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Introduction:

The *Graham-Buffett* Course sequence is important to this college because it enables us to attract students who want this perspective on investing and managing corporations—a perspective that has been successfully employed by Mr. *Buffett*, Mr. Hawkins and before them, *Benjamin Graham*.

This perspective is quite simple but is sometimes lost in the complexity of our University analysis. The perspective is that you have to understand the underlying economics of the businesses that you invest in, work in. You have to be clear-eyed and not be swayed by the crowd or passing fancies of the moment. And you have to learn and stick to disciplined principles of business valuation.

In the long run this disciplined approach will more often than not bring success or more importantly avoid spectacular failures.

Hopefully at the *University of Florida* we can successfully convey those principles and create a program for the very best students and in time the very best employers as well.

We thank *Mr. Hawkins* for his gift ($1 million) and share his thoughts today.

Mason Hawkins: He is someone I have admired tremendously for the last 30 years. In addition, he is someone each of us could pattern our lives after as a role model. It is my honor to introduce our lifetime's best long-term investor……

Buffett: (holds mike) Testing: One million $, two million $….three million $.

I would like to say a few words primarily and then the highlight for me will be getting your questions. I want to talk about what is on your mind.

Your Future

I would like to talk for just one minute to the students about your future when you leave here. Because you will learn a tremendous amount about investments, you all have the ability to do well; you all have the IQ to do well. You all have the energy and initiative to do well or you wouldn't be here. Most of you will succeed in meeting your aspirations.

But in determining whether you succeed there is more to it than intellect and energy. I would like to talk just a second about that. In fact, there was a guy, *Pete Kiewit* in Omaha, who used to say, he looked for three things in hiring people: integrity, intelligence and energy. And he said if the person did not have the first two, the later two would kill him, because if they don't have integrity, you want them dumb and lazy.

We want to talk about the first two because we know you have the last two. You are all second-year MBA students, so you have gotten to know your classmates. Think for a moment that I granted you the right--you can buy 10% of one of your classmate's earnings for the rest of their lifetime. You can't pick someone with a rich father; you have to pick someone who is going to do it on his or her own merit. And I gave you an hour to think about it.

Will you give them an IQ test and pick the one with the highest IQ? I doubt it. Will you pick the one with the best grades? The most energetic? You will start looking for qualitative factors, in addition to (the quantitative) because everyone has enough brains and energy. You would probably pick the one you responded the best to, the one who has the leadership qualities, the one who is able to get other people to carry out their interests. That would be the person who is generous, honest and who gave credit to other people for their own ideas. All types of qualities. Whomever you admire the most in the class. Then I would throw in a hooker. In addition to this person you had to go short one of your classmates.

That is more fun. Who do I want to go short? You wouldn't pick the person with the lowest IQ, you would think about the person who turned you off, the person who is egotistical, who is greedy, who cuts corners, who is slightly dishonest.

As you look at those qualities on the left and right hand side, there is one interesting thing about them, it is not the ability to throw a football 60 yards, it is not the ability the run the 100 yard dash in 9.3 seconds, it is not being the best looking person in the class, they are all qualities that if you really want to have the ones on the left hand side, you can have them.

They are qualities of behavior, temperament, character that are achievable, they are not forbidden to anybody in this group. And if you look at the qualities on the right hand side the ones that turn you off in other people, there is not a quality there that you have to have. You can get rid of it. You can get rid of it a lot easier at your age than at my age, because most behaviors are habitual. The chains of habit are too light to be felt until they are too heavy to be broken. There is no question about it. I see people with these self-destructive behavior patterns at my age or even twenty years younger and they really are entrapped by them.

They go around and do things that turn off other people right and left. They don't need to be that way but by a certain point they get so they can hardly change it. But at your age you can have any habits, any patterns of behavior that you wish. It is simply a question of which you decide.

If you did this… *Ben Graham* looked around at the people he admired and *Ben Franklin* did this before him. *Ben Graham* did this in his low teens and he looked around at the people he admired and he said, "I want to be admired, so why don't I behave like them?" And he found out that there was nothing impossible about behaving like them. Similarly he did the same thing on the reverse side in terms of getting rid of those qualities. I would suggest is that if you write those qualities down and think about them a while and make them habitual, you will be the one you want to buy 10% of when you are all through. And the beauty of it is that you already own 100% of yourself and you are stuck with it. So you might as well be that person, that somebody else.

Well that is a short little sermon. So let's get on with what you are interested in. Let's start with questions………..

Question: What about Japan? Your thoughts about Japan?

***Buffett*:** My thoughts about Japan? I am not a macro guy. Now I say to myself *Berkshire Hathaway* can borrow money in Japan for 10 years at one percent. One percent! I say gee, I took *Graham*'s class 45 years ago and I have been working hard at this all my life maybe I can earn more than 1% annually, it doesn't seem impossible. I wouldn't want to get involved in currency risk, so it would have to be Yen-denominated. I would have to be in Japanese Real Estate or Japanese companies or something of the sort and all I have to do is beat one percent. That is all the money is going to cost me and I can get it for 10 years. So far I haven't found anything. It is kind of interesting. The Japanese businesses earn very low returns on equity - 4% to 5% - 6% on equity and it is very hard to earn a lot as an investor when the business you are in doesn't earn very much money.

Now some people do it. In fact, I have a friend, Walter Schloss, who worked at *Graham* at the same time I did. And it was the first way I went at stocks to buy stocks selling way below working capital. A very cheap, quantitative approach to stocks. I call it the cigar butt approach to investing. You walk down the street and you look around for a cigar butt someplace. Finally you see one and it is soggy and kind of repulsive, but there is one puff left in it. So you pick it up and the puff is free--it is a cigar butt stock. You get one free puff on it and then you throw it away and try another one. It is not elegant. But it works. Those are low return businesses.

But time is the friend of the wonderful business; it is the enemy of the lousy business. If you are in a lousy business for a long time, you will get a lousy result even if you buy it cheap. If you are in a wonderful business for a long time, even if you pay a little bit too much going in you will get a wonderful result if you stay in a long time.

I find very few wonderful businesses in Japan at present. They may change the culture in some way so that management gets more share holder responsive over there and stock returns are higher. At the present time you will find a lot of low return businesses and that was true even when the Japanese economy was booming. It is amazing; they had an incredible market without incredible companies. They were incredible in terms of doing a lot of business, but they were not incredible in terms of the return on equity that they achieved and that has finally caught up with them. So we have so far done nothing there. But as long as money is 1% there, we will keep looking.

Question: You were rumored to be one of the rescue buyers of *Long Term Capital*, what was the play there, what did you see?

***Buffett*:** The *Fortune* Magazine that has *Rupert Murdoch* on the cover. It tells the whole story of our involvement; it is kind of an interesting story. I got the really serious call about *LTCM* on a Friday afternoon that things were getting serious. I know those people most of them pretty well--most of them at *Salomon* when I was there. And the place was imploding and the FED was sending people up that weekend. Between that Friday and the following Wed. when the NY Fed, in effect, orchestrated a rescue effort but without any Federal money involved. I was quite active but I was having a terrible time reaching anybody.

