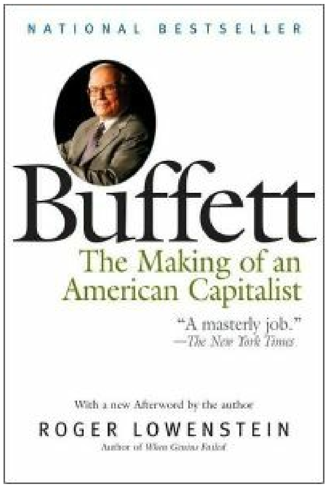

Book **Buffett**

The Making of an American Capitalist

Roger Lowenstein
Random House, 2008
First Edition:1995

Recommendation

Bill Gates, Sam Walton and John D. Rockefeller became immensely wealthy by developing innovative businesses. Warren Buffett became rich by picking stocks better than anyone else. *Forbes* recently listed him as the world's richest man, but he lives in the same Omaha house he bought for $31,500 in 1958. He drives his own car, prepares his own taxes, wears inexpensive suits and does not employ servants beyond an "every other week" housekeeper. Buffett is a simple man with simple tastes. He likes hamburgers, Cherry Cokes and peanuts. Financial journalist Roger Lowenstein does a masterful job of reporting on Buffett's life and explaining his straightforward, common sense investing approach without speculation, fancy charts or complex technical analysis. Buffett focuses on three basics: tolerable risk, a company's value and its stock price. If the price is well below the true value, he's interested. Buffett used this easy-to-understand formula to build his fortune. It must work: When the book went to print, Buffett had a net worth of $64 billion. Using fascinating historical detail and colorful anecdotes, Lowenstein explains how Buffett did it. If you want to know, *BooksInShort* recommends reading this book.

Take-Aways

- Warren Buffett is the world's greatest investor. No one else even comes close.
- Buffett is astute at analyzing the financial value of companies.
- Three main factors guide his investments: tolerable risk, a company's basic worth and a market valuation that is significantly lower than that worth.
- Buffett's principal investment rule: "Never lose money."
- Better than any of his contemporaries, Buffett understands that the market always "catches up" with value.
- Buffett cares primarily about a business's long-term value and wants his shareholders to have the same priority.
- Thus, Buffett normally holds onto investments for years, just as he does his friends.
- Buffett treats his enterprises' investors as partners, not as faceless shareholders.
- This runs counter to most CEOs' treatment of shareholders as changeable entities, like diners at a restaurant.
- Anyone can use Buffett's stock selection strategy. It requires an understanding of business, and careful review of annual reports and similar information.

Summary

An Investor in a Class by Himself

To see how truly superior Warren Buffett is at picking stocks, envision a chart depicting the value of his company, Berkshire Hathaway, compared to the Dow Jones Industrial Average. Over the course of many years, Berkshire's line on the chart begins to shoot straight up. During the same period, the Dow's line meanders in a vaguely vertical direction, looking like a weathered hillside silhouette. Of course, the difference is not surprising. Berkshire Hathaway is Buffett's holding company and primary investment vehicle. And Buffett is the world's most astute investor.

> "In the annals of investing, Warren Buffett stands alone."

When Buffett invested in Berkshire Hathaway in 1962, its stock was valued at $7.60. By 2007, a single share cost $141,600. No one in history has been better at analyzing stock values and making investment decisions. If you had invested $10,000 in Buffett's portfolio partnership in 1956 and stayed with it, your money would have grown to $550 million. A good return on investment? There has never been anything like it.

The "Oracle from Omaha"

Warren Edward Buffett was born in Omaha, Nebraska, on August 30, 1930. His father, Howard, sold stock and bonds. His pretty, petite mother, Leila, was a former college girl who joked that she had "majored in marrying." Buffett was a precocious child who was excellent with numbers and who enjoyed charting stock prices. From his earliest days, he planned to be a millionaire by age 30. His proudest possession as a young boy was a metal coin changer. Very early, Buffett started building his assets. At age six, he sold Cokes door to door. When he was 11, Buffett made his first investment: "three shares of Cities Service preferred...at $38 a share." His favorite book was *One Thousand Ways to Make $1,000*.

> "I will tell you the secret of getting rich on Wall Street...You try to be greedy when others are fearful and you try to be very fearful when others are greedy." [– Warren Buffett]

During high school, Buffett had numerous businesses, including magazine sales and newspaper deliveries (he had five routes). He sold errant golf balls that he paid neighborhood children to find. In 1945, at age 14, he invested his savings in a 40-acre Nebraska farm. After graduation from high school, he briefly attended the University of Pennsylvania, but he transferred back to his home state and later graduated from the University of Nebraska.

