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Berkshire Hathaway Annual Meeting
May 2, 2009
Complete Notes

One good way to gain insight from the investment knowledge and experiences of Warren Buffett and Charlie Munger—two of the most capable investors ever—is to attend the Berkshire Hathaway Annual Shareholders Meeting. An even better way is to attend the meeting, take careful notes, and then organize and reflect upon Buffett and Munger's comments. That's one reason why we have prepared this article. Another reason is to share this important material with our clients.

During the question and answer portion of the 2009 annual meeting, Buffett and Munger were asked a total of 51 questions over approximately five hours. Allowing some time for the questions to be asked, Buffett and Munger spent, on average, over five minutes answering each question—revealing the depth of their responses and the generosity of Buffett and Munger with their time. As we have always done, we adhered to Berkshire's ground rules banning recording devices at the annual meeting, so what follows is a summary of the handwritten notes taken by five individuals from our office, none of whom is a stenographer. Although we have tried mightily to remain faithful to Buffett and Munger's wording and intent, it is possible that their exact words varied from our notes. Although Buffett and Munger need no clarification, we have supplemented some of their answers with elaborating comments for investors. Please note that neither Buffett nor Munger has reviewed or endorsed our summaries of their responses or our own comments. John Brock, Patrick Labbe, Sarah Roach and MaryEllen Telck provided invaluable help in producing this summary of the annual meeting. Jerome Bruni, our portfolio manager, wrote the comment sections, following Buffett and Munger's responses.

In recent years, some Berkshire shareholders have posed questions pretty far off topic, thus reducing the time available to address the major questions of interest to the thousands of shareholders who traveled from around the world to hear Buffett and Munger. This year, questions from the floor were alternated with questions posed by three journalists (Carol Loomis of *Fortune*, Becky Quick of CNBC, and Andrew Ross Sorkin of *The New York Times*), who selected from among approximately 5,000 questions that were e-mailed to them in advance. In terms of addressing the questions on most people's minds, the new system worked quite well.

Before the question and answer session, Buffett typically shows a humorous, hour-long movie that includes skits, some of the funnier GEICO, Dairy Queen and Fruit of the Loom commercials, and coverage of an assortment of topics. Although the movie has more entertainment than educational value, in light of some press reports that have mistakenly described the meeting's tone as "somber," we're including a brief description of parts of the movie. This year there was a short skit featuring Buffett giving golf advice to Tiger Woods, along with a replay of last year's skit with Susan Lucci. Another segment showed Buffett, demoted to a mattress salesman at Nebraska Furniture Mart, describing the unique features of the new "Nervous Nellie" mattress. (It features a hidden compartment for storing stock certificates, cash, etc.) Mixed in with the humor, Buffett always includes a film clip of his 1991 testimony before Congress after the Salomon Brothers scandal, when Buffett became the temporary chairman of Salomon in order to help the company restore its credibility (and survive). In this clip, Buffett described a letter he sent to Salomon employees, telling them to obey all laws ***and*** behave in a manner such that they would not be ashamed if their actions were published on the front page of their local newspaper and read by their families, friends, etc. Buffett also told Salomon's employees, "If you lose money for the firm, I will be understanding. Lose a shred of reputation for the firm, and I will be ruthless." "Ruthless" is a strong word, but we think Buffett is taking the opportunity to emphasize to ***Berkshire's*** current employees how important he feels ethical conduct is.

Whenever Buffett takes the time to prepare a slide to display at the annual meeting, you can assume that he wants to make a point. This year, after the movie, Buffett began by projecting a slide showing a Berkshire trade confirmation, which indicated that in December of 2008 Berkshire sold $5 million in T-bills scheduled to mature April 29, 2009—for $5,000,090.07. Since T-Bills don't pay explicit interest (they are issued at discounts from their face value and ultimately mature at face value), typically the only day a T-bill is worth face value is its maturity day. The fact that some buyer was willing to pay a ***premium*** to face value fully four months prior to maturity—i.e., was willing to ***lose*** money—is truly astounding, and it speaks of the degree of turmoil and panic that characterized financial markets late last year. As Buffett put it, "I'm not sure you'll see that again in your lifetime." We certainly hope he's right.

Derivatives.