We put in a bid on Wednesday morning. I talked to *Bill McDonough* at the NY Fed. We made a bid for 250 million for the net assets but we would have put in 3 and 3/4 billion on top of that. $3 billion from *Berkshire*, $700 mil. from *AIG* and $300 million. from *Goldman Sachs*. And we submitted that but we put a very short time limit on that because when you are bidding on 100 billion worth of securities that are moving around, you don't want to leave a fixed price bid out there for very long.

In the end the bankers made the deal, but it was an interesting period. The whole LTCM is really fascinating because if you take *Larry Hillenbrand, Eric Rosenfeld, John Meriwether* and the two Nobel prize winners. If you take the 16 of them, they have about as high an IQ as any 16 people working together in one business in the country, including *Microsoft*. An incredible amount of intellect in one room. Now you combine that with the fact that those people had extensive experience in the field they were operating in. These were not a bunch of guys who had made their money selling men's clothing and all of a sudden went into the securities business. They had in aggregate, the 16, had 300 or 400 years of experience doing exactly what they were doing and then you throw in the third factor that most of them had most of their very substantial net worth's in the businesses. Hundreds and hundreds of millions of their own money up (at risk), super high intellect and working in a field that they knew. Essentially they went broke. That to me is absolutely fascinating.

If I ever write a book it will be called, <u>Why Smart People Do Dumb Things</u>. My partner says it should be autobiographical. But this might be an interesting illustration. They are perfectly decent guys. I respect them and they helped me out when I had problems at *Salomon*. They are not bad people at all.

But to make money they didn't have and didn't need, they risked what they did have and what they did need. That is just plain foolish; it doesn't matter what your IQ is. If you risk something that is important to you for something that is unimportant to you it just doesn't make sense. I don't care if the odds you succeed are 99 to 1 or 1000 to 1 that you succeed. If you hand me a gun with a million chambers with one bullet in a chamber and put it up to your temple and I am paid to pull the trigger, it doesn't matter how much I would be paid. I would not pull the trigger. You can name any sum you want, but it doesn't do anything for me on the upside and I think the downside is fairly clear. Yet people do it financially very much without thinking.

There was a lousy book with a great title written by Walter Gutman—<u>You Only Have to Get Rich Once</u>. Now that seems pretty fundamental. If you have $100 million at the beginning of the year and you will make 10% if you are unleveraged and 20% if you are leveraged 99 times out of a 100, what difference if at the end of the year, you have $110 million or $120 million? It makes no difference. If you die at the end of the year, the guy who makes up the story may make a typo, he may have said 110 even though you had a 120. You have gained nothing at all. It makes absolutely no difference. It makes no difference to your family or anybody else.

The downside, especially if you are managing other people's money, is not only losing all your money, but it is disgrace, humiliation and facing friends whose money you have lost. Yet 16 guys with very high IQs entered into that game. I think it is madness. It is produced by an over reliance to some extent on things. Those guys would tell me back at Salomon; a six Si*gm*a event wouldn't touch us. But they were wrong. History does <u>not</u> tell you of future things happening. They had a great reliance on mathematics. They thought that the Beta of the stock told you something about the risk of the stock. It doesn't tell you a damn thing about the risk of the stock in my view.

Si*gm*a's do not tell you about the risk of going broke in my view and maybe now in their view too. But I don't like to use them as an example. The same thing in a different way could happen to any of us, where we really have a blind spot about something that is crucial, because we know a whole lot of something else. It is like *Henry Kauffman* said, "The ones who are going broke in this situation are of two types, the ones who know nothing and the ones who know everything." It is sad in a way.

I urge you. We basically never borrow money. I never borrowed money even when I had $10,000 basically, what difference did it make. I was having fun as I went along it didn't matter whether I had $10,000 or $100,000 or $1,000,000 unless I had a medical emergency come along.

I was going to do the same things when I had a little bit of money as when I had a lot of money. If you think of the difference between me and you, we wear the same clothes basically (SunTrust gives me mine), we eat similar food—we all go to *McDonald's* or better yet, *Dairy Queen*, and we live in a house that is warm in winter and cool in summer. We watch the Nebraska (football) game on big screen TV. You see it the same way I see it. We do everything the same—our lives are not that different. The only thing we do is we travel differently. What can I do that you can't do?

I get to work in a job that I love, but I have always worked at a job that I loved. I loved it just as much when I thought it was a big deal to make $1,000. <u>I urge you to work in jobs that you love</u>. I think you are out of your mind if you keep taking jobs that you don't like because you think it will look good on your resume. I was with a fellow at Harvard the other day who was taking me over to talk. He was 28 and he was telling me all that he had done in life, which was terrific. And then I said, "What will you do next?" "Well," he said, "Maybe after I get my MBA I will go to work for a consulting firm because it will look good on my resume." I said, "Look, you are 28 and you have been doing all these things, you have a resume 10 times than anybody I have ever seen. Isn't that a little like saving up sex for your old age?

There comes a time when you ought to start doing what you want. Take a job that you love. You will jump out of bed in the morning. When I first got out of *Columbia Business School*, I wanted to go to work for *Graham* immediately for nothing. He thought I was over-priced. But I kept pestering him. I sold securities for three years and I kept writing him and finally I went to work for him for a couple of years. It was a great experience. But I always worked in a job that I loved doing. You really should take a job that if you were independently wealthy that would be the job you would take. You will learn something, you will be excited about, and you will jump out of bed. You can't miss. You may try something else later on, but you will get way more out of it and I don't care what the starting salary is.

When you get out of here take a job you love, not a job you think will look good on your resume. You ought to find something you like.

If you think you will be happier getting 2x instead of 1x, you are probably making a mistake. You will get in trouble if you think making 10x or 20x will make you happier because then you will borrow money when you shouldn't or cut corners on things. It just doesn't make sense and you won't like it when you look back.

Question: What makes a company something that you like?

Buffett: I like businesses that I can understand. Let's start with that. That narrows it down by 90%. There are all types of things I don't understand, but fortunately, there is enough I do understand. You have this big wide world out there and almost every company is publicly owned. So you have all American business practically available to you. So it makes sense to go with things you can understand.

I can understand this, anyone can understand this (*Buffett* holds up a bottle of *Coca-Cola*). Since 1886, it is a simple business, but it is not an easy business—I don't want an easy business for competitors. I want a business with a moat around it. I want a very valuable castle in the middle and then I want the Duke who is in charge of that castle to be very honest and hard working and able. Then I want a moat around that castle. The moat can be various things: The moat around our auto insurance business, Geico, is low cost.

People <u>have</u> to buy auto insurance so everyone is going to have one auto insurance policy per car basically. I can't sell them 20, but they have to buy one. I can sell them 1. What are they going to buy it on? (based on what criteria?) They (customers) will buy based on service and cost. Most people will assume the service is identical among companies or close enough. So they will do it on cost. So I have to be a low cost producer--that is my moat. To the extent that my costs are further below the other guy, I have thrown a couple of sharks into the moat. All the time you have this wonderful castle, there are people out there who are going to attack it and try to take it away from you. I want a castle I can understand, but I want a castle with a moat around it.