Ben Graham

After Nebraska, Buffett attended Columbia University's Business School. In New York, he studied under investment guru Benjamin Graham. Co-author of *Security Analysis*, a seminal work, Graham was famous for his idiosyncratic investment philosophy. He did not "watch the tape"; instead, he looked for companies with low stock prices. He invested only in viable businesses with good "earnings, assets, future prospects and so forth." He focused on "intrinsic value that was independent of...market price." Graham bought stocks when their prices were lower than the business's basic value. He trusted that, over time, the market prices would catch up with the value. Graham was an exceedingly cautious investor. His primary goal was not to "make money – it was to avoid losing any."

> "For Warren, who had witnessed the Depression and the war as a child, government was society's defender, not its enemy."

Buffett soaked up this sensible philosophy. To him, Graham's concepts were the Rosetta stone. In 1951, Buffett received his M.S. in economics. After graduation, he worked for Graham in New York City. When Graham retired and moved to Beverly Hills, Buffett returned to Omaha.

Off and Running

By this time, Buffett had married Susan Thompson and they had started a family. Buffett launched his own investment firm, Buffett Associates Ltd., and ran it from his bedroom. He developed an investment pool for his friends and family. He started with $105,000 in capital and, as general partner, put up only $100 of his own cash. At 26, he was confident he would become rich quickly. An avid reader of annual reports, Moody's analyses and the financial pages, Buffett "was familiar with virtually every stock and bond in existence."

> "Graham was far more than Buffett's tutor. It was Graham who provided the first reliable map to that wondrous and often forbidding city, the stock market."

Buffett set a personal goal of beating the Dow "by an average of 10 points a year." With this in mind, he set exacting terms for his partners. He refused to disclose his investment options. He would provide only an annual summary of his results. Partners could add or withdraw money just one day each year. Otherwise, Buffett invested their capital as he saw fit. He did not charge a management fee, but he got a percentage of the returns he realized for his partners. If he had failed to earn profits for them, he would have made no income.

> "The Buffetts started out in a $65-a-month, three-room apartment...so run-down that mice crawled into their shoes at night."

Buffett achieved a strong 10% return in his first year, a period when the Dow suffered an 8% drop. By his third year, Buffett had doubled his partners' initial investments. After five years, the partnership's returns were up 251% (whereas the Dow went up 74.3%). With such stunning results, Buffett had no problem picking up new investment partners. By 1962, the partnership had $7.2 million in investment capital. Buffett did his own research and trusted his own judgment, using Graham's formula of choosing low-priced stocks of companies with good fundamentals.

> "When Buffett gave his kids a loan, they had to sign a loan agreement."

Soon, Buffett added another partner, Charlie Munger, a brilliant West Coast lawyer with a degree from Harvard Law. After they started doing business, Munger began running his own investment partnership. Buffett found it "spooky" that he and Munger were so similar in philosophy and thought. The two men worked closely together for many years. They co-invested in extensive enterprises, including Buffett's crown jewel, Berkshire Hathaway.

Berkshire Hathaway

Over the years, Buffett continued to make superbly smart investment decisions. In the process, he made his partners wildly rich. He invested in many companies, including American Express (he loved its brand), GEICO (he liked its plentiful cash) and Disney (he understood the value of its library of classic animated features). Buffett expanded on Graham's philosophy. Rather than looking at companies as just accumulations of numbers, as Graham did, Buffett looked at them qualitatively in terms of their growth potential. This approach worked. By 1963, Buffett was a millionaire four times over.

> "Though skeptical of government bailouts, Buffett definitely did not share the neoconservative faith that marketplace judgments were inherently correct."

Berkshire Hathaway, a manufacturer of men's suit liners based in New Bedford, Massachusetts, caught Buffett's eye. In 1962, its stock sold for $7.60 per share, but it had "$16.50 of working capital." Buffett quickly invested. By 1963, the Buffett Partnership was Berkshire Hathaway's largest shareholder. Over time, Buffett bought more Berkshire stock. He became a director of the firm, then chairman of its executive committee. By 1965, he was fully in charge. In 1967, he bought another promising firm, National Indemnity, in Omaha. Buffett loved insurance companies because they sat on huge pools of funds. He could use National Indemnity's cash to invest in other businesses. By this time, Buffett was plowing Berkshire's capital into investments in publishing, banking and other fields.

> "Buffett's Salomon investment...puts him in bed with Wall Streeters, whose general greed he has scorned in the past." [– financial journalist Carol Loomis, *Fortune*]

Then, in 1969, at the peak of a bull market, Buffett liquidated his partnership, although he allowed his partners to keep their proportional holdings in two investments, one of which was Berkshire Hathaway. Buffett had become suspicious of the highly speculative nature of the stock market at the time. Plus, he was tired of the "rat race" of portfolio management. Instead, he wanted to focus exclusively on "long-term, controlled companies, such as Berkshire." Right after Buffett got out of the market, it crashed. Once again, the Oracle of Omaha had timed things perfectly.