On behalf of a number of shareholders who had asked about Berkshire's derivatives positions, Carol Loomis noted that Buffett has previously referred to derivatives as financial weapons of mass destruction. She mentioned Slim Pickens' character in the movie *Dr. Strangelove* (who rode a nuclear bomb dropped from an aircraft) and asked whether there was any similarity in Berkshire's use of financial weapons of mass destruction. Given the large amount of value that's been destroyed by the use of derivatives, is it appropriate for Berkshire to hold large derivative positions?

> **Buffett:** Yes, derivatives pose problems to the world. Our job is to make money over time, and our use of derivatives doesn't impinge on Berkshire's capital—we have

posted collateral of less than 1% of our total marketable securities. I said in 2002 that we use them. We think that as long as we explain [our use of] derivatives, the benefits outweigh the costs. We received $4.9 billion in premiums [for writing equity puts] and can use this money for 15 – 20 years. I personally think that we'll make money on our equity put options. We'd have to lose money over 15 – 20 years [to lose on our equity puts]. We had a financial hurricane, [yet regarding] the equity put contracts, there's a good chance we'll make money on those. During the last week we modified two put contracts—reducing the term to about 10 years and reducing the strike price from 1,514 to 994. Our shareholders are intelligent enough to understand [the situation] if we explain it.

Munger: I would agree that there should be limits, and we have stayed well short of the limit that's appropriate.

> **Comment:** Much has been made of Berkshire's use of derivatives, perhaps because Buffett has spoken in the past quite clearly about the ways in which derivatives can be—and sometimes have been—misused by investment banks, hedge funds and others. Rather than being hypocritical in using derivatives, Buffett has gone to unusual lengths to explain why Berkshire has written long-term equity puts. Writing a put is somewhat like writing insurance, something Berkshire has ***lots*** of experience doing. When a company writes insurance, it typically receives an upfront fee and makes a promise to pay in the future if certain events occur. In the case of Berkshire's equity puts, it received $4.9 billion upfront (with no counterparty posting requirements) and would have to pay out 15 – 20 years later ***only if*** the S&P 500 (and other indexes) were lower than a predetermined level—1,514, using the S&P 500 example Buffett gave. Put differently, from today's S&P 500 level (approximately 920), this index would need to gain only 2.5 – 3.4% annually (for 15 – 20 years) in order to reach 1,514. In the meantime, Berkshire would have $4.9 billion to invest (and earn returns). If Berkshire averages 5 – 10% returns over the 15 – 20 year terms of the puts (which amount to significantly lower returns than Berkshire has earned over its remarkable history), that money will grow to $10.2 – 33.0 billion! But wait—there's more. Buffett announced that the terms of two put contracts were modified to reduce the term to 10 years and the strike price to 994. Now, the S&P 500 needs to average only about 0.8% annually to reach the updated strike price. It would be virtually unprecedented for there to be no real economic growth for the next 10 years, but forget real growth for a minute. Inflation ***alone*** should be more than sufficient to advance the S&P 500 well beyond 994 in 10 years. When Buffett says he thinks Berkshire will make money on its equity puts, we think it's likely he is employing a good deal of Midwestern understatement. If you're looking for possible future problems for Berkshire, look elsewhere.

Financial Literacy.

A shareholder from Denver asked Buffett to comment on the state of financial literacy. Is there anything that could be added to educational curricula to improve it? What should future generations know?

> **Buffett:** I think there's a problem with the current generation. ABC has a new TV program coming out [on the subject]. Financial literacy is a tough sell in a world of credit cards and calculators. But we're making progress over time. We recommend working with students to make them literate, and they'll have a terrific advantage. We hope our annual reports contribute. But people do silly things. On my honeymoon in 1952, I was 21, my wife was 19, and we stopped at the Flamingo in Las Vegas and saw well-dressed people who traveled thousands of miles to do something very dumb. [That tells you] it's a world of opportunity. I started teaching at the University of Nebraska at age 21.
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> **Munger:** [We live in a] world of legalized gambling, in the form of lotteries, and high-cost credit card debt. We've been going in the wrong direction. I don't think you can teach people high finance who can't use a credit card.
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> **Buffett:** If you're willing to pay 18% on a credit card, you will not come out well. It's probably good for our business. They'll go their way, we'll go our way. We're looking for things that are mispriced.
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>> **Comment:** Although Berkshire's annual reports (and Buffett's various public appearances) certainly do advance financial literacy, they are seldom read or heeded by those who stand to gain the most. We think it's fair to say that—as the well-known "Mr. Market" story implies—Buffett has spent much of his career taking advantage of others' foolishness or lack of emotional stability.
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>> **Comment/rant:** Compounding the public's financial illiteracy, in perhaps the worst public/private alliances we can imagine, various states sponsor lotteries—with terrible odds for players—while private newspapers and local TV outlets consider winning lottery numbers "news." While state lotteries typically keep a mind-numbing 50% of the amount wagered (versus 1 – 5% in most Las Vegas casinos), we hear about "corporate greed" in the media—sometimes rightfully—yet hardly a word about states' greedy cultivation of gambling and get-rich-quick schemes.