<u>*Kodak*</u>

30 years ago, *Eastman Kodak's* moat was just as wide as *Coca-Cola*'s moat. I mean if you were going to take a picture of your six-month old baby and you want to look at that picture 20 years from now or 50 years from now. And you are never going to get a chance—you are not a professional photographer—so you can evaluate what is going to look good 20 or 50 years ago. What is in your mind about that photography company *(Share of Mind*) is what counts. Because they are promising you that the picture you take today is going to be terrific 20 to 50 years from now about something that is very important to you. Well, *Kodak* had that in spades 30 years ago, they owned that. They had what I call <u>share of mind</u>. Forget about share of market, share of mind. They had something—that little yellow box—that said *Kodak* is the best. That is priceless. They have lost some of that. They haven't lost it all.

It is not due to *George Fisher*. *George* is doing a great job, but they let that moat narrow. They let *Fuji* come and start narrowing the moat in various ways. They let them get into the Olympics and take away that special aspect that only *Kodak* was fit to photograph the Olympics. So *Fuji* gets there and immediately in people's minds, *Fuji* becomes more into parity with *Kodak*.

You haven't seen that with *Coke*; *Coke*'s moat is wider now than it was 30 years ago. You can't see the moat day by day but every time the infrastructure that gets built in some country that isn't yet profitable for *Coke* that will be 20 years from now. The moat is widening a little bit. Things are, all the time, changing a little in one direction or the other. Ten years from now, you will see the difference. Our managers of the businesses we run, I have one message to them, and we want to widen the moat. We want to throw crocs, sharks and gators—I guess—into the moat to keep away competitors. That comes about through service, through quality of product, it comes about through cost, some times through patents, and/or real estate location. So that is the business I am looking for.

Now what kind of businesses am I going to find like that? Well, I am going to find them in simple products because I am not going to be able to figure what the moat is going to look like for *Oracle, Lotus* or *Microsoft*, ten years from now. Gates is the best businessman I have ever run into and they have a hell of a position, but I really don't know what that business is going to look like ten years from now. I certainly don't know what his competitors will look like ten years from now. I know what the chewing business will look like ten years from now. The Internet is not going to change how we chew gum and nothing much else is going to change how we chew gum. There will lots of new products. Is *Spearmint* or *Juicy Fruit* going to evaporate? It isn't going to happen. You give me a billion dollars and tell me to go into the chewing gum business and try to make a real dent in *Wrigley's*. I can't do it. That is how I think about businesses. I say to myself, give me a billion dollars and how much can I hurt the guy? Give me $10 billion dollars and how much can I hurt *Coca-Cola* around the world? I can't do it. Those are good businesses.

Now give me some money and tell me to hurt somebody in some other fields, and I can figure out how to do it.

So I want a simple business, easy to understand, great economics now, honest and able management, and then I can see about in a general way where they will be ten (10) years from now. If I can't see where they will be ten years from now, I don't want to buy it. Basically, I don't want to buy any stock where if they close the NYSE tomorrow for five years, I won't be happy owning it. I buy a farm and I don't get a quote on it for five years and I am happy if the farm does OK. I buy an apartment house and don't get a quote on it for five years, I am happy if the apartment house produces the returns that I expect. People buy a stock and they look at the price next morning and they decide to see if they are doing well or not doing well. It is crazy. They are buying a piece of the business. That is what *Graham*—the most fundamental part of what he taught me.

You are not buying a stock, you are buying part ownership in a business. You will do well if the business does well, if you didn't pay a totally silly price. That is what it is all about. You ought to buy businesses you understand. Just like if you buy farms, you ought to buy farms you understand. It is not complicated.

Incidentally, by the way, in calling this *Graham-Buffett*, this is pure *Graham*. I was very fortunate. I picked up his book (The Intelligent Investor) when I was nineteen; I got interested in stocks when I was 6 or 7. I bought my first stock when I was eleven. But I was playing around with all this stuff—I had charts and volume and I was making all types of technical calculations and everything. Then I picked up a little book that said you are not just buying some little ticker symbol, that bounces around every day, you are buying part of a business. Soon as I started thinking about it that way, everything else followed. It is very simple. So we buy businesses we think we can understand. There is no one here who can't understand *Coke*………….. (end of first side.)

If I was teaching a class at business school, on the final exam I would pass out the information on an Internet company and ask each student to value it. Anybody that gave me an answer, I'd flunk (Laughter).

I don't know how to do it. But people do it all the time; it is more exciting. If you look at it like you are going to the races--that is a different thing--but if you are investing…. Investing is putting out money to be sure of getting more back later at an appropriate rate.

And to do that you have to understand what you are doing at any time. You have to understand the business. You can understand some businesses but not all businesses.

Question: **You covered half of it which is trying to understand a business and buying a business. You also alluded to getting a return on the amount of capital invested in the business. How do you determine what is the proper price to pay for the business?**

***Buffett*:** It is a tough thing to decide but I don't want to buy into any business I am not terribly sure of. So if I am terribly sure of it, it probably won't offer incredible returns. Why should something that is essentially a cinch to do well, offer you 40% a year? We don't have huge returns in mind, but we do have in mind not losing anything. We bought *See's Candy* in 1972, *See's Candy* was then selling 16 m. pounds of candy at a $1.95 a pound and it was making 2 bits a pound or $4 million pre-tax. We paid $25 million for it—6.25 x pretax or about 10x after tax. It took no capital to speak of. When we looked at that business—basically, my partner, Charlie, and I—we needed to decide if there was some untapped pricing power there. Where that $1.95 box of candy could sell for $2 to $2.25. If it could sell for $2.25 or another $0.30 per pound that was $4.8 on 16 million pounds. Which on a $25 million purchase price was fine. We never hired a consultant in our lives; our idea of consulting was to go out and buy a box of candy and eat it.

What we did know was that they had share of mind in California. There was something special. Every person in Ca. has something in mind about *See's Candy* and overwhelmingly it was favorable. They had taken a box on Valentine's Day to some girl and she had kissed him. If she slapped him, we would have no business. As long as she kisses him, that is what we want in their minds. *See's Candy* means getting kissed. If we can get that in the minds of people, we can raise prices. I bought it in 1972, and every year I have raised prices on Dec. 26th, the day after Christmas, because we sell a lot on Christmas. In fact, we will make $60 million this year. We will make $2 per pound on 30 million pounds. Same business, same formulas, same everything--$60 million bucks and it still doesn't take any capital.

And we make more money 10 years from now. But of that $60 million, we make $55 million in the three weeks before Christmas. And our company song is: "What a friend we have in Jesus." (Laughter). It is a good business. Think about it a little. Most people do not buy boxed chocolate to consume themselves, they buy them as gifts—somebody's birthday or more likely it is a holiday. Valentine's Day is the single biggest day of the year. Christmas is the biggest season by far. Women buy for Christmas and they plan ahead and buy over a two or three week period. Men buy on Valentine's Day. They are driving home; we run ads on the Radio. Guilt, guilt, guilt—guys are veering off the highway right and left. They won't dare go home without a box of Chocolates by the time we get through with them on our radio ads. So that Valentine's Day is the biggest day.

Can you imagine going home on Valentine's Day—our *See's Candy* is now $11 a pound thanks to my brilliance. And let's say there is candy available at $6 a pound. Do you really want to walk in on Valentine's Day and hand—she has all these positive images of *See's Candy* over the years—and say, "Honey, this year I took the low bid." And hand her a box of candy. It just isn't going to work. So in a sense, there is untapped pricing power—it is not price dependent.

