BERKSHIRE HATHAWAY ANNUAL MEETING

Omaha, Nebraska

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The majority of the content has come from the typewritten notes of Peter Boodell. A couple of other sources were used, most notably some of the notes from University of Maryland Professors David Kass and Susan White.

The editing and formatting was performed by:
Max Olson, Joe Koster, and Lincoln Minor.

[The movie ends after Becky Quick "reports" that Warren Buffett has switched jobs with All My Children's *Susan Lucci. Charlie Munger walks onto the stage and takes a seat. He is followed by Susan Lucci, who sits down in Warren's regular spot.]*

CHARLIE MUNGER: Where could he be?

SUSAN LUCCI: Detained at the TV studio. Hi Charlie, I'm Susan Lucci. He's going to be a big star.

CM: You have some important qualities that Warren lacks.

SL: There are some changes we need to make. We need to change our dividend policy. We are so cheap to our shareholders.

CM: Sounds good to me.

SL: And I want guidance on earnings, weekly. And we need to pay our directors more than $900 a year. *[The directors, sitting just in front of the stage, leap up and cheer.]*

[Warren Buffett walks in]

WARREN BUFFETT: What's that talk about dividends? My show is Berkshire Hathaway—*All My Children* can't do without you, and I can't do without Berkshire.

SL: The deal is off?

WB: You've brought me back to my senses. Pick out anything you would like at Borsheim's, and charge it to Charlie.

[Lucci hugs Buffett and Munger, and exits the stage—to applause.]

WB: Let's get this show on the road. We are going to follow the usual procedure. We are going to answer questions between now and then, based on who gets lined up at the microphone first. Our best estimate is that 31,000 people are here today.

We have Charlie Munger—he can hear and I can see—we work together for that reason. Let me introduce the Board of Directors (hold your applause until the end): Howard Buffett, Bill Gates, Don Keough, Tom Murphy, Walter Scott, Ron Olson, Susan Decker, Dave Gottesman, Charlotte Guyman—the best directors in America. We'll take a break at noon.

Q1: Bombay, India. I salute your 100% honesty. What are the key traits needed to correct the crowd mentality?

CM: He wants to know how to become less like a lemming.

WB: Since you repeated the question, I'll let you give first answer.

CM: He wants to invest less like a lemming.

WB: I started investing when I was 11. I believe in reading everything in sight. I wandered around for 8 years with technical analysis. I read *The Intelligent Investor*, chapters 8 and 20 I recommend the most, and if you absorb it you won't be a lemming. I read it early in 1950, and I think it's as good a book now as then. You can't get a bad result if you follow it. There is another book out there, *Foods You Will Enjoy,* about the Buffett family grocery store. Neither of us was any good at groceries. You don't want to pay attention to my grandfather's advice on stocks. *The Intelligent Investor* has three big lessons: (1) think of a stock as a part ownership of a business; (2) the market is there to serve you, not instruct you; and (3) always require a margin of safety. Berkshire shareholders are better than most at understanding that they own a part of a business.

Q2: Cologne, Germany. How is the operational integration of Cologne Re going?

WB: It is a 95% subsidiary of General Re, of which we own 100%. The oldest reinsurance company in the world. It does a wonderful job. We have a process in place such that we will soon own 100% of Cologne. It runs fine as it is. They have run their own portfolio, but I will take responsibility for Cologne's investment portfolio. We will consolidate 100% rather than 95%.

Q3: Fort Lee. Recession, stock market up in April, etc. Where will the market go next?

WB: I could expand on that question, but I couldn't answer it. Charlie and I haven't the faintest idea where it goes next week, next month or next year. We are not in that business. It isn't our game. We see thousands of companies priced every day. We ignore 99% of what we see. Every now and then, we find an attractive price for a business. When we buy it, we would be happy if the market was closed for a few years; you wouldn't get a price quote daily if you owned a farm. We look at expected yield, cost of taxes. If you buy a farm, you would look at the cost of fertilizers, what a farm produces relative to the purchase price, price per acre, production per acre, etc. We make judgments.

CM: Nothing to add.

WB: He's been practicing for weeks. *[laughter]*

Q4: Seattle. I am bad at hiring good managers. How do you assess a person's capabilities?

WB: You have to understand that we cheat. If you give me 100 MBAs (I am meeting over 30 schools this year), I no more could take the 100 and rank them - it would be impossible. We buy businesses with great management in place. We have seen their record. They come with the business. Our job is not to select great managers; our job is to retain them. A majority of them are wealthy. They don't have a monetary reason to work in many cases. We have 19 people at headquarters and 250,000 around the world. Our job is to make sure they have the same enthusiasm. We have to see passion in their eyes and believe the passion will remain, but we can create an environment to keep them happy. At these annual meetings, we tell them what a great job they did and make them feel appreciated. We don't have contracts—it doesn't work. Our managers are appreciated.

I can't be of help if you are looking at a group of MBAs. They know at this point in life how to fool you, what answers to give you. I would look for people with a passion for the job, doing more than their share, who are good communicators. In baseball, you have to hang up your cleats at 40, but our guys go on and on and on. Mrs. B worked until she was 103, then died the next year. That's a good lesson for our managers. *[laughter]*

CM: Story of Howard Amundsen; a young man asked him how do you get ahead? He replied, 'I always keep a few million dollars lying around just in case a good opportunity shows up.'

Q5: Would you use stock options to enter a position in a public company?

WB: If you want to buy or sell a stock, you should buy or sell a stock. We sold puts on Coca-Cola once, but usually it is best to just buy stock. Using option technique is an idea where you get to buy a stock cheap. Four out of five times you may get it right and one time you may miss the opportunity to buy. We virtually have never used options to enter or exit a position. We have sold long-term equity put options described in our press release. We don't get involved in fancy techniques.

CM: If I remember right, a public authority was wondering if they should set up an option exchange market. Warren was alone in the opinion of opposing it. You wrote a letter saying it wouldn't do any good to throw out margin rules in this fashion. It doesn't serve the country. I always thought Warren was totally right. Turning financial markets into gambling markets to enrich the croupiers doesn't make sense.

WB: A University of Chicago Graduate student asked me once, what are we being taught that is wrong? In business school the amount of time spent teaching option pricing is total nonsense. You only need two courses, (1) how to value a business, and (2) how to think about stock market fluctuations. The thing is that instructors know the formulas and you don't, so they have something to fill the time. It has nothing to do with investment success—what matters is buying businesses at the right price. If you were teaching Biblical studies and you could read the Bible forward, backward, and in four different languages, you would find it hard to tell everyone that it comes down to the Ten Commandments. The priests want to spend a lot of time preaching. You must have an attitude where you aren't influenced by the market. You need a mindset, and you need to have the attitude to divorce yourself from letting the market influence you.

Q6: Germany. You are both very generous. What are the joys of giving or the pitfalls of donating money?

WB: I've never given up anything that made a difference to me. There are people that drop in the collection plate an amount that makes a difference in their lives. I've never given a penny that way. I've lived a long time, which gives you a huge advantage in accumulating money. I'm giving away excess, not necessity. What I am doing is useful, but it isn't on a par with people who give real money. Doris [Doris Buffett, Warren's older sister] gives away money and time which is a real cost—she gives help beyond the money. She is retail; I am wholesale. You should give to things that you personally have interest in. I won't prioritize your giving.

CM: Regarding pitfalls, I would predict that if you have an extreme political ideology, you are very likely to make a lot of dumb charitable gifts.

WB: If you hang around Charlie enough, you get the sunny side of life. *[laughter]*

Q7: Bombay. What is your level of involvement when the company has an ethical dilemma? For example, Fruit of the Loom's competitors have sweatshops.

WB: We let managers run businesses, and their standards over the years have been extraordinary. I am very happy turning over the keys to the financial and business performance. I write them a letter every two years, and I ask them to send a letter with their successor. I also tell them we have all the money we need. We never want to trade reputation for money. Not only do they behave to conform to the law, but they act as if there was going to be a story in the local paper in the morning written by an intelligent, investigative reporter. There are no budgets. We have no incentives to cause people to do anything or push people to play games.

