, why, of course, you can widely diversify. Nobody's entitled to a lot of money for recognizing that because it's a truism. It's like knowing that two and two equals four. But the investment professionals think they're helping you by arranging diversification. An idiot can diversify a portfolio or a computer for that matter.*
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> *But the whole trick of the game is to have a few times when you know that something is better than average and invest only where you have that extra knowledge. And then if you get just a few opportunities that's enough. What the hell do you care if you own three securities and JPMorgan Chase owns a hundred. You know, what's wrong with only a few securities?*
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> *Warren always said that if you lived in a growing town and you owned stock in three of the best enterprises in the town, isn't that diversified enough? The answer is: of course, it is. They're all wonderful places.*
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> *And that "Fortune's Formula", which got so famous, which was a formula to tell people how much to bet on each transaction, if you had an edge. And, of course, the bigger your edge, the closer the*

transaction was to a certain winner, the more you should bet. And of course, there's mathematics behind it. But of course, it's true. It's perfectly possible to buy only one thing because the opportunity is so great and such a cinch, or only two or three.

So the whole idea of diversification, if you're looking for excellence, is totally ridiculous. It doesn't work. It gives you an impossible task. What fun is it to do an impossible task over and over again. I find it agonizing. And just who would want to do it?