Think of *Disney*. *Disney* is selling Home Videos for $16.95 or $18.95 or whatever. All over the world—people, and we will speak particularly about Mothers in this case, have something in their mind about *Disney*. Everyone in this room, when you say *Disney,* has something in their mind about *Disney*. When I say *Universal Pictures*, if I say *20th Century Fox*, you don't have anything special in your mind. Now if I say *Disney*, you have something special in your mind. That is true around the world.

Now picture yourself with a couple of young kids, whom you want to put away for a couple of hours every day and get some peace of mind. You know if you get one video, they will watch it twenty times. So you go to the video store or wherever to buy the video. Are you going to sit there and premier 10 different videos and watch them each for an hour and a half to decide which one your kid should watch? No. Let's say there is one there for $16.95 and the *Disney* one for $17.95—you know if you take the *Disney* video that you are going to be OK. So you buy it. You don't have to make a quality decision on something you don't want to spend the time to do. So you can get a little bit more money if you are *Disney* and you will sell a lot more videos. It makes it a wonderful business. It makes it very tough for the other guy.

How would you try to create a brand—*Dreamworks* is trying—that competes with *Disney* around the world and replaces the concept that people have in their minds about *Disney* with something that says, *Universal Pictures*? So a mother is going to walk in and pick out a *Universal Pictures* video in preference to a *Disney*. It is not going to happen.

Coca-Cola is associated with people being happy around the world. Everyplace – *Disne*yland, the *World Cup*, the *Olympics*—where people are happy. Happiness and *Coke* go together. Now you give me—I don't care how much money—and tell me that I am going to do that with *RC Cola* around the world and have five billion people have a favorable image in their mind about *RC Cola*. You can't get it done. You can fool around, you can do what you want to do. You can have price discounts on weekends. But you are not going to touch it. That is what you want to have in a business. That is the moat. You want that moat to widen.

If you are *See's Candy*, you want to do everything in the world to make sure that the experience basically of giving that gift leads to a favorable reaction. It means what is in the box, it means the person who sells it to you, because all of our business is done when we are terribly busy. People come in during theose weeks before Chirstmas, Valentine's Day and there are long lines. So at five o'clock in the afternoon some woman is selling someone the last box candy and that person has been waiting in line for maybe 20 or 30 customers. And if the salesperson smiles at that last customer, our moat has widened and if she snarls at 'em, our moat has narrowed. We can't see it, but it is going on everyday. But it is the key to it. It is the total part of the product delivery. It is having everything associated with it say, *See's Candy* and something pleasant happening. That is what business is all about.

Question: If I have every bought a company where the numbers told me not to. How much is quantitative and how much is qualitative?

Buffett: The best buys have been when the numbers almost tell you not to. Because then you feel so strongly about the product. And not just the fact you are getting a used cigar butt cheap. Then it is compelling. I owned a windmill company at one time. Windmills are cigar butts, believe me. I bought it very cheap, I bought it at a third of working capital. And we made money out of it, but there is no repetitive money to be made on it. There is a one-time profit in something like that. And it is just not the thing to be doing. I went through that phase. I bought streetcar companies and all kinds of things. In terms of the qualitative, I probably understand the qualitative the moment I get the phone call. Almost every business we have bought has taken five or ten minutes in terms of analysis. We bought two businesses this year.

General Re is a $18 billion deal. I have never been to their home office. I hope it is there. (Laughter) "There could be a few guys there saying what numbers should we send *Buffett* this month?" I could see them going once a month and saying we have $20 billion in the bank instead of $18 billion. I have never been there.

Before I bought *Executive Jet*, which is fractional ownership of jets, before I bought it, I had never been there. I bought my family a quarter interest in the program three years earlier. And I have seen the service and it seems to develop well. And I got the numbers. But if you don't know enough to know about the business instantly, you won't know enough in a month or in two months. You have to have sort of the background of understanding and knowing what you do or don't understand. That is the key. It is defining your circle of competence.

Everybody has got a different circle of competence. The important thing is not how big the circle is, the important thing is the size of the circle; the important thing is staying inside the circle. And if that circle only has 30 companies in it out of 1000s on the big board, as long as you know which 30 they are, you will be OK. And you should know those businesses well enough so you don't need to read lots of work. Now I did a lot of work in the earlier years just getting familiar with businesses and the way I would do that is use what *Phil Fisher* would call, the "Scuttlebutt Approach." I would go out and talk to customers, suppliers, and maybe ex-employees in some cases. Everybody. Everytime I was interested in an industry, say it was coal, I would go around and see every coal company. I would ask every CEO, "If you could only buy stock in one coal company that was not your own, which one would it be and why? You piece those things together, you learn about the business after awhile.

Funny, you get very similar answers as long as you ask about competitors. If you had a silver bullet and you could put it through the head of one competitor, which competitor and why? You will find who the best guy is in the industry. So there are a lot of things you can learn about a business. I have done that in the past on the business I felt I could understand so I don't have to do that anymore. The nice thing about investing is that you don't have to learn anything new. You can do it if you want to, but if you learn *Wrigley's* chewing gum forty years ago, you still understand *Wrigley's* chewing gum. There are not a lot of great insights to get of the sort as you go along. So you do get a database in your head.

I had a guy, *Frank Rooney*, who ran *Melville* for many years; his father-in-law died and had owned *H.H. Brown*, a shoe company. And he put it up with *Goldman Sachs*. But he was playing golf with a friend of mine here in Florida and he mentioned it to this friend, so my friend said "Why don't you call Warren?" He called me after the match and in five minutes I basically had a deal.

But I knew Frank, and I knew the business. I sort of knew the basic economics of the shoe business, so I could buy it. Quantitatively, I have to decide what the price is. But, you know, that is either yes or no. I don't fool a lot around with negotiations. If they name a price that makes sense to me, I buy it. If they don't, I was happy the day before, so I will be happy the day after without owning it.

Question: The Asian Crisis and how it affects a company like *Coke* that recently announced their earnings would be lower in the fourth quarter.

Buffett: Well, basically I love it, but because the market for *Coca-Cola* products will grow far faster over the next twenty years internationally than it will in the United States. It will grow in the U.S. on a per capita basis. The fact that it will be a tough period for who knows—three months or three years—but it won't be tough for twenty years. People will still be going to be working productively around the world and they are going to find this is a bargain product in terms of a portion of their working day that they have to give up in order to have one of these, better yet, five of them a day like I do.

This is a product that in 1936 when I first bought 6 of those for a quarter and sold them for a nickel each. It was in a 6.5 oz bottle and you paid a two cents deposit on the bottle. That was a 6.5 oz. bottle for a nickel at that time; it is now a 12 oz. can which if you buy it on Weekends or if you buy it in bigger quantities, so much money doesn't go to packaging—you essentially can buy the 12 ozs. for not much more than 20 cents. So you are paying not much more than twice the per oz. price of 1936. This is a product that has gotten cheaper and cheaper relative to people's earning power over the years. And which people love. And in 200 countries, you have the per capita consumption use going up every year for a product that is over 100 years old that dominates the market. That is unbelievable.