The TARP.

Becky Quick read a question from an individual in Logan, Ohio, who noted that Wells Fargo reportedly wanted to decline TARP funds, and its Chairman, Dick Kovacevich, referred to the TARP as an "asinine" government program. Do you agree with the Wells' chairman, Charlie? And Warren, do you agree with Charlie?

Munger: Government is reacting to the biggest financial crisis in 70 years. It's unreasonable to expect perfect agreement with all of one's ideas. Of course there will be some ideas that are foolish, but government is entitled to be judged more leniently in times of such trouble. I think the idea that [a company's] earnings go up when its credit declines [due to the lower market value of its debt] is insane accounting.

Buffett: Mid-September was as close to a total financial meltdown as there could be. There was a commercial paper freeze-up, and $100 billion was taken out of money market funds. It required prompt action. We were looking into the abyss. I commend the actions taken, especially since they [government officials] were working 20 hours a day. Merrill Lynch would have gone if Bank of America didn't buy it. I sympathize with Dick Kovacevich's "asinine" comment. He was called on a Sunday and told to be in Washington D.C. the next day, without knowing why. He was told they [Wells Fargo] would take it [TARP funds], and he had an hour to sign. That's the nature of an emergency. By and large, the authorities did a good job. Among the large banks, Wells is a wonderful bank and has some advantages that other banks don't. I recommend [JP Morgan CEO] Jamie Dimon's shareholder letter; it's on JP Morgan's website. Jamie did a great job. It's as good a shareholder letter as I've seen. It's a long letter, but worth reading. He did a great job writing about the crisis.

Comment: As Buffett noted, once investors were rattled to the point that they started to make large sales of stocks, bonds and—remarkably—money funds, the financial system came under extreme pressure. It was imperative that investor confidence be restored ASAP. In market economies it is private investors, not governments, that supply the vast majority of funds for businesses and consumers through:

- bank savings that get loaned to consumers and businesses;
- corporate stock purchases that fund new companies and help established companies grow;
- corporate bond purchases that are really loans to businesses;
- mutual fund purchases that are used to purchase stocks and bonds;
- money fund purchases that are used to buy commercial paper (short-term corporate IOUs) and jumbo certificates of deposit, among other short-term investments.

When investors stop investing, a market economy will fail. It's that simple. Thus, fast government action was necessary last fall, and the regulatory and political process produced the TARP. Regarding Jamie Dimon's shareholder letter, we wholeheartedly suggest you read it. We further suggest you listen to one of JP Morgan's quarterly conference calls. What you'll hear is a CEO who is completely immersed in his business, as opposed to the more typical CEO, who hands off many questions he's asked to a bevy of subordinates. Full disclosure: We own both JP Morgan and Wells Fargo stock. And Berkshire Hathaway, of course.

Discounted Cash Flows.

A shareholder from St. Louis, Missouri asked about 10-year discounted cash flow models.

Buffett: All investing is laying out cash now to get some more back in the future. The concept of "a bird in the hand" came from Aesop in about 600 BC. He knew a lot, but not that [he lived in] 600 BC. He couldn't know everything. [laughter] The question is, how many birds are in the bush? What is the discount rate? How confident are you that you'll get [the bird]? Et cetera. That's what we do. If you need to use a computer or calculator to figure it out, you shouldn't [buy the investment]. Those types of [situations] fall into the "too-hard" bucket. It should be obvious. It should shout at you, without all the spreadsheets. We see something better.

Munger: Some of the worst business decisions I've seen came with detailed analysis. The higher math was false precision. They do that in business schools, because they've got to do something.