A Time for Tap Dancing

During the early 1970s, stocks were remarkably cheap. Buffett, who had invested most of the money he controlled in bonds, began to buy stocks again. Seeing great bargains everywhere, he bought extensively. His initial purchases included California Water Service, General Motors, Omaha National and Scripps-Howard Investment. He was elated about making incredibly valuable purchases at deep discounts. Some mornings, he would wake and "want to tap-dance."

> "From Buffett's viewpoint, everybody wanted a piece of him, like camera-toting tourists pursuing a colorful native."

Buffett invested heavily in the Washington Post Co., Interpublic, Coca-Cola, GEICO (for the second time) and Salomon Brothers. In 1991, Buffett temporarily became Salomon's chairman amid an infamous U.S. Treasury bond scandal that nearly killed the prestigious Wall Street investment firm. Buffett also bought the U.S.'s largest furniture retailer, the Nebraska Furniture Mart, which had annual sales of $100 million. Rose Blumkin, then an 89-year-old dynamo, owned and ran it. "Mrs. B" was still working at the Mart seven days a week when she reached 99.

> "Asked once if he could play the piano, Munger replied, 'I don't know; I never tried.' Buffett saw in him a kindred intellect and blistering independence."

The 1990s were a perfect time for an investor like Buffett, who focused not on macroeconomic trends, or stock ups and downs, but on the fundamental value of businesses. "Now is the time to invest and get rich," Buffett told *Forbes*. And so he did. Buffett became a billionaire, then a multibillionaire, then a multi-multibillionaire – and, eventually, the richest man in the world.

Giving Away His Money

Buffett and his wife set up their charitable organization, the Buffett Foundation, in the 1970s. By 2006, in his 70s, Buffett began to plan for his eventual death. He decided to give five-sixths of his fortune to the Bill and Melinda Gates Foundation, which fights diseases in Third-World nations, among many other activities. Why not donate his fortune to his own foundation? Buffett's generous, humble gesture is typical of his unassuming personality. Bill Gates and Buffett were close friends, but more than anything else, Buffett believes in working inside of his own "circle of competence" – which does not include charitable giving. Buffett is sure the Gates Foundation will do a better job of donating his money to worthwhile causes than he would have.

In a Nutshell: Buffett's Investment Philosophy

All his life, Buffett eschewed the latest Wall Street fads, investment strategies, complex technical analyses (charting) and assorted voodoo approaches for picking stocks. Buffett's method is simple (but not easy), straightforward and logical: Search for stocks with inherent long-term value that substantially exceeds their current market prices. Of course, doing this in an informed, effective manner requires a solid understanding of business, as well as a discerning eye. The idea is to see a stock "as a share of a business, rather than as a blip on a screen."

> "If you gave me $100 billion and said take away the soft drink leadership of Coca-Cola in the world, I'd give it back to you and say it can't be done." [– Buffett]

To emulate Buffett, the potential investor must pore over annual reports, trade publications and other background materials to secure the most reliable, revealing information. Buffett loved doing such research, though others may find it tedious. Can the average investor get results with this approach? Absolutely, says Munger, Buffett's long-term partner and alter ego. "Hundreds of thousands can perform quite well – materially better – than they otherwise might," said Munger, who calls Buffett's system "perfectly learnable." Buffett's primary investment guidelines include:

- **Ignore analysts' forecasts** – Also, don't worry about macroeconomic trends. Pay close attention to one bedrock characteristic: "long-term business value."
- **Don't buy what you don't understand** – Invest in what you know, that is, your own circle of competence. You cannot correctly valuate a stock you do not understand.
- **Strong management counts** – Seek companies where the executives put their shareholders' interests above their own. This does not include firms where CEOs pay themselves obscene salaries, and take immense benefits and other gilded perks.
- **Study the competition** – Learn the field comprehensively. Don't get mired in analysts' summaries. Trust what you learn independently, your instincts and your common sense.
- **Select the gold, not the dross** – Merrill Lynch could always recommend for or against any stock. Not Buffett. He focuses his research on only a few potential winners.
- **Don't buy a stock until you are certain you are ready** – Then buy as much of it as you can. After his 1985 Cap Cities purchase, Buffett did not buy common stock for three years. But when Coca-Cola's price became attractive, Buffett quickly purchased a block of its stock equal to about 25% of Berkshire

Hathaway's market value.

About the Author

Financial journalist **Roger Lowenstein** worked many years for *The Wall Street Journal*. He wrote the newspaper's "Heard on the Street" column from 1989 to 1991.