One thing that people don't understand is one thing that makes this product worth 10s and 10s of billions of dollars is one simple fact about really all colas, but we will call it *Coca-Cola* for the moment. It happens to be a name that I like. **Cola has no taste memory.** You can drink one of these at 9 O'clock, 10 O'clock, 1 O'clock and 5 O'clock. The one at 5 o'clock will taste as good to you as the one you drank early in the morning, you can't do that with Cream Soda, Root Beer, Orange, Grape. All of those things accumulate on you. Most foods and beverages accumulate; you get sick of them after a while. And if you eat See's Candy—we get these people who go to work for us at See's Candy and the first day they go crazy, but after a week they are eating the same amount as if they were buying it, because chocolate accumulates on you. There is no taste memory to Cola and that means you get people around the world who will be heavy users—who will drink five a day, or for *Diet Coke*, 7 or even 8 a day. They will never do that with other products. So you get this incredible per capita consumption. The average person in this part of the world or maybe a little north of here drinks 64 ozs. of liquid a day. You can have 64 ozs. of that be *Coke* and you will not get fed up with *Coke* if you like it to start with in the least. But if you do that with anything else; if you eat just one product all day, you will get a little sick of it after a while.

It is a huge factor. So today over 1 billion of *Coca-Cola* product servings will be sold in the world and that will grow year by year. It will grow in every country virtually, and it will grow on a per capita basis. And twenty years from now it will grow a lot faster internationally than in the U.S., so I really like that market better, because there is more growth there over time. But it will hurt them in the short term right now, but that doesn't mean anything. *Coca-Cola* went public in 1919; the stock sold for $40 per share. The Chandler family bought the whole business for $2,000 back in the late 1880s. So now he goes public in 1919, $40 per share. One year later it is selling for $19 per share. It has gone down 50% in one year. You might think it is some kind of disaster and you might think sugar prices increased and the bottlers were rebellious. And a whole bunch of things. You can always find reasons that weren't the ideal moment to buy it. Years later you would have seen the Great Depression, WW II and sugar rationing and thermonuclear weapons and the whole thing—there is always a reason.

But in the end if you had bought one share at $40 per share and reinvested the dividends, it would be worth $5 million now ($40 compounding at 14.63% for 86 years!). That factor so overrides anything else. If you are right about the business you will make a lot of money. The timing part of it is very tricky thing so I don't worry about any given event if I got a wonderful business what it does next year or something of the sort. Price controls have been in this country at various times and that has fouled up even the best of businesses. I wouldn't be able to raise prices Dec 31st on See's Candy. But that doesn't make it a lousy business if that happens to happen, because you are not going to have price controls forever. We had price controls in the early 70s.

The wonderful business—you can figure what will happen, you can't figure out when it will happen. You don't want to focus too much on when but you want to focus on what. If you are right about what, you don't have to worry about when very much.

Question: What about your business mistakes?

***Buffett*:** How much time do you have? The interesting thing about investments for me and my partner, *Charlie Munger*, the biggest mistakes have not been mistakes of commission, but of omission. They are where we knew enough about the business to do something and where, for one reason or another, sat they're sucking out thumbs instead of doing something. And so we have passed up things where we could have made billions and billions of dollars from things we understood, forget about things we don't understand. The fact I could have made billions of dollars from *Microsoft* doesn't mean anything because I never could understand *Microsoft*. But if I can make billions out of healthcare stocks, then I should make it. And I didn't when the Clinton health care program was proposed and they all went in the tank. We should have made a ton of money out of that because I could understand it. And didn't make it.

I should have made a ton of money out of *Fannie Mae* back the mid-1980s, but I didn't do it. Those are billion dollar mistakes or multi-billion dollar mistakes that generally accepted accounting principles don't pick up. The mistakes you see. I made a mistake when I bought *US Air Preferred* some years ago. I had a lot of money around. I make mistakes when I get cash. *Charlie* tells me to go to a bar instead. Don't hang around the office. But I hang around the office and I have money in my pocket, I do something dumb. It happens every time. So I bought this thing. Nobody made me buy it. I now have an 800 number I call every time I think about buying a stock in an airline. I say, "I am *Warren* and I am an air-aholic." They try to talk me down, "Keep talking don't do anything rash." Finally I got over it. But I bought it. And it looked like we would lose all our money in it. And we came very close to losing all our money in it. You can say we deserved to lose our money it.

We bought it because it was an attractive security. But it was not in an attractive industry. I did the same thing in *Salomon.* I bought an attractive security in a business I wouldn't have bought the equity in. So you could say that is one form of mistake. Buying something because you like the terms, but you don't like the business that well. I have done that in the past and will probably do that again. The bigger mistakes are the ones of omission. Back when I had $10,000 I put $2,000 of it into a *Sinclair Service Station* which I lost, so the opportunity cost on that money is about $6 billion right now--fairly big mistakes. It makes me feel good when my *Berkshire* goes down, because the cost of my Sinclair Station goes down too. My 20% opportunity cost. I will say this, it is better to learn from other people's mistakes as much as possible. But we don't spend any time looking back at *Berkshire*. I have a partner, *Charlie Munger*; we have been pals for forty years—never had an argument. We disagree on things a lot but we don't have arguments about it.

We never look back. We just figure there is so much to look forward to that there is no sense thinking of what we might have done. It just doesn't make any difference. You can only live life forward. You can learn something perhaps from the mistakes, but the big thing to do is to stick with the businesses you understand. So if there is a generic mistake outside your circle of competence like buying something that somebody tips you on or something of the sort. In an area you know nothing about, you should learn something from that which is to stay with what you can figure out yourself. You really want your decision making to be by looking in the mirror. Saying to yourself, "I am buying 100 shares of General Motors at $55 because…….." It is your responsibility if you are buying it. There's gotta be a reason and if you can't state the reason, you shouldn't buy it. If it is because someone told you about it at a cocktail party, not good enough. It can't be because of the volume or a reason like the chart looks good. It has to be a reason to buy the business. That we stick to pretty carefully. That is one of the things *Ben Graham* taught me.

Question: The current tenuous economic situation and interest rates? Where are we going?

***Buffett*:** I don't think about the macro stuff. What you really want to in investments is figure out <u>what is important and knowable</u>. If it is unimportant and unknowable, you forget about it. What you talk about is important but, in my view, it is not knowable. Understanding *Coca-Cola* is knowable or *Wrigley's* or *Eastman Kodak*. You can understand those businesses that are knowable. Whether it turns out to be important depends where your valuation leads you and the firm's price and all that. But we have never not bought or bought a business because of any Macro feeling of any kind because it doesn't make any difference. Let's say in 1972 when we bought *See's Candy*, I think *Nixon* put on the price controls a little bit later, but so what! We would have missed a chance to buy something for $25 million that is producing $60 million pre-tax now. We don't want to pass up the chance to do something intelligent because of some prediction about something we are no good on anyway. So we don't read or listen to in relation to macro factors at all. The typical investment counselor organization goes out and they bring out their economist and they trot him out and he gives you this big macro picture. And they start working from there on down. In our view that is nonsense.

If *Alan Greenspan* was on the one side of me and *Robert Rubin* on the other side and they both were whispering in my ear exactly what they were going to do the next twelve months, it wouldn't make any difference to me what I would pay for *Executive Jet* or *General Re* or anything else I do.

Question: What is the benefit of being an out-of-towner as opposed to being on Wall Street?