CM: We have no rule against foreign plants. We don't favor foreign plants; we just do what makes sense. The US was making one billion pairs of shoes per year, 30 years ago. We tried to compete with a great brand and workmanship. We found out it wouldn't work against shoes produced in China. There are one billion pairs of shoes now in the USA but they're all produced outside of the US. Some of those factories don't have the same norms. We won't tell the world how to run a business. We have standards, but not everyone's are the same.

Q8: California. Chinese tungsten prices are going up—will this have an impact on Iscar's machine tool production?

WB: The reason the Iscar plant was built in China was to serve China. It's growing. It's nice to be near a raw material, but the geographic plant decision has nothing to do with changes in the price of the product. If you are creating a higher value-added product like Iscar, there may be a three-to-six-month adjustment to raw material prices, but there won't be substitutes for tungsten as a raw material for cutting tools in the near term. Raw materials do get passed through. In the carpet business, oil-based raw materials are having more trouble passing costs. Over time it will pass through. But we'd be having trouble in that anyway. This candy will reflect sugar and cocoa over time. You can have squeezes here and there, but it's not a big deal. When I visited the facility in Dalian, I had very high expectations for Iscar and they've been exceeded in every way; both financial and human expectations.

CM: I would say that the short answer is that while we don't like inflation because it is bad for our country and civilization, we will probably make more money over time because there is inflation.

Q9: Melbourne, Australia. Berkshire has bought a lot of shares in the last twelve months of listed companies. Do you expect returns to be between 7-10% over many years? Well below your achievements in the past.

WB: Yes. We would be very happy if we could buy pretax returns of 10%, dividends included. We would probably settle for a little less than that. Berkshire's returns will be less, no question, in the future than in the past. We operate now in a universe of stocks with market caps of at least $10 billion, but really $50 billion and up in order to have an impact. This universe is not as profitable. If we find one with a $10 billion market cap, a 5% position is $500 million. If it doubles, we make $325 million; this is less than 2/10ths of 1% for Berkshire. We have found things to do from time to time to make money. They are nice, but they don't move the needle much at Berkshire. Anyone who expects us to replicate the past should sell their stock. We'll get decent returns, but not *indecent* returns.

CM: You can take Warren's promises to the bank. We are happy making money at a lower rate in the future, and we suggest you adopt the same attitude. You may have better things to do with your money than buying Berkshire. You will find things that are more intelligent, if you spend the time. We don't think it is the most attractive investment in the world. We like buying good-sized to very large businesses, with good management. It is a nice formula; it should work well over time.

Q10: First of three questions about the Klamath River dams in Oregon, owned by PacifiCorp. Will you make PacifiCorp accountable? [Problem of green/blue algae, polluting the water and killing the salmon]

WB: The first dam was built in 1907. We are prohibited from commenting on this. There are strong disagreements.

DAVID SOKOL *[Chairman of MidAmerican Energy, the Berkshire subsidiary that owns PacifiCorp]*: It was inappropriate for Mr. Buffett to respond. These four dams on the Klamath River, there are a whole series of issues in the federal regulatory re-licensing process. It will be ongoing for eight years. It won't culminate for another six years. There are twenty-eight various parties that are party to a discussion about what should or should not happen with these assets. Of these twenty-eight parties, there are four different directions that this process could go. We will be pleased to find a resolution. It is up to the regulatory commission, state legislators, and then each regulator in each state. We are working constructively with each of the parties. We have met with each of the parties, and hope we find an acceptable compromise.

Q11: California. How do you maintain your good mental and physical health?

WB: *[Holding up a piece of See's candy]* You start with a balanced diet—See's, Mars, and Coke. *[laughter]* If Charlie and I can't have a decent attitude, who can? We get to do what we like every day, and we work with people who love to do what they do. We are not forced to do what we don't want. I get to do what I like every day. We are very blessed in so many ways. How could you be sour? Charlie is 84 and I am 77. We have slowed down, but we pretend we haven't. There is no reason to look at the minuses in life. It would be crazy. We count our blessings. Not much more to it than that.

CM: I wish we were poster boys for the benefits of running marathons with slim bodies, but as much as you can tell, we don't pay attention to health advocates and dietary rules. I for one don't plan to change.

WB: From the moment we get up, until we go to sleep, we are associating with wonderful people. We are biased. We live in the best country in world. We could have stayed in my grandfather's store and it would have been terrible.

CM: If you are in a job you would pay to have, and you are supposed to be an exemplar—there is a lot to be said for not paying yourself very well.

WB: On corporate compensation, the idea that you have to pay someone $10 million in pensions just to keep him around… there's something wrong in that.

CM: Executives should volunteer to get paid less, as they would stay in their jobs at a quarter or half of their pay and would not be able to get better jobs elsewhere.

Q12: Germany (high school student). What should I do with my life?

WB: We prefer questions that are harder. *[laughter]*

Q12 CONT: What would you do if you started over?

WB: You have to find your passion in life. I would choose the same job. I enjoy it. It is a terrible mistake to sleepwalk through your life. Unless Shirley MacLaine is right, you won't have another one. My dad had a business with [investment] books on his shelves, and they turned me on. This was before *Playboy*. If he was a minister, I'm not sure I would have been as enthused. If you have obligations, you have to deal with realities. I tell students to go work for an organization you admire or an individual you admire, which usually means that most MBAs I meet become self-employed. *[laughter]* I went to work for Ben Graham. I never asked my salary. Get the right spouse. Charlie talks about the man who spent twenty years looking for the perfect woman and found her. Unfortunately, she was looking for the perfect man. If you are lucky, you will be happy and as a result, you will behave better. It makes it easier.

CM: You'll do better if you have passion for something in which you have aptitude. If Warren had gone into ballet, no one would have heard of him.

WB: Or would have heard of me very differently. *[laughter]*

Q13: (from a teacher trying to help introverts) What advice would you give to the quieter, introverted population, in order to raise their visibility and gain the recognition they deserve?

WB: I avoided all classes that had public speaking; I got physically ill if I had to speak. I signed up for a Dale Carnegie course. I gave them a check for $100, and then I went home and stopped payment on the check. I was in Omaha, and finally took $100 cash to Wally Kean. I took that Carnegie course, and then I went to the University of Omaha to start teaching—knowing I had to get in front of people. Ability to communicate in writing and speaking—it is undertaught—and enormously important. If you can communicate well, you have an enormous advantage. Force yourself into situations where you have to develop those abilities. It helps to do it in front of similar people to start. At Dale Carnegie—they made us stand on tables. I may have gone too far. You are doing something very worthwhile if you are helping introverted people get outside of themselves.

CM: It is a pleasure to have an educator come along who is doing something simple and important rather than foolish and unimportant.

WB: I hope he won't name names *[laughter]*.

Q14: Second question about the Klamath River.

WB: Regulators will deal with those issues. When government gets involved in eminent domain, there are always tradeoffs. Overall you have people with widely different interests. A big interest is the cost of electricity. Every commission that makes a decision on coal vs. gas makes a tradeoff, and tradeoffs are partly an economic cost and partly other issues. FERC [Federal Energy Regulatory Commission] will listen to everyone. They have to listen to everyone. We will do exactly what they say. We follow the dictates of regulatory bodies. They give us a fair return. From the standpoint of profitability, it is neutral. Society will make the decision.

DS: We distributed a study that found an accumulation of bio-algae and microcystin. There are 27 other lakes in Oregon with that type of blue-green algae. It is created from lakes that have a high abundance of nutrients. Klamath is hyper-eutrophic—there's a great abundance of algae and nutrients. There are 4 reservoirs. FERC does take it into account. Some do not call for the removal of the dam. All the parties will need to come to agreement.

Q15: Singapore. From the partnership letters in 1964, you had a strategy called 'generals relatively undervalued.' We have recently begun to implement a technique where we buy something at 12x, when comps sell at 20x. Comps go to 10x. Is this pair trading?