Buffett: The priesthood has to look like they know more than "a bird in the hand." You won't get tenure if you say "a bird in the hand." False precision is totally crazy. The markets saw it in the Long-Term Capital Management [hedge fund] in 1998. It only happens to people with high IQs. The markets of mid-September last year were [such that] you can't calculate standard deviations. People's actions don't observe laws of math. It's a terrible mistake to think higher math will take you a long way—you don't need to understand it, [and] it may lead you down the wrong path.

Comment: According to some reports, Buffett—perhaps the most successful investor of all time—didn't study calculus in college. If true, Buffett's life clearly makes the case that higher math is not necessary to achieve tremendous investment success. (The author of this comment—having studied a good deal of math—fully agrees with Buffett about higher math.) Importantly, Buffett makes the point that high IQs and mathematical wizardry ***may actually get in the way of successful investing***, because they can imply a precision that simply doesn't exist. Investors who over-emphasize math sometimes do so because: (1) math, not investing, is what they know, and (2) they may have what's known as "physics envy."

Comment/short rant: Munger's criticisms of business schools, here and elsewhere, are both scathing and absolutely spot-on.

Moody's.

Andrew Ross Sorkin relayed a question regarding Moody's potential conflicts of interest. Why does Buffett retain Moody's in Berkshire's portfolio? Why didn't you use your influence to address Moody's perceived problems?

Buffett: I don't think conflicts of interest were the biggest causes of the ratings agencies' problems. Five years ago, virtually everyone thought home prices couldn't go down. Home prices always go up [it was widely believed]. There was an almost total belief that house prices would rise. They [the ratings agencies, investors, etc.] just didn't understand the various things that can happen in a bubble with $20 trillion in total assets. People leveraged up their biggest asset enormously. As it began to melt down, it became self-reinforcing. They [the ratings agencies] would have been criticized [if they'd bucked prevailing wisdom]. Taking a different view 4 – 5 years ago might have led to Congressional committees asking how they could be so un-American as to take such a dim view of American homeowners. Ratings agencies and the American people made terrible mistakes. So did Congress and regulators. I never made a call to Moody's regarding their procedures. When we own stock, we don't own them [companies] to change them. We've had very little luck when we've tried to change companies. Ratings agencies are still a good business. It's a business with few people [companies] in it, it doesn't require capital, and it has the fundamentals of a good business. They won't be doing the [previous] volume in capital markets for awhile. Charlie and I pay no attention to ratings. We don't outsource credit analysis.

Munger: Ratings agencies eagerly sought models that let them use higher math and make the decisions they wanted to make. To a man with a hammer, everything looks like a nail.

Buffett: The people who stirred up the Kool-Aid drank it. It was stupidity, and everyone else was doing it. I send out letters to managers every couple of years: If you're doing [something] because everyone else is, that's the wrong reason. That's not an acceptable excuse at Berkshire. We couldn't get Salomon to stop doing business with Mark Rich [who Buffett likened to Al Capone in the 1930's]. It's hard to get large organizations to not do what successful competitors are doing.

> **Comment:** "Hanlon's razor" states, "Never ascribe to malice that which can be adequately explained by stupidity." In the case of the ratings agencies, Buffett substitutes the forces of conventional wisdom and peer pressure for stupidity. We'd suggest that it's precisely because Buffett and Munger don't outsource credit or investment analysis that Berkshire has been so successful. (Why any competent investor would outsource decision-making to people with inferior records escapes us.) Munger's comment about "a man with a hammer" succinctly explains a lot of dangerous behavior by "quant" investors.

> **Comment/short rant:** The contribution by the ratings agencies to the most recent financial crisis is ***immense***. There's blood on their hands. The people at Moody's and other ratings agencies are smart enough to know that their earlier credit analyses were way too lenient, and we suspect their current tendency is to try to appear very strict in order to counter criticism of their earlier work. However, unduly strict guidelines can be nearly as harmful to our economy as unduly lenient ones.

The Residential Real Estate Market.

A shareholder from Berkley, California asked Buffett where he saw the residential real estate market in the next year or two.

Buffett: We don't know. I see a lot of data. In the last few months, you've seen a real pick up in activity in California in the low to medium-priced homes at or below $750,000. There are many different markets, and many California markets will be difficult. There's been no bounce in prices yet, though activity is up on lower prices. Looking at real estate brokerage data, it looks like something close to stability in California in the $750,000 and less segment at these much reduced prices. Mortgages being put on books today are much better than before. Interest rates are down and it's easier to make payments. It's improving. There are about 1.3 million households created in a year, but in a recession it tends to be lower. If you create 2.0 million houses a year, then you run into trouble. There's an excess inventory of about 1.5 million now. With housing starts down to 500,000 [annual rate], the excess supply will be absorbed. We are eating up the excess at a rate of 700,000 – 800,000 units per year. It takes a couple of years. There are two options: blow them [the excess inventory] up—I hope they blow up yours [Charlie's] instead of mine—or sell them. South Florida will be tough for a long time. You can't do it in a day or a week, but it will get done. Then prices will stabilize. Then we can go to [building] one million per year. The situation is being corrected.

Munger: In places like Omaha, I would buy a house tomorrow, if I were a young person.

Buffett: There are approximately 80 million houses in the country, and about 25 million do not have a mortgage. The situation is being corrected.

Comment: The arithmetic of housing is powerful and straightforward, as Buffett indicates. During normal times the country needs an average of about 1.5 million new homes to be built each year in order to accommodate population growth, household formation and the wearing out of the existing housing stock. There is currently a larger than normal inventory of unsold homes, but with housing starts ***far*** below normal, it is only a matter of time before inventories normalize and home prices stabilize. Anyone who thinks housing starts and home prices will decline indefinitely is in for a surprise.

Comment/short rant: Home price data, such as the Case-Shiller index, usually compare recent home prices with prices from ***a year ago***, not the prior month. Therefore, when headlines read, "Home prices fell 17% last month," what they ***really*** mean is that home prices are 17% lower than they were 12 months ago.

Recent Investment Performance for Buffett's Eventual Replacement(s).

Carol Loomis asked a question from an individual in New York City, who wanted to know how the four investment managers "in the wings" to eventually replace Buffett performed in 2008. How would Buffett rate these managers? Are all four still on the list?

Buffett: All four are still on the list of candidates. There are three candidates for the CEO position—all are internal candidates—and four possibilities for the investment manager—inside and outside Berkshire—one or more could be chosen. It's up to the board. The CEO will come from inside. The [investment head candidates] did no better than match the S&P 500's decline of 37% in 2008. They didn't cover themselves in glory, but I didn't either.

Munger: Every investment manager that I know of who I regard as intelligent and successful—they all got creamed last year.

Buffett: All four have better than average long-term records—modestly to significantly better than average over the past 10 years, and I suspect [they] will be better over the next 10 years. There were a lot of things that didn't work last year. I did not change the list [of candidates]. If I dropped dead tonight, the board knows who the new CEO would be. The choice of the new investment manager will be made in consultation with the new CEO. The investment management position is not so critical [time-wise].

Munger: We don't want an investment manager who thought he could jump into cash due to macroeconomic factors and then jump back [into stocks].

Buffett: We would exclude any such person.

Comment: There is no such thing as an investor with above-average results every year, yet a remarkable amount of money has been lost chasing this nonexistent ideal. Importantly, as Buffett and Munger state, the job of a money manager is ***not*** to sell stocks before markets decline and then jump back in before markets gain. ***That's just not possible, so attempts to do so reveal a lack of understanding about investing.*** Patient, long-term investors like Buffett and Munger ultimately take advantage of impatient, uninformed investors. The best long-term investment choices frequently don't feel like the best short-term choices.

Nationalized Health Care.

A questioner from Overland Park, Kansas asked how Buffett and Munger envision a nationalized healthcare system, and how it would affect Berkshire's portfolio.

Munger: Something more like Europe, supplemented by a private system, like private schools [compete with public schools], will probably come to the U.S. in due course. I'm a Republican, but I'm not personally horrified by that. I wish they'd put it off for a year to solve other economic problems.

Buffett: Berkshire will adjust. It would pose no specific problems and specific opportunities.

Comment: Perhaps the reason Munger seemed resigned to some aspect of national health care is that the trajectory of health care spending and the aging of the U.S. population combine to make one thing very clear: The U.S. health care system, in its present form, cannot continue very long. It must change, and it will. Nevertheless, given the stresses in the current economy, change—which could be somewhat disruptive over the short term—could easily wait until next year, as Munger suggested.

Training Buffett's Successor.

Becky Quick asked a question for shareholder Irving Finster: Why is Buffett reluctant to bring in his [CEO] successor now? Why not train him now?

Buffett: Irving is a friend of mine. He's had no success writing to me on this for 30 or 40 years, so he wrote to Becky. If there were a good way to inject [the new person now] to make him a better CEO, I would, but the truth is, the candidates are running major businesses ***today***. It wouldn't help to sit around [Berkshire's] headquarters. We could meet every hour, and I could say, "Here's what I'm thinking, what do you think?" I could throw him *The Wall Street Journal*. It's a waste of time—they are 100% ready right now. The biggest job is that they will have to develop relationships with [Berkshire's] managers, sellers of businesses, shareholders—different constituencies. Their biggest challenge will be to understand personalities. They have different batting styles, but they all hit very well. Charlie and I have worked together for decades, without constantly talking.

Munger: You're more qualified to be CEO by successfully running your own business than watching someone else do it his way. Many successful models are a lot like Berkshire—like Johnson & Johnson, decentralized.

Buffett: Most managers at Berkshire are doing what they want—running their businesses. We don't see an advantage in having a crown prince around. To name [the CEO] now could create problems.

Comment: The meat of Buffett's comment isn't necessarily his good reasons not to bring in a successor for OJT. Focus on his discussion about his relationship with the managers of potential Berkshire acquisitions. One important way Berkshire grows is by acquiring companies that are sold to Berkshire by their founders, in no small measure due to Warren Buffett's reputation of keeping existing management in place and respecting corporate cultures. He specifically doesn't break companies up and sell them in pieces. Trust is a key ingredient in Berkshire's acquisitions, and Buffett's successor must work to maintain this kind of trust.

The Next Generation of Investors.

A shareholder from Omaha asked Buffett how he would teach the next generation of investors.

Buffett: I had 49 university groups, in clumps of six, [visit me] last year. [An education in] investing requires only two courses: How to Value a Business, and How to Think About Markets. You don't have to know how to value ***all*** businesses. Start with a small circle of competence, things you can understand. [Look for] things that are selling for less than they're worth. Forget about things you can't understand. You need to understand accounting, which has enormous limitations. [You need to] understand when a competitive advantage is durable or fleeting. Learn that the market is there to serve you, not instruct you. In the investing business, if you have an IQ of 150, sell 30 points to someone else. You do not need to be a genius. You need to have emotional stability, inner peace and be able to think for yourself, [since] you're subjected to all sorts of stimuli. It's not a complicated game; you don't need to understand math. It's simple, but not easy.

Munger: Exactly half of future investors are going to be in the bottom 50%. There is so much that's false and nutty in business schools. Reducing the nonsense would be a good goal.

Buffett: Emotional makeup is more important than technical skill.

Munger: Absolutely. If you think your IQ is 160 and it's really 150, you're a disaster.

Buffett: A student in one of the groups asked me, "What are we learning that's wrong?"

Munger: How do you answer in only one hour? [laughter]

Buffett: [My experience] has given me a jaundiced view of academia generally. Efficient market theory—that everything is priced appropriately—is bunk. There's a certain degree to which ideas that are nutty take hold and propagate. Max Planck [remarked about] the resistance of the human mind to new ideas: "Science advances one funeral at a time."

> **Comment:** Investors should read—and re-read—Buffett's and Munger's statements, because ***this is really important stuff***. These powerful, succinct comments about successful investing probably didn't make any news report, which is one good reason to attend the Berkshire annual meeting.

Ajit's Successor.

Andrew Ross Sorkin asked whether Berkshire has a succession plan for Ajit Jain (the head of Berkshire's insurance operations).

Buffett: You can't—it would be impossible to replace Ajit. We wouldn't try. We won't give as much latitude to his successor. Authority goes with the individual, not the position. In the insurance business, giving away your "pen" [underwriting authority] can do enormous damage. In 1980, Mutual of Omaha gave a pen to someone, and lost half their net worth. Ajit and I talk daily, because it's so interesting—like how many years can you insure Mike Tyson—but I'm not needed. We won't find a substitute for Ajit.

Munger: Invest in a business any fool can run, because someday a fool will. If it won't stand a little mismanagement, it's not much of a business. We're not looking for mismanagement, even if we can withstand it.

Buffett: We do not assign tasks to people beyond their capabilities. Ajit is a one-off situation.

Berkshire's Value.

A questioner from Louisville, Kentucky asked Buffett what he thought about the market's valuation of Berkshire shares, noting that the stock price is off more than the decline in Berkshire's operations.