Buffett: I worked on Wall Street for a couple of years and I have my best friends on both coasts. I like seeing them. I get ideas when I go there. **But the best way to think about investments is to be in a room with no one else and just think.** And if that doesn't work, nothing else is going to work. The disadvantage of being in any type of market environment like Wall Street in the extreme is that you get over-stimulated. You think you have to do something every day. The *Chandler* family paid $2,000 for this company (*Coke*). You don't have to do much else if you pick one of those. And the trick then is <u>not</u> to do anything else. Even not to sell at 1919, which the family did later on. So what you are looking for is some way to get one good idea a year. And then ride it to its full potential and that is very hard to do in an environment where people are shouting prices back and forth every five minutes and shoving reports in front of your nose and all that. Wall Street makes its money on activity. <u>You make your money on inactivity.</u>

If everyone in this room trades their portfolio around every day with every other person, you will all end up broke. And the intermediary will end up with all the money. If you all own stock in a group of average businesses and just sit here for the next 50 years, you will end up with a fair amount of money and your broker will be broke. He is like the Doctor who gets paid on how often to get you to change pills. If he gave you one pill that cures you the rest of your life, he would make one sale, one transaction and that is it. But if he can convince you that changing pills every day is the way to great health, it will be great for him and the prescriptionists. You won't be any healthier and you will be a lot worse off financially. You want to stay away from any environment that stimulates activity. And Wall Street would have the effective of doing that.

When I went back to Omaha, I would go back with a whole list of companies I wanted to check out and I would get my money's worth out of those trips, but then I would go back to Omaha and think about it.

Question: How to evaluate *Berkshire* or *MSFT* if it does not pay dividends?

Buffett: It won't pay any dividends either. That is a promise I can keep. All you get with *Berkshire*, you stick it in your safe deposit box and then every year you go down and fondle it. You take it out and then you put it back. There is enormous psychic reward in that. Don't underestimate it.

The real question is if we can retain dollar bills and turn them into more than a dollar at a decent rate. That is what we try to do. And *Charlie Munger* and I have all our money in it to do that. That is all we will get paid for doing. We won't take any options or we won't take any salaries to speak of. But that is what we are trying to do. It gets harder all the time. The more money we manage the harder it is to do that. We would do way better percentage wise with Berkshire if it was 1/100th the present size. It is run for its owners, but it isn't run to give them dividends because so far every dollar that we earned or could have paid out, we have turned into more than a dollar. It is worth more than a dollar to keep it. Therefore, it would be silly to pay it out. Even if everyone was tax-free that owned it. It would have been a mistake to pay dividends at Berkshire. Because so far the dollar bills retained have turned into more than a dollar. But there is no guarantee that happens in the future. At some point the game runs out on that. That is what the business is about. Nothing else about the business do we judge ourselves by. We don't judge it by the size of its home office building or anything the like the number of people working there. We have 12 people working at headquarters and 45,000 employees at Berkshire, 12 people at HQ and 3,500 sq ft. and we won't change it.

But we will judge ourselves by the performance of the company and that is the only way we will get paid. But believe me, it is a lot harder than it used to be.

Question: What tells you when an investment has reached its full potential?

Buffett: I don't buy *Coke* with the idea it will be out of gas in 10 years or 50 years. There could be something that happens by I think the chances are almost nil. So what we really want to do is buy businesses that we would be happy to own forever. It is the same way I fell about people who buy *Berkshire.* I want people who buy *Berkshire* to plan to hold it forever. They may not for one reason or the other but I want them at the time they buy it to think they are buying a business they are going to want to own forever.

And I don't say that is the only way to buy things. It is just the group to join me because I don't want to have a changing group all the time. I measure *Berkshire* by how little activity there is in it. If I had a church and I was the preacher and half the congregation left every Sunday. I wouldn't say, "It is marvelous to have all this liquidity among my members."

Terrific turnover… I would rather go to church where all the seats are filled every Sunday by the same people. Well that is the way we look at the businesses we buy. We want to buy something virtually forever. And we can't find a lot of those. And back when I started, I had way more ideas than money so I was just constantly having to sell what was the least attractive stock in order to buy something I just discovered that looked even cheaper. But that is not our problem really now. So we hope we are buying businesses that we are just as happy holding five years from now as now. And if we ever found a huge acquisition, then maybe we would have to sell something. Maybe to make that acquisition but that would be a very pleasant problem to have.

We never buy something with a price target in mind. We never buy something at 30 saying if it goes to 40 we'll sell it or 50 or 60 or 100. We just don't do it that way. Anymore than when we buy a private business like *See's Candy* for $25 million. We don't ever say if we ever get an offer of $50 million for this business we will sell it. That is not the way to look at a business.

The way to look at a business is this going to keep producing more and more money over time? And if the answer to that is yes, you don't need to ask any more questions.

Questions: How did you decide to invest in *Salomon*?

Buffett: *Salomon* like I said, I went into that because it was a 9% security in 1987 in September 1987 and the Dow was up 35% and we sold a lot of stuff. And I had a lot of money around and it looked to me like we would never get to do anything, so I took an attractive security form in a business I would never buy the common stock of. I went in because of that and I think generally it is a mistake. It worked out OK finally on that. But it is not what I should have been doing. I either should have waited in which case I could have bought more *Coca-Cola* a year later or thereabouts or I should have even bought *Coke* at the prices it was selling at even though it was selling at a pretty good price at the time. So that was a mistake.

On *Long-Term Capital* that is—we have owned other businesses associated with securities over the years-–One of them is arbitrage. I've done arbitrage for 45 years and Graham did it for 30 years before that. That is a business unfortunately I have to be near a phone for. I have to really run it (arbitrage operations) out of the office myself, because it requires being more market-attuned because I don't want to do that anymore. So unless a really big arbitrage situation came along that I understood, I won't be doing much of that. But I've probably participated in about 300 arbitrage situations at least in my life maybe more. It was a good business, a perfectly good business.

LTCM has a bunch of positions, they have tons of positions, but the top ten are probably 90% of the money that is at risk, and I know something about those ten positions. I don't know everything about them by a long shot, but I know enough that I would feel OK at a big discount going in and we had the staying power to hold it out. We might lose money on something on that, but the odds are with us. That is a game that I understand. There are few other positions we have that are not that big because they can't get that big. But they could involve yield curve relationships or on the run/off the run governments that are just things you learn over time being around securities markets. They are not the base of our business. Probably on average, they have accounted for ½ - ¾ a percentage point of our return a year. They are little pluses you get for actually having been around a long time.

Arbitrage

One of the first arbitrages I did involved a company that offered cocoa beans in exchange for their stock. That was in 1955. I bought the stock, turned in the stock, got warehouse certificates for cocoa beans and they happen to be a different type but there was a basis differential and I sold them. That was something I was around at the time, so I learned about it. There hasn't been a cocoa deal since. 40 odd years, I have been waiting for a cocoa deal. I haven't seen it. It is there in my memory if it ever comes along. *LTCM* is that on a big scale.

Question: Diversification?