WB: Yes, we didn't know we started so early. Ben Graham did it in 1920. He did pair trading. He was right 4 out of 5, but the last one would kill him. We shorted the market to some degree. We would borrow stocks from universities. We were early in this. We wouldn't short a stock because it was unattractive but as a general market short [hedge]. I would borrow from the Treasurer of Columbia [University], "which ones do you want", "just give me all of them". It provoked some odd looks when I told the universities I wanted to short all of their stocks. It was not a big deal. We might have made a little money on it in the 1960s, but it is not something we do these days. If you have good long ideas on businesses that are undervalued, it is not necessary to short. 130/30 [simultaneously holding a 130% exposure to a long portfolio; and a 30% exposure to a short portfolio] is being marketed today. Many will sell you the idea of the day. No great statistical merit.

CM: We made our money by being long wonderful businesses, not by using a long-short strategy.

Q16: Germany. There are discounts in the fixed income market. Will you take advantage?

WB: We have seen some important dislocations. I've brought some figures. [Buffett grabs a stack of printouts.] Tax exempt money market funds [auction facilities]. $330 billion of them. Repricing of first-grade munis every 7 days. LA County Museum of Art. Jan 24th: 3.1%. Jan 31st: 4.1%. Feb 7th: 8%. Feb 14th: 10%. Fell back down to 3% on Feb 21st. Now 4.2%. Somehow, rates were much higher on Valentine's Day. Look at the bid sheet of Citigroup. Repricing every 7 days. You would find the same issue on several different pages. The same broker, at the same time, was quoting different prices on different pages for the same issue. On one page we bid 11%, and someone else bid 6%. You found this in 1974, and after LTCM [the 1998 Long-Term Capital Management blowup]. These are great times to make extra money. Auctions in esoteric securities. We have $4 billion invested in it. We will have made some insignificant money in this for a few months. There may be opportunities that we can't spot. If you have enough time, you can figure out some things that are really mispriced. We don't play with that; we just don't have enough time. If you spend enough time you may find those that Charlie and I can't find because we just can't look at that many things.

CM: What is interesting is how brief these opportunities are. Some idiot bought munis, bought 20x what he could afford on an incredible margin. Those things were dumped on margin calls and suddenly got really mispriced. The dislocation was very brief, but very extreme. The moves are fast and short. You must think fast and resolutely. You have to be like a man who stands by a stream where fish come by once a year.

WB: 2002 junk bond market happened.

CM: Very big dislocations happen about twice a century.

WB: That means we only have four or five times we can do it. *[laughter]*

Q17: India. Question on how to grow a small business into a big business?

WB: Berkshire was a small business at one time. It just takes time. It is the nature of compound interest. You can't build it in one day, or one week. Charlie and I never tried to do a masterstroke to convert Berkshire into something four times bigger. We just consistently kept doing what we understood and, if you have fun doing it, then it'll be something quite large at some point. Nothing magical. It would be nice to multiply money in a few weeks. In a general way, we have done the same things for years. We will have more businesses in a few years - some will do worse, but most will do better. It is an automatic formula for getting ahead, but not galloping. We are happy not doing anything at all. As Gypsy Rose Lee said, 'I have everything I had before, just two inches lower.' [laughter] We want everything in two years to be higher.

CM: It's the nature of things that most small businesses will never be big businesses. It is the nature of things that most big businesses fall into mediocrity or worse. Most players have to die. We have only made one new business, and that is the reinsurance business—run by Ajit. We only created from scratch one small business into a big one. We've only done it once. We are a one-trick pony.

WB: Without Ajit, we wouldn't have done it all.

CM: The best investment we ever made was the fee we paid to an executive recruiter to find Ajit Jain.

WB: We went into the muni bond [insurance] business. Ajit got the company up, licensed and running. In Q1'08, our premium volume was $400 million. Our volume was bigger than anyone else, and I wouldn't be surprised if it was bigger than all the rest combined. They did 278 transactions. All done in an office with 29 or 30 people. One of the interesting things about it was that almost all the business was from people who already had insurance from others who are rated AAA. So we pay out only if the muni defaulted AND the bond insurer didn't pay. We wrote for 2.25% when the original guy charged 1%. This tells you something about AAA in bond insurance in 2008. Ajit has done a remarkable job. We wrote a couple policies for Detroit sewers, and people have found these bonds trading at a better price than others only insured by other bond insurers. I congratulate Ajit for it.

Q18: If you can't talk with management, and can't read the annual report, and didn't know the price, but could only look at the financial statements, what metric would you look at?

WB: Investing is laying out money now to get more money later on. Let's leave the market price out. If you were buying a farm, you would think about bushels per acre—you are looking to the asset itself. Ask yourself: do I understand enough about the business so that the financials will be able to tell me meaningful things that will help me to foresee the statements in the future? I have bought stocks the way you describe. They were in businesses I understood, and if I could buy at 40% of X, I'd be okay with the margin of safety. If you don't tell me the nature of the business, financial statements won't tell me much. We've bought many securities, and with most, we've never met management. We use our general understanding of business and look to specifics from financial statements.

CM: One metric catches people. We prefer businesses that drown in cash. An example of a different business is construction equipment. You work hard all year and there is your profit sitting in the yard. We avoid businesses like that. We prefer those that can write us a check at the end of the year.

WB: We could value an apartment if we knew where the apartment is, and we know the monthly checks. I have bought a lot of things off the financials. There is a lot I wouldn't buy even if it had the best management in the world, as it doesn't make much difference in a bad business.

Q19: Third question about the Klamath River.

WB: The net benefits vs. losses must be weighed. There are lots of competing ideas and desires in a large society. It is up to the government to sort it out. People are coming to different conclusions about tradeoffs, and generally those are at the state level. The Oregon Public Utility Commission, I am sure, is aware of the issue. They have to consider the best way to generate electricity for the citizens of Oregon.

DS: We want to clarify that we are not polluting the water. We recognize the various issues. We have a 50-year FERC license. A societal answer, hopefully, will be reached.

CM: I note how refreshing it is to find people addressing a pollution problem that has nothing to do with burning carbon.

Q20: Philadelphia. I'm 12 years old. There are a lot of things they don't teach you in school. What things should I be looking into?

WB: I'd read a daily newspaper. You want to learn about the world around you. Bill Gates quit at letter P in the *World Book Encyclopedia*. Just sop it up, and find what is most interesting to you. The more you learn, the more you want to learn. It is fun.

CM: My suggestion is that the young person asking the question has already figured out how to succeed in life.

Q21: Germany. Chocolate industry. I cannot buy See's Candies in Bonn Germany. See's Candies vs. Lindt. Sees' has a 20% profit margin; their growth is

okay. Lindt does 14%, but is now global. Which is better, high profits with low growth, or high growth with lower profits?

WB: It doesn't make any difference. We want a company with a durable advantage, which we can understand, a management we can trust, at a good price. We've looked at every confectionary business. We can sometimes take action. If you have a good private business, the best thing to do is to keep it. No reason to sell it. If you don't need the billion, then it's just a farm. We never urge people to sell good businesses, but if they do need to sell, they can keep more of the attributes they love by selling to Berkshire. We are a larger buyer. Most people shouldn't sell us their business, but we want them to think of us if they do decide to sell. We want to be on the radar screen. We are going to get more on the radar screen in Europe. There is a price at which we would buy stock in Lindt, but it is unlikely to sell there. Many CEOs want to sell to me, but there are thousands of businesses in the world. We should buy the most attractive amongst the ones we understand and like. Stocks give you bargains, but individual owners won't. But we will do it at a fair price. We aren't going to look for a given confectionary company.

CM: We don't do anything when the phrase 'regardless of price' enters the equation. I watched a man who sold a business to a known crook just for a higher price, but who you knew would ruin the business. It's better to sell companies you created to someone who would be a good steward at a lower price.

Q22: Do you hedge and what are your thoughts on the U.S. dollar?