Buffett: The question is about diversification. I have a dual answer to that. If you are not a professional investor. If your goal is not to manage money to earn a significantly better return than the world, then I believe in extreme diversification. I believe 98% - 99% who invest should extensively diversify and not trade, so that leads them to an index fund type of decision with very low costs. All they are going to do is own part of America. And they have made a decision that owning a part of America is worthwhile. I don't quarrel with that at all. That is the way they should approach it unless they want to bring an intensity to the game to make a decision and start evaluating businesses. Once you are in the businesses of evaluating businesses and you decide that you are going to bring the effort and intensity and time involved to get that job done, then I think diversification is a terrible mistake to any degree. I got asked that question the other day at *SunTrust*. *If you really know businesses, you probably shouldn't own more than six of them.*

If you can identify six wonderful businesses, that is all the diversification you need. And you will make a lot of money. And I can guarantee that going into a seventh one instead of putting more money into your first one is gotta be a terrible mistake. Very few people have gotten rich on their seventh best idea. But a lot of people have gotten rich with their best idea. So I would say for anyone working with normal capital who really knows the businesses they have gone into, six is plenty, and I probably have half of what I like best. <u>I don't diversify personally.</u> All the people I've known that have done well with the exception of *Walter Schloss*, *Walter* diversifies a lot. I call him Noah, he has two of everything.

Question: How do you distinguish the *Cokes* of the world from the *Proctor & Gambles* of this world?

Buffett: Well, *P&G* is a very, very good business with strong distribution capability and lots of brand names, but if you ask me and I am going to go away for twenty years and put all my family's net worth into one business, would I rather have *P&G* or *Coke*? Actually *P&G* is more diversified among product line, but I would feel more sure of *Coke* than *P&G*. I wouldn't be unhappy if someone told me I had to own *P&G* during the twenty-year period. I mean that would be in my top 5 percent. Because they are not going to get killed, but I would feel better about the unit growth and pricing power of a *Coke* over twenty or thirty years.

Right now the pricing power might be tough, but you think a billion servings a day for a penny each or $10 million per day. We own 8% of that, so that is $800,000 per day for *Berkshire Hathaway.* You could get another penny out of the stuff. It doesn't seem impossible. I think it is worth a penny more. Right now it would be a mistake to try and get it in most markets. But over time, *Coke* will make more per serving than it does now. Twenty years from now I guarantee they will make more per serving, and they will be selling a whole lot more servings. I don't know how many or how much more, but I know that.

P&G's main products--I don't think they have the kind of dominance, and they don't have the kind of unit growth, but they are good businesses. I would not be unhappy if you told me that I had to put my family's net worth into *P&G* and that was the only stock I would own. I might prefer some other name, but there are not 100 other names I would prefer.

Question: Would you buy *McDonald's* and go away for twenty years?

Buffett: *McDonald's* has a lot of things going for it, particularly abroad again. Thee position abroad in many countries is stronger than it is here. It is a tougher business over time. People don't want to be eating--exception to the kids when they are giving away beanie babies or something--at *McDonald's* every day. If people drink five *Cokes* a day, they probably will drink five of them tomorrow. The fast food business is tougher than that but if you had to pick one hand to have in the fast food business, which is going to be a huge business worldwide, you would pick *McDonald's*. I mean it has the strongest position.

It doesn't win taste test with adults. It does very well with children and it does fine with adults, but it is not like it is a clear winner. And it is gotten into the game in recent years of being more price promotional--you remember the experiment a year ago or so. It has gotten more dependent on that rather than selling the product by itself. I like the product by itself. I feel better about *Gillette* if people buy the *Mach 3* because they like the *Mach 3* than if they get a *Beanie Baby* with it. So I think fundamentally it is a stronger product if that is the case. And that is probably the case.

We own a lot of *Gillette* and you can sleep pretty well at night if you think of a couple billion men with their hair growing on their faces. It is growing all night while you sleep. Women have two legs, it is even better. So it beats counting sheep. And those are the kinds of business…(you look for). But what type of promotion am I going to put out there against *Burger King* next month or what if they sign up *Disney* and I don't get *Disney*? I like the products that stand alone absent price promotion or appeals although you can build a very good business based on that. And *McDonald's* is a terrific business. It is not as good a business as *Coke*. There really hardly are any. It is a very good business and if you bet on one company in that field bet on *(garbled) McDonald's.* We bought *Dairy Queen* a while back that is why I am plugging it shamelessly here.

Question: What do I think about the utility industry?

Buffett: I have thought about that a lot because you can put big money in it. I have even thought of buying the entire businesses. There is a fellow in Omaha actually that has done a little of that through *Cal Energy*. But I don't quite understand the game in terms of how it is going to develop with deregulation. I can see how it destroys a lot of value through the high cost producer once they are not protected by a monopoly territory.

I don't for sure see who benefits and how much. Obviously the guy with very low cost power or some guy has hydro-power at two cents a KwH has a huge advantage. But how much of that he gets to keep or how extensively he can send that outside his natural territory, I haven't been able to figure that out so I really know what the Industry will look like in ten years. But it is something I think about and if I ever develop any insights that call for action, I will act on them. Because I think I can understand the attractiveness of the product. All the aspects of certainty of users need and the fact it is a bargain and all of that. I understand. I don't understand who is going to make the money in ten years. And that keeps me away.

Question: Why do large caps outperform small caps (1998)?

Buffett: We don't care if a company is large cap, small cap, middle cap, micro cap. It doesn't make any difference. The only questions that matter to us:

- Do we understand the business?
- Do we like the people running it?
- And does it sell for a price that is attractive?

From my personal standpoint running *Berkshire* now because we got, pro forma for *Gen. Re,* \$75 to \$80 billion to invest in and I only want to invest in five things, so I am really limited to very big companies. But if I were investing \$100,000, I wouldn't care whether something was large cap or small cap or anything. I would just look for businesses I understood.

Now, I think, on balance, large cap companies as businesses have done extraordinarily well the last ten years--way better than people anticipated they would do. You really have American businesses earning close to something 20% on equity. And that is something nobody dreamed of and that is being produced by very large companies in aggregate. So you have had this huge revaluation upwards because of lower interest rates and much higher returns on capital. If America business is really a disguised bond that earns 20%, a 20% coupon it is much better than a bond with a 13% coupon. And that has happened with big companies in recent years, whether it is permanent or not is another question. I am skeptical of that. I wouldn't even think about it--except for questions of how much money we run--I wouldn't even think about the size of the business. *See's Candy* was a $25 million business when we bought it. If I can find one now, as big as we are, I would love to buy it. It is the <u>certainty</u> of it that counts.

Question: The securitization of real estate?

Buffett: There has been enormous securitization of the debt too of real estate and that is one of the items right now that is really clogging up the capital markets. The mortgage back securities are just not moving, commercial, not residential mortgage backs. But I think you are directing your question at equities probably. The equities, if you leave out the corporate form, have been a lousy way to own equities. You have interjected a corporate income tax into something that people individually have been able to own with a single tax, and to have the normal corporate form you have a double taxation in there. You really don't need it and it takes too much of the return.

REITS have, in effect, created a conduit so you don't get the double taxation, but they also generally have fairly high operating expenses. If you get real estate, let's just say you can buy fairly simple types of real estate at an 8% yield, or thereabouts, and you take away close to 1% to 1.5% by the time you count stock options and everything, it is not a terribly attractive way to own real estate. Maybe the only way a guy with a $1,000 or $5,000 can own it but if you have $1 million or $10 million, you are better off owning the real estate properties yourself instead of sticking some intermediary in between who will get a sizable piece of the return for himself. So we have found very little in that field.