WB: We are happy to invest in businesses overseas, as I don't think currencies will depreciate in a big way. We could offset but, overall, the US is following policies that will make the US dollar weaker. I'd bet weaker over the next 10 years, so we feel no need to hedge earnings generated overseas. If I landed from Mars today, with a billion Mars dollars, and was thinking about where to put money… What would I like to exchange? I wouldn't put one billion Mars dollars into US dollars. I don't mind earnings overseas. We own 200 million shares of Coca-Cola. That is $600 million of earnings to us, and $500 million of that comes from the rest of the world. I think it's a net plus over time. We are not in the business of hedging currencies.

CM: Nothing to add.

Q23: New York. With small sums of money, what strategies would you pursue?

WB: If I were working with small sums of money, it would open up thousands of possibilities. We have found very mispriced bonds. We found them in Korea a few years ago. You could make big returns but had to be of small size. I wouldn't be in currencies with a small amount of money. I had a friend who used to buy tax liens. I'd look in small stocks or specialized bonds. Wouldn't you say that, Charlie?

CM: Sure.

Q24: St Louis. Huge confusion now, what advice do you have? Three candidates are pandering to voters—some not demonstrating a profound understanding of economics. Decrease interest rates? Won't we have gigantic inflation?

WB: Politics is difficult. Famous line from Bill Buckley about what would you do if elected? 'I would demand a recount.' The truth is that you get lots of pandering in the policies that are proposed. The candidates are pretty smart about economics. The political process is something that doesn't lend itself to Douglas-Lincoln debates on the fine points. I think the current candidates will be better in office than on a soapbox. We have a country that works well regardless of who is in office. You want to buy stock in a business that is so good because sooner or later an idiot will run it. I think we have three very good candidates. The motivations of people running are better than their proclamations. You may win a badge for courage, but you won't win the presidency in Iowa if you're against ethanol.

CM: When Enron shocked the nation, our politicians passed Sarbanes-Oxley. We are currently shooting at an elephant with a peashooter. I confidently predict we will have changes in regulation, and they won't work for everybody. Human nature always has incentives to rationalize and misbehave. For this reason, we will have turmoil for as far ahead as you can see. [There will always be something.]

WB: I would gladly pay to have this job. Let's assume I was campaigning for this job, and if so, my answers might be different. It is a corrupting process, naturally. There is a boom in oil and also in soybeans. Because of increases in food prices, would anyone expect to propose an excess profits tax on farmers? But what about an excess profits tax on Exxon? Situational ethics and policymaking depend a lot on voters. I'm not sure I'd be able to do better, but if I wanted to be President, I'm not sure my behavior wouldn't be bad too. Any one of the three candidates will do well in the White House. I think they will do what is best for the country.

Q25: Can you provide an update on the succession plan?

WB: We have three CEO candidates who could step in. The Board will pick someone for CEO. For investment officer, the Board has four names. As we've discussed, any one, or all four, would be good or better than me at this job. Any one of the four would be here tomorrow if I died tonight. They are all reasonably young, and all well to do.

Compensation is not a major factor. Any of the four would come. There's no reason to come now. I worked for Ben Graham, but in the end I wanted to make the decisions. I prefer to make my own decisions. It is better in this case. When I'm not around to make decisions—the Board will decide how many to use. They will be heavily influenced by the incoming CEO, by how he wants to work with them. There will be no gap. They could easily have a better record than my recent record.

CM: We still have a rising young man here named Warren Buffett. I think we want to encourage this rising young man to reach his full potential.

WB: On the corporate America aging issue, I think we are doing fine. Our average age is 80, so we are only aging at 1.25% per year—the lowest rate of aging in corporate America. If you have a 50-year-old management team, they age 2% every year. I think you run a bigger risk there. *[laughing]*

Q26: New York City. American Express and Washington Post were big positions for you. How do you get confident enough with that [smaller] level of diversification?

WB: If we were running only our own money, putting 75% of our net worth in a single position is not a problem if it is something we really have high confidence in. Putting 500% or more of your net worth in a position is a problem. Several times I have had 75% of my non-Berkshire net worth in a situation. You will see things where it would be a mistake not to act. You won't see them often, and the press and your friends won't be talking about them. Wouldn't you say, Charlie? 75% is not a real significant amount?

CM: Sometimes, I have had more than 100% in an individual investment.

WB: You just had a good banker. Look at LTCM—they put 25x their money in things that had to converge—but couldn't play out the hand. There are people in this room with more than 90% of their worth in Berkshire. I saw things in 2002 in junk bonds that would have been worth going heavily into. You could have bought Cap Cities in 1974—selling for one-third the property value, with the best manager, and in a good business. You could have put 100% in Coca-Cola when we bought it and that wouldn't have been a dangerous position.

CM: Students learn corporate finance at business schools. They are taught that the whole secret is diversification. But the exact rule is the opposite. The 'know-nothing' investor should practice diversification, but it is crazy if you are an expert. The goal of investment is to find situations where it is safe *not* to diversify. If you only put 20% into the opportunity of a lifetime, you are not being rational. Very seldom do we get to buy as much of any good idea as we would like to.

Q27: Boys Town. I'm here representing Parent's TV Council. We want to keep toxic violence off television. I've read Berkshire is a troublesome advertiser?

WB: Geico is Berkshire's highest spender on advertising—$700 million. I don't regard their ads as offensive. Please contact Tony Nicely for further questions about Geico. He is here. I can't think of another company that advertises as much.

Q28: New Jersey. Partly because of marrying well, I am able to manage the money of my husband and myself full time. I wanted to ask a diversification question. Each of us has a traditional and a Roth

IRA. Should the assets in those accounts be separated, or managed as a single entity?

WB: Sounds like your marriage will last. Think of it as one unit. Don't worry about the location of assets. Just look at the whole picture. Don't treat them as separate pots. I don't think about what entities things are in. With that, I'll turn it to our marital expert, Charlie Munger.

CM: Taxable income may be more suitable for a tax-deferred account. Apart from that, put it all in one pot.

Q29: Akron, Ohio. Oil will run out this century. Considering US policy is to do nothing until the last second, will we face World War III? Will oil companies go to zero?

WB: Oil won't run out - it doesn't work that way. At some point the daily productive capacity will level off and then start declining gradually. There is the depletion aspect and the decline curves. We are producing 86 million barrels per day or so, more than ever produced. We are closer, by my calculations, to almost our productive capacity, than we have ever been. I think our surplus capacity is less, and quite a bit less, than in the past. Whatever that peak is, whether it's 5 years, 10 years, etc., the world will adjust, and we will think about it. Adjustments will cause demand to taper off. I don't know how much oil is there, but there are lots of barrels of oil in place. We never recover total potential. We may have better engineering recovery in the future. It is nothing like an on and off switch. You may still have enormous political considerations to get access to available oil since it is so important. There is nothing you can do over a short period of time to wean the world off oil.

CM: If we get another 200 years of growth dispersed over the world while the population goes up, all oil, coal and uranium will run out, so we will have to use the sun. I think there will be some pain in this process. I think it is stupid to use up the hydrocarbons of the world so quickly. It's stupid when there are so few, and limited, alternatives. What should we have done? We should have brought all the oil over from the Middle East in the 1930s and put it in our ground. Are we doing it now? No. Government policy is behind in rationality. If we are to have a prosperous civilization, we must use the sun.

WB: Charlie, what is your over/under for oil production in 25 years?

CM: Oil in 25 years? Down.

WB: If that is true, that is a big number. China is doing about 10 million cars this year, so down in 25 years is significant.

Q30: Maybe there should be a Buffett/Munger Presidential ticket. Please name three difficult policy decisions and three perfect solutions to better the country.

WB: Charlie will serve the first term, so he'll answer first.

CM: That takes us so far afield. Three perfect solutions to the problems of mankind, we are not up to it.

WB: I would do something about the tax system. The super rich should pay more. The middle class should pay a little less.

Q31: Arizona. Food shortages, trends in next decade?

CM: I said last year that the policy of turning American corn into motor fuel was one of dumbest ideas in the history of the world. I flew here with a head of academics—he agreed, it was stunningly stupid. It is probably on its way out.

Q32: Princeton (guest lecturer). Imagine you are investing with small sums of money at 30 years old, with your first $1 million. Your savings can cover expenses for 18 months. You are not a full-time investor. What advice do you have, please be as specific as possible. What asset classes and what percents?

WB: Put it all in a low cost index fund. Vanguard. Reliable, low cost. If you're not professional, you are thus an amateur. Unless bought during strong bull market, that investment would outperform bonds over a long period of time and I would forget it and go back to work.

CM: The great horde of professionals are taking croupier profits out of the system, and most of them are pretending to be experts. If you don't have prospects as a professional investor, do an index fund.

WB: No one will give you that advice since it doesn't make anyone money. You will get a good return. Why should you expect more than that when you don't bring anything to the party?

Q33: Austin, Texas. I have four children. Can you give them advice about keeping up with the Joneses?

WB: Just keep up with the Buffetts. *[laughter]* We've always been fans of living within your means and income. You'll have a lot more income later on. They will follow the example of their parents. You shouldn't increase your cost of living without improving your standard of living. If you go too tough on children, they go crazy later on. There are plenty of people I don't advise to save. If you already have money in a 401(k) and Social Security and have a little left over, who is to say you should give up taking your children to Disney World and the associated happiness now for a 30-foot boat later vs. a 20-foot boat later. There are benefits to spending now. It is not always better to save 10% than 5%, but definitely better than spending 105%. You need to live a life that is true to yourself. We don't encourage extreme frugality. You are not a better or worse person if you live differently from your neighbor.

CM: The best method is to train your child.

Q34: Idaho. Are investment banks so complex that the head is not aware of the risks?

WB: Exceptionally good question. The answer is probably yes in most places, though there are a few CEOs I respect a lot. Gen Re had 23,000 derivative contracts. I could have worked full time on that, and I probably still couldn't have gotten my head around it all. And we had exposures that I thought were possible and heads of business units didn't—I don't want slim, I want none. I am Chief Risk Officer at Berkshire. If something goes wrong, I cannot assign it to a committee. I think big investment banks and big commercial banks are almost too big to manage effectively in the way they have elected to run their business. It will work most of the time. You may not see the risk. A 1-in-50-year risk - it won't be in the interest of a 62 year old executive who is retiring at 65 to worry about it. I worry about everything. Many CEOs say they didn't know about what was going on. It's easier to admit he doesn't know what's going on than to admit that he knew what was going on and let it go on. I've been asked for advice on regulation. Somehow, the press hasn't picked up on this too much. OFHEO [Office of Federal Housing Enterprise Oversight] supervised Fannie [Mae] and Freddie [Mac]—their activities had a public element, and were semi-regulated. For 200 people [at OFHEO] it was their sole job to examine the books. They were two-for-two with two of the biggest accounting scams in the history of the world. The person at the top must have it in their DNA to see risks. In many ways, there are firms that in terms of risk are too big to manage. If too big to fail, there are interesting policy implications.

CM: It is crazy to allow things, which are run with knavery, to get too big to fail. As an industry, there is a crazy culture of greed and overreaching and overconfidence, trading algorithms. It is demented to allow derivative trading such that clearance risks are embedded in the system. Assets are all "good until reached for" on balance sheets. We had $400 million of that at General Re, "good until reached for". In the drug business, you must prove it is good. It is a crazy culture, and to some extent, an evil culture. Accounting people really failed us. Accounting standards ought to be dealt with like engineering standards.

WB: Salomon [Salomon Brothers during the 1991 scandal] was trading with Marc Rich who had fled the country. They said they wanted to keep trading with him. Only by total directive could we stop it. I think the Fed did the right thing with Bear [Stearns]. They would have failed on Sunday night, and walked to a bankruptcy judge. They had $14.5 trillion of derivative contracts—not as bad as it sounds, but the parties that had those contracts would have been required to undo the contracts to establish the liability from the estate. With the $400 million at Gen Re, we had 4-5 years. At Bear, it would have been 4-5 hours. It would have been a spectacle. Two of the witnesses at the testimony said, 'we understood we couldn't borrow unsecured, but we didn't understand we couldn't borrow secured.' The world does not have to lend you money. If they don't want to lend you money, an extra 10 basis points won't make a difference. It depends on people's willingness to lend you money, which comes down to how other people feel about you. If you are dependent on borrowed money, you have to wake up every day worried about what the world thinks of you.

Q35: San Francisco. In 2002, you invested in PetroChina and all you did was read the annual report. Most professional investors have more resources at hand. Wouldn't you want to do more research? What do you look for in an annual like that? How could you make the investment only on a report?

WB: I read it in the spring of 2002, and I never asked anyone else their opinion. I thought it was worth $100 billion after reading the report. I then checked the price, and it was selling for $35 billion. What is the sense of talking to management? It doesn't make any difference. If the market value was $40 billion, you would need to refine the analysis. We don't like things you have to carry out to 3 decimal places. If someone weighed somewhere between 300-350 pounds, I wouldn't need precision—I would know they were fat. If you can't make a decision on PetroChina off the figures, you go on to the next one. You weren't going to learn more if you thought their big [oil] field was going to decline out slightly faster, etc.

CM: We have lower due diligence expenses than anyone in America. I know of a place that pays over $200 million to its accountants every year, and I know we are safer because we think like engineers—we want margins of reliability. It is a very dicey process.

WB: If you think the auditors know more about an acquisition, then they should run the business and you should take up auditing. When we got the call on Mars-Wrigley—I wasn't going to look at labor costs or leases. The value of Wrigley does not depend on the value of the lease or an environmental problem. There is a whole lot of trivia that doesn't mean anything. I never made an investment that would have been avoided due to conventional due diligence. We would have lost deals. On big deals, people rely more and more on process. When people want a deal, they will come to us. Mars only wanted to deal with Berkshire—there were no lawyers involved and no Directors involved. I got a call, it made sense, and I said yes. There was no material adverse change clause. Our $6.5 billion will be available regardless, even if Ben Bernanke runs off to South America with Paris Hilton. *[eruption of laughter]* That assurance is worth something. If you say, 'I'll do it, but I need X, Y, Z, etc.'—that is costly.

Q36: Norman, Oklahoma. Do you believe in Jesus Christ?

WB: I am an agnostic.

CM: I don't want to talk about my religion.

WB: Being an agnostic, I don't have to have an opinion.

Q37: What safeguards are in place against breaking up Berkshire?

WB: My stock will be sold over a period of years after my death. That takes a lot of time. Berkshire is a very large company and will get bigger over time, so it would be very difficult for someone to do a takeover of that size. It can't happen at all until I die [since there are a lot of votes concentrated until then]. I told my lawyer I wanted a ten-year distribution period—to make sure my estate lasts quite a while, to which my lawyer said that was like telling his teenage son to have a normal sex life. If we do decent compounding, we'll be one of the largest companies in the USA. It will be difficult to break us up.

CM: Warren doesn't plan to leave early. He wants people to say at his funeral, "That is the oldest looking corpse I've ever seen."

WB: I am unlikely to change my views on that subject. *[laughter]*

Q38: Chicago. What are the economic characteristics that make Kraft a good business?

WB: Most big food businesses are good businesses in that they earn good returns on tangible assets. If you own important branded assets in this country, and you have good assets, it is not easy to take on those products. Just imagine Coca-Cola. They sell 1.5 billion servings every day. It has been in everyone's mind since 1886—associated with good value, happiness and refreshment. It is virtually impossible to take it on in a huge way. It may not be the same with Kraft. Kool-Aid, but I'm not sure I want to take on Kool-Aid. To implant RC Cola in people's minds globally is very, very difficult. A brand is a promise. Coca-Cola delivers something to you. Virgin Cola—an unusual promise in a product—tried and couldn't figure it out. Whatever it was, it didn't work. Don Keough would know. Who would buy a can for two-cents-a-can less than Coca-Cola? We feel pretty good about branded products if they're leaders in their field. There is nothing unusual about Kraft that's different from Kellogg. Some good factors are price. If you don't pay too much, you will do okay. But you won't get superrich, as the attributes [of a strong brand] are well recognized.

Q39: Chicago, Illinois. How did you select the four investment professionals who could succeed you in the CIO [Chief Investment Officer] position?

WB: The criteria are in the 2006 Annual Report. Records are important. Human qualities are important. We think we can make those judgments, and we made an affirmative judgment on four. We need someone who can see risks, especially ones that haven't happened before. All the banks have models, but they didn't have the faintest idea [what could happen under new circumstances]. You need someone you trust with analytics, but one that also has the ability to contemplate new possibilities and risks. That is a rare quality. That inability to envision something not in the models can be fatal. Charlie and I spend a lot of time thinking about things that could hit us out of the blue that other people don't include in their thinking. We miss a lot of opportunities. But we think it's essential when managing other people's money. You should read the 2006 Annual Report again.

CM: You can see how risk-averse Berkshire is. We try to behave in a way so that no rational person will worry about our credit. We also try to behave in a way that if people don't like our credit, we wouldn't notice it for months. That double layering of protection against risk is like breathing. The alternative culture is that you call a man a Chief Risk Officer, but often he is just a man who makes you feel good while you do dumb things. Like the Delphic oracle, a dumb soothsayer, and people say how can he do dumb things if he has a PhD and can do all the advanced math? You crave a system such that you torture reality to fit a structure that doesn't match with extreme situations in reality. You feel confident because you compute the risks, but you haven't—you have just clobbered up your own head.

WB: We run Berkshire so that if the world was working in a different way tomorrow, we don't have a problem. We are not dependent on others. It may mean giving up earning a higher return 99% or 99.5% of the time in any given year, but we wouldn't feel comfortable running the business any other way. Why be exposed to ruin and disgrace and embarrassment [for a few extra percentage points]? If we can earn a decent return on capital, what is an extra point? This cannot be farmed out. Management thought they were farming it out at some institutions.

Q40: Germany. How large is the universe of companies whose intrinsic value you know? Why invest in South Korea or China?

WB: Our immediate decision is whether we can figure it out. We are thought to be rude sometimes, when really we are just being polite in not wasting someone's time. We know very early in a conversation whether what someone is talking about is actionable. We don't worry about stuff we miss. We know there are many things that we won't know enough about when we finish thinking about it, so we throw it out. We make a decision in five minutes. We know about a lot of industries, and there are some things we don't understand. We like to expand our universe of knowledge. If we can't make a decision in five minutes, we can't learn enough in five months. If we get a call, with a business for sale—or I am reading a paper or 10-K [annual company SEC filing], we will move right then if there's a big difference between price and value.

CM: We can make a lot of decisions about a lot of things very fast and very easily, and we are unusual in that. The reason is that there is such an enormous amount of things we don't look at. If you don't do startups, you blot a lot of complexity out of your life. What we found out is that there are still a lot of things to look at and that are available, even if we filter out all those things.

WB: There are a lot of giveaways in the first sentence or two. We waste a lot of time, but we waste it on things we want to waste it on.

Q41: What do you think and know about Carlos Slim?

WB: We had lunch 15 years ago, and it was pleasant. Outside of that visit and what I read in the newspaper, I don't know much about him.

CM: You speak to the total knowledge of both of us about Carlos Slim.

Q42: New York City. Should the U.S., and U.S. companies such as Coca-Cola, withdraw sponsorship of the Beijing Olympics because of humanitarian values?

WB: I think the Olympics should be allowed to continue forever with everyone participating. It is hard to grade a couple hundred countries. It is a terrible mistake to try to start grading. The more that participate, the better. I would not start getting punitive. I think it's a terrible mistake to ban countries from the Olympics. The United States only started allowing women to vote in the 1920s, and I consider that a huge violation of human rights, but we wouldn't want to be banned from the Olympics for the years prior. I think that over time, China is contributing and getting better.

CM: Warren understates my position. Many are distressed by imperfections in China, so I ask—has China gotten more or less imperfect as the decades have gone by? It is moving in the right direction. That is a good thing, and it is not good to pick the worst thing about a person you don't like and obsess about it.

WB: You will do better with people you are working with if you nudge them a bit.

Q43: Scottsdale, Arizona. What are the future trends in coal? Does the cost advantage outweigh the environmental impact?

WB: In the short term, the world will use more coal. There is an environmental disadvantage to it. We will slowly figure out ways to do things coal does now that are environmentally more friendly. But it won't happen fast. If you shut down coal plants, we wouldn't be able to hold this meeting. At MidAmerican, we have put in a lot of wind capacity, probably more than anybody. But we are dependent a lot on coal, and now it is cleaner than it was. It is a worldwide problem, with the Chinese building a lot of coal plants. Per capita, Americans have done a lot of negative things to this planet, so it is hard for us to preach. It will take a leader who can lead on this.

CM: I ask the people who are very against coal, 'which would they rather use up first, coal or hydrocarbons?' Coal is less desirable as a chemical feedstock to feed the world. [So, oil is more important to feeding the world]. There is an environmental reason for pro-coal use. Most people don't think this way, but I do.

WB: Charlie doesn't take comfort in numbers [having the herd agree with him].

Q44: Stockton, California. Small regional banks - what would you look at before you buy?

WB: It is hard to make a categorical decision about regional banks. So much depends on the character of the institution. It will be a reflection of the CEO you have. A bank can mean anything. It can be an institution that is doing all sorts of crazy things. The Bank of Commonwealth was an example. We owned a bank in Rockford, Illinois, run by Dean Aback—he would always run a super, sound bank. You should know the culture of the management and the institution before making the decision to buy a bank. We own Wells Fargo and M&T, but it doesn't mean they are immune. But likely they are immune from institutional stupidity. There was a wise man that said there are more banks than bankers. If you think about that a while, you will get my point.

CM: The questioner is on to something. So many large banks have cast a pall over the entire industry. You are prospecting in a likely territory.

WB: If you took the 20 largest and the 20 smallest banks in Florida, I don't know if you could tell the difference.

CM: It is a territory that has some promise.

WB: That is a wildly bullish statement from Charlie. I may need to go start buying! *[laughter]*

Q45: Chicago. How can further nuclear proliferation be prevented?

WB: The great problem of mankind is that the genie is out of the bottle on nuclear weapons. More and more people will know how to do damage. Psychotics will wish ill will. Materials and deliverability is the choke point. People generally associate this risk with terrorists and rogue states. But I regard it as a big threat to the future of mankind. We haven't made much progress and we should be doing everything to reduce access to materials. We have a proposal to reduce the rationale to have big weapons. The world has 6.5 billion people, and it is very likely that twice the number of people wish ill than when the world had 3 billion. We used to just pick up a stone and throw it at our neighbor, so massive damage was limited. Since 1945, everything in the world has changed except how men think. There's been exponential growth, and we haven't gotten rid of the nuts. We live in a dangerous world, and it's getting more dangerous as we go along. In the Cuban Missile Crisis, the odds were probably 50/50. We were lucky. It won't go away. You would hope we have an administration which will try to figure out how to minimize the risk. It should be paramount to eliminate deaths on a large scale.

CM: Well, you can talk about death on a large scale. The population of Mexico probably had a population decline of 95% as result of European pathogens. It won't wipe out the species. I hope that cheers you up.

WB: The cockroaches will survive.

Q46: Florida. I teach at a community college in Florida, teaching students to invest in themselves. Financial independence and freedom. Slow and steady wins the race. Law of reciprocity. Etc, etc, etc. What else should I be doing?

WB: *[Laughing]* I'm ready to hire your entire class right now. The most important investment is in themselves. Potential horsepower is rarely achieved. Just imagine you are 16 and your parents are going to give you the car of your choice. But the catch is that it is the only car you would get for the rest of your life. How would you choose to proceed? Of course, you will read the manual 5 times. How would you treat it? You'll keep it garaged, change the oil twice as frequently as you're supposed to, and keep rust to a minimum because you know it needs to last a lifetime. I tell students that you get only one body and one mind. You'd better treat them the same way. It's hard to change habits at age 50 or 60. Anything students do to invest in body and mind is good, particularly in the mind. We didn't work too hard on bodies around here. It pays off in an extraordinary way. The best asset is your own self. You can become, to an enormous degree, the person you want to be. When I talk to university classes, I ask them to buy one classmate to own [his or her earnings] for the rest of their life. They would pick the person not with the highest IQ, but the ones who are the most effective; the ones you want to be around. These people are easy to work with, generous, on time, don't claim credit, help others. Those are good habits to develop. Leaders are effective because people want to be around them.

CM: I have a specific suggestion that I would add to your extensive repertoire. I would teach them to avoid being manipulated by vendors and lenders by using their own tricks against them. Cialdini has a new book—it is called *Yes!* It is not as good as *Influence*, but I recommend it and recommend adding both of those books to your repertoire.

Q47: Chicago. Nine years old. I know you like baseball. My favorite team is the Chicago Cubs. Would you like to buy the Chicago Cubs from Sam Zell? Is it a good investment?

WB: It's been a good investment. Earnings haven't gone up so much, though cable [television] expanded the stadium. There were 40,000 seats in 1939, and cable multiplied seats in a huge way, and a lot of it went to the players, but some stuck to the owners. When I was your age, I thought I would buy a team. If the Cubs sell for $700 million, I don't think I would buy at that price—but there is a psychological income to some owners. It is a way to instant celebrity. A certain percentage of people want the route to that life. Many people have loads of money. I've had calls from others about the Cubs. I think I will leave that to you.

WB: Charlie is a harder sell. I might do something like that.

CM: [Referring to Buffett's minority stake in the Omaha Royals—the Triple-A affiliate of the Kansas City Royals baseball team] You have already done it once.

WB: Touché. *[laughter]*

Q48: Americans don't save. Why? What can we do? Municipalities and the Fed don't save. Asians save 40% of their income. Why is it that Americans do not save, and what can we do to correct our long-term problem?

WB: The savings rate has fallen. It may be negative. But the value of the country in real terms increases decade to decade. It's worth more now than 20 years ago—something good has happened. The propensity to save seems innate in some places. If you own Berkshire, you are saving because we retain earnings and therefore you are net saving—and I have been doing it in Berkshire for 43 years. I don't know that the savings rate—based on calculations on consumption and imports—is accurate. We are importing $700 billion more of services than we are exporting [per year]. We are exporting claims against America. But we are so rich, it may not be really apparent. Average standards are likely to improve, but it may be disproportionate. In net real terms, the value on a per capita basis will very likely increase decade to decade. But it is nothing compared to China or Korea where the savings rate is very high. We may not save very much because we don't need to. We are a very rich country, and we may not need to save as much as other countries trying to reach their potential.

Q49: Germany. May I ask you your reasons for coming to Germany?

WB: We want more family owners of German businesses. We want more owners who, when they think of the need to monetize, have Berkshire on their radar screen. We aren't as prominent in Germany as we are in the US. We are looking for good companies and we want them to know us. We should be better known in a month.

CM: Germany is particularly impressive—an advanced civilization, especially in engineering and industrials, with German advancement and inventiveness. It is amazing the impact Germans have had on field after field in America. Look at all the machines in factories with German names.

WB: Sounds like Charlie should go to Germany.

Q50: California. What can we learn from past blowups?

WB: They're all a little different, and they all have similarities. This one had origins in the mortgage field and residential real estate. Trouble in one area has a way of spreading to another area. In my lifetime, I can't remember one where this particular residential real estate bubble sent out the kind of shock wave and exposure of so many other bad practices and weaknesses elsewhere like this one. There isn't any magic to analysis. There are stupid things that won't be done soon again; and not the same way again. But variations of it will occur again. Humans are what lead to stupidity and behavior. Primal urges, wanting to believe in the tooth fairy that pops up from time to time, sometimes occur on a very big scale. I have no great insights on the solutions.

CM: It was a particularly foolish mess. We talked about an idiot in the credit delivery grocery business, Webvan. An Internet-based delivery service for groceries [that failed terribly]—that was smarter than what happened in the mortgage business. I wish we had those Webvan people back. I have a rule: The politicians are never so bad you don't live to want them back. *[laughter]*

Q51: What can be done to improve the accuracy of financial statements of financial institutions? What can be done to improve the integrity of financial statements?

WB: It is a very tough thing. I still lean strongly towards fair value accounting—it is hard to use, but should we use cost? I think there are more troubles when you start openly valuing things at prices that don't matter instead of best estimates, even if inaccurate. I would stick with financials reporting assets at fair value. When you get into CDO-squared [Collateralized Debt Obligation-Squared], the documentation is enormous. If you read a standard residential security prospectus—it consists of thousands of mortgages, then different tranches. Then, you take a CDO and you take junior tranches on a whole bunch of juniors—put them together, and diversified in theory—a big error to start with. That was nuttiness squared. You had to read 15,000 pages to understand a CDO and 750,000 pages to evaluate one single security in a CDO-squared. To let people use the 100 cents they paid as the stated value versus the 10 cents it trades at in the market is an abomination. Fair value discipline, mild as it may be, may keep managements from doing some stupid things. I lean toward the market value approach. When you get towards complex instruments, I don't know how you value it. Charlie, back at Salomon, I think you found one mismarked by $20 million, right?

CM: A lot goes on in the bowels of American industry which is not pretty. A lot of people got overdosed on Ayn Rand. They would hold that even an axe murderer in a free market is a wise development. I think Alan Greenspan did a good job on average, but he overdosed on Ayn Rand, in that whatever happens in a free market is going to be all right. We should prohibit some things. If we had banned the phrase, "this is a financial innovation which will diversify risk," we would have been far better off.

Q52: Statement about finance, economics, the US Constitution, etc.

WB: Do you have a question?

Q52 CONT: No.

WB: I sort of suspected that.

Q53: What is the future of mass transit?

WB: Passenger traffic? [**Yes.**] The American public generally doesn't like mass transit. Americans have a love affair with their car, which translates into an aversion to mass transit. One person to a car seems to be a popular method for moving around. We are unlikely to see expansion in mass transit. The American public is genetically averse to mass transit. It seems to be human nature that people want to drive even if they have to pay $4 a gallon on gas and double on parking. I wouldn't be optimistic about something that has a long trend in human nature to reverse all of the sudden.

CM: You have a more optimistic view of it than I have.

Q54: North Oaks, Minnesota. If you were in charge of the country, how would you handle the climate crisis?

CM: I'm in an awkward position of agreeing with Al Gore; we shouldn't be burning so many hydrocarbons. But, we have different reasons. His brain doesn't work the way mine does. You'll have to judge for yourself which you prefer.

WB: We'll have a vote later.

Q55: To win, first you must not lose. If corporate default rates escalate, will the credit default swap problem materialize as a threat to the financial system? You are a great pricer of risk. You must consider selling insurance without pricing appropriately. Is there a chance the CDS [Credit Default Swap] market may eclipse subprime?

WB: The CDS notional value is about $60 trillion. There is lots of double counting, etc, but no doubt it is a lot of money. They are swaps, or insurance against companies going bankrupt. We have written two types of derivatives, and we have insured a swap that pays to someone else in the event of a default on high yield indices. I think we will make significant money. I think there is no question that the corporate default rate will rise. That has been included in the price in writing this insurance. Will the CDS market lead to chaos? Probably not, but if Bear [Stearns] had failed, you would have had chaotic conditions. A CDS is a payment by one party to another. When someone loses money on a loan, they've lost real money, but there is not a swap of dollars immediately when the loan goes bad. In a CDS, there is an exchange of cash. Whether the counterparties fail [on a massive scale]—I don't think it will happen. We've had enormous collateral payments from one firm to another in this recent crisis. Fairfax Financial made $1 billion in CDS's. This means another guy lost $1 billion. They have been the most volatile of instruments—and it really hasn't created a problem in the system. If the Fed must step in, I don't think it will be due to CDS's. It may cause big losses, but it will be matched by big gains by others. There is a problem of an overnight disruption in the system [i.e. Bear, nuclear bomb]—where discontinuity and collateral postings are inadequate. At that time, large CDS exposure could exacerbate chaos to a considerable degree.

CM: Could we have a mess in CDS's? Yes, but the stupidity is not as bad as sweeping bums off skid row to give them houses. There is an issue of insuring against the outcome of losing money on a $100 million bond issue when you have $3 billion worth of contracts on that $100 million bond issue—there are incentives to manipulate the smaller loss to make a big collection on the larger position. It used to be illegal to buy life insurance on people you didn't know, with big payoffs in the event of their death. Why did we want enormous bets to be made in unregulated markets? We have a major nutcase bunch of regulators and proprietors in this field.

WB: Charlie 1 point, Invisible Hand 0 points.

Q56: Why do you not believe in dividends when Benjamin Graham believed in them?

WB: I had to show a little individuality. *[laughter]* I do believe in dividends, including dividends at companies where we own stock. The test on dividends is, 'can you create more than one dollar of value with the one you retain?' It would be a mistake for See's to retain money because they have no ability to use the cash they make to generate a high return internally. We hope to move the capital to a place where it will be worth $1.20. If we do that, taxable or not, they are better off if we retain money. But when the time comes that we don't think we can use money effectively, we will pay it out. But because we have the ability to redistribute money in a tax-efficient way within the company, we have more reason to retain earnings in the company. We like companies where we have investments to pay to us the money they can't use effectively.

CM: Costco paid no dividend when they were growing rapidly. As St. Augustine said: "God give me chastity, but not yet."

Q57: Book recommendations?

WB: We try to have a good selection in the bookstore downstairs. I am partial to Larry Cunningham's book [*The Essays of Warren Buffett, Lessons for Corporate America*, 2nd edition].

Q58: Texas. Do you foresee Berkshire buying any businesses in India or China in the near future?

WB: We would like to. The odds are somewhat against buying anything outside of the USA. MiTek has possibilities outside the USA. If we get lucky, we'll buy one or two businesses in the next 3 or 4 years. Where they'll be, who knows? We wouldn't rule it out. We looked at insurance in India and China, but they restrict ownership in any domestic insurance company. The limit is 25% in China, and I think 25% in India. We probably don't want to go in to own [only] 25%. We want to have more ownership to make it worthwhile. You will see the day that Berkshire owns businesses, in my view, in both countries.

CM: Nothing to add.

Q59: Minnesota. Will you share what or who had the biggest influences on you?

WB: My biggest educator was my father. It is important who you marry. Those are great teachers. Ben Graham, Dave Dodd. I devour books. Charlie likes Ben Franklin. My grandfather at the family grocery store. The most important job you have is to be the teacher to your children. You are the big, great thing to them. You don't get a rewind button. You don't get to do it twice. Teach by what you do, not what you say. By the time they get through formal school, they would have learned more from you than from school. Provide warmth and food and everything else. It won't change when they get to graduate school—and you get no rewind button. You teach with what you do, not what you say.

CM: Differing people learn in differing ways. I was put together to learn by reading. If someone is talking to me—it doesn't work as well. With a book, I can learn what I want at a speed that works. It works for my nature. For those people who are like me, welcome, it is a nice fraternity.

WB: [Speaking to Charlie] Did you learn more from your father? Your father probably had more impact on you before your readings?

CM: My father did have an impact. He always took more than his share of work and risk—that was helpful. The conceptual stuff—I learned from books. Those authors are fathers in a different sense.

WB: If you keep reading books, you'll learn a lot. If you read 20 books, you can learn a hell of a lot. Having the right parents is very lucky. If you get the right spouse too, that's just doubling down.

Q60: Chicago. Thank you for the respect you show for common shareholders. Executive pay - what can we do to get the country and the issue going the right way?

WB: Compensation - you can't do much. There are relatively few people that could do a lot, by withholding votes. Big shots don't like being embarrassed and it will make boards of directors sit up and take notice. It would not take many of the big institutions, only a few of the biggest, and the press would do the rest. You want a good press. The press needs material. I don't know how you create incentives for big institutions to do that. A lot of checklists that institutions use are asinine. Ben Graham bemoaned investors as a bunch of sheep. The press would do the work if they had material, but they won't respond to you. Small shareholders can write persuasive notes. It takes a real effective pressure to change behavior when self-interest is in their favor.

CM: In England, they got taxes up to 90%, so there was no possibility of earning a large income. That was counterproductive. You can get the politics of envy that ruins economics. I think people taking compensation have a moral duty not to take it; a moral duty to be underpaid. If generals and archbishops can do it, why can't the leaders of a large enterprise take less than the last dollar? That said, it is very difficult to implement.

WB: Envy is the silliest [of all the sins], because you feel worse and the other people feel fine; maybe they feel better. Rule out envy as part of your repertoire. Gluttony has some upside, with maybe some temporary side effects. Lust—of course I'll let Charlie speak to that. *[laughter]*

Q61: Pharma? How do you value the pipeline of drug companies?

WB: Unlike many businesses, when we invest in pharma, we don't know the answer on the pipeline, and it'll be a different pipeline 5 years from now anyway. We don't know whether Pfizer or Merck, etc, have a better chance, or which of those will come out with a blockbuster. But we do feel we have a group of companies bought at a fair price that, overall, will do well and should offer chances for decent profits. These companies are doing very important things. I could not tell you the potential in the pipeline. A group approach makes sense. It is not the way we would go at banks. If you buy pharma at a reasonable multiple, you will probably do okay 5-10 years from now.

CM: You now have a monopoly on our joint knowledge of pharmacology.

WB: He gets cranky at the end of the day. *[laughter]*

Q62: China. Thank you for your observations on the Olympics. I'm here with a group of Chinese executives. We came here to see how companies should be run. You did a quick trade on PetroChina. What comes to your mind when selling? Any suggestions for these Chinese executives?

WB: I met Dr. Gao recently from the China Investment Corp. for lunch. I was very impressed with him. We had lunch in Omaha. PetroChina was a $35 billion company when we bought [and I thought it was worth $100 billion]. When oil was at $70-75 per barrel, the analysis was the same but I then thought it was worth about $275-300 billion. That is about where it was then trading, so we sold. It went up significantly afterwards because of the A-share listing, and at one point, it became the most valuable company in the world by market cap. They've done a terrific job. If it went to a significant discount, we would buy again. I'm not so sure we don't have a lot to learn from China vs. what we have to teach. China has a remarkable society. I traveled 45 minutes outside of Dalian, and saw hundreds of plants that were developed in recent years. The Chinese are starting to realize their potential. There is lots of ability, but the system did not realize its potential. I think it will continue to get better. I would look for the best practices and I would discard the rest. If you look at effective individuals—why do people want to be around them? You should copy those qualities. I would look for what I admire and emulate it, and try not to let distasteful things be copied.

CM: I hope you will go back to China and tell them that you found one individual that really approves of Confucius' respect for elderly males.

Q63: California. What is your fondest hope for Berkshire?

WB: I hope for two things: decent performance, and that the culture is maintained. We are shareholder- and manager-oriented. We want to be the best home in the world for wonderful family businesses. I fully expect that what we have tried to build into Berkshire will live into the future far beyond my tenure as CEO. We have great candidates to succeed me and we have a Board and managers that have all seen what works. We have a very fine and strong culture. I am sure it will be continued, and that we will get good results. I hope in 20 years that fine businesses will immediately think that if they have to sell their business, they would sell it to Berkshire.

CM: I would like to see Berkshire observed even more as an exemplar, and that we have even more influence on changes in other places. Things that have happened here would be useful to other companies.

WB: We also want it to have the oldest living managers. *[laughter; standing ovation]*

Please note that because recording devices were not permitted at the meeting, all notes were quickly handwritten or typed and therefore should not be relied upon as strict quotes.