You will see an announcement in the next couple of weeks that may belie what I am telling you today. I don't want you to think I am double crossing you up here. But generally speaking we have seen very little in that field that gets us excited. People sometimes get very confused about--they will look at some huge land company, like *Texas Pacific Land Trust*, which has been around over 100 years and has got a couple of million acres in Texas. And they will sell 1% of their land every year and they will take that (as income? Garbled) and come up with some huge value compared to the market value. But that is nonsense if you really own the property. You can't move. You can't move 50% of the properties or 20% of the properties, it is way worse than an illiquid stock. So you get these, I think, you get some very silly valuations placed on a lot of real estate companies by people who really don't understand what it is like to own one and try to move large quantity of properties.

REITS have behaved horribly in this market as you know and it is not at all inconceivable that they become a class that would get so unpopular that they would sell at significant discounts from what you could sell the properties for. And they could get interesting as a class and then the question is whether management would fight you in that process because they would be giving up their income stream for managing things and their interests might run counter to the shareholders on that. I have always wondered about REITS that have managements they say their assets are so wonderful, and they are so cheap and then they (management) go out and sell stock. There is a contradiction in that. They say our stock is very cheap at $28 and then they sell a lot of stock at $28 less an underwriting commission. There is a disconnect there. But it is a field we look at.

Charlie and I can understand real estate, and we would be open for very big transactions periodically. If there was a *LTCM* situation translated to real estate, we would be open to that, the trouble is so many other people would be too that it would unlikely go at a price that would get us really get us excited.

Question: A down market is good for you?

Buffett: I have no idea were the market is going to go. I prefer it going down. But my preferences have nothing to do with it. The market knows nothing about my feelings. That is one of the first things you have to learn about a stock. You buy 100 shares of *General Motors (GM).* Now all of a sudden you have this feeling about *GM*. It goes down, you may be mad at it. You may say, "Well, if it just goes up for what I paid for it, my life will be wonderful again." Or if it goes up, you may say how smart you were and how you and *GM* have this love affair. You have got all these feelings. <u>The stock doesn't know you own it</u>.

The stock just sits there; it doesn't care what you paid or the fact that you own it. Any feeling I have about the market is not reciprocated. I mean it is the ultimate cold shoulder we are talking about here. Practically anybody in this room is probably more likely to be a net buyer of stocks over the next ten years than they are a net seller, so everyone of you should prefer lower prices. If you are a net eater of hamburger over the next ten years, you want hamburger to go down unless you are a cattle producer. If you are going to be a buyer of *Coca-Cola* and you don't own *Coke* stock, you hope the price of *Coke* goes down. You are looking for it to be on sale this weekend at your Supermarket. You want it to be down on the weekends not up on the weekends when you tend the Supermarket.

The NYSE is one big supermarket of companies. And you are going to be buying stocks, what you want to have happen? You want to have those stocks go down, way down; you will make better buys then. Later on twenty or thirty years from now when you are in a period when you are dis-saving, or when your heirs dis-save for you, then you may care about higher prices. There is Chapter 8 in *Graham's* <u>Intelligent Investor</u> about the attitude toward stock market fluctuations, that and Chapter 20 on the Margin of Safety are the two most important essays ever written on investing as far as I am concerned. Because when I read Chapter 8 when I was 19, I figured out what I just said but it is obvious, but I didn't figure it out myself. It was explained to me. I probably would have gone another 100 years and still thought it was good when my stocks were going up. We want things to go down, but I have no idea what the stock market is going to do. I never do and I never will. It is not something I think about at all.

When it goes down, I look harder at what I might buy that day because I know there is more likely to be some merchandise there to use my money effectively in.

Moderator: Ok, Warren, we will let you take one more question from the audience….

Buffett: I will let you pick who get it. You can be the guy…(laughter).

Question: What would you do to live a happier life if you could live over again?

Buffett: This will sound disgusting. The question is how would I live my life over again to live a happier life? The only thing would be to select a gene pool where people lived to 120 or something where I came from.

I have been extraordinarily lucky. I mean, I use this example and I will take a minute or two because I think it is worth thinking about a little bit. Let's just assume it was 24 hours before you were born and a genie came to you and he said, "Herb, you look very promising and I have a big problem. I got to design the world in which you are going to live in. I have decided it is too tough; you design it. So you have twenty-four hours, you figure out what the social rules should be, the economic rules and the governmental rules and you and your kids and their kids will live under those rules.

You say, "I can design anything? There must be a catch?" The genie says there is a catch. You don't know if you are going to be born black or white, rich or poor, male or female, infirm or able-bodied, bright or retarded. All you know is you are going to take one ball out of a barrel with 5.8 billion (balls). You are going to participate in the ovarian lottery. And that is going to be the most important thing in your life, because that is going to control whether you are born here or in Afghanistan or whether you are born with an IQ of 130 or an IQ of 70. It is going to determine a whole lot. What type of world are you going to design?

I think it is a good way to look at social questions, because not knowing which ball you are going to get, you are going to want to design a system that is going to provide lots of goods and services because you want people on balance to live well. And you want it to produce more and more so your kids live better than you do and your grandchildren live better than their parents. But you also want a system that does produce lots of goods and services that does not leave behind a person who accidentally got the wrong ball and is not well wired for this particular system. I am ideally wired for the system I fell into here. I came out and got into something that enables me to allocate capital. Nothing so wonderful about that. If all of us were stranded on a desert island somewhere and we were never going to get off of it, the most valuable person there would be the one who could raise the most rice over time. I can say, "I can allocate capital!" You wouldn't be very excited about that. So I have been born in the right place.

Gates says that if I had been born three million years ago, I would have been some animal's lunch. He says, "You can't run very fast, you can't climb trees, you can't do anything." You would just be chewed up the first day. You are lucky; you were born today. And I am. The question getting back, here is this barrel with 6.5 billion balls, everybody in the world, if you could put your ball back, and they took out at random a 100 balls and you had to pick one of those, would you put your ball back in?

Now those 100 balls you are going to get out, roughly 5 of them will be American, 95/5. So if you want to be in this country, you will only have 5 balls, half of them will be women and half men--I will let you decide how you will vote on that one. Half of them will below average in intelligence and half above average in intelligence. Do you want to put your ball in there? Most of you will not want to put your ball back to get 100. So what you are saying is: I am in the luckiest one percent of the world right now sitting in this room--the top one percent of the world. Well, that is the way I feel. I am lucky to be born where I was because it was 50 to 1 in the United States when I was born. I have been lucky with parents, lucky with all kinds of things and lucky to be wired in a way that in a market economy, pays off like crazy for me. It doesn't pay off as well for someone who is absolutely as good a citizen as I am (by) leading Boy Scout troops, teaching Sunday School or whatever, raising fine families, but just doesn't happen to be wired in the same way that I am. So I have been extremely lucky so I would like to be lucky again.

Then the way to do it is to play out the game and do something you enjoy all your life and be associated with people you like. I only work with people I like. If I could make $100 million dollars with a guy who causes my stomach to churn, I would say no because in way that is very much like marrying for money which is probably not a very good idea in any circumstances, but if you are already rich, it is crazy. I am not going to marry for money. I would really do almost exactly what I have done except I wouldn't have bought the *US Air*.

Thank you.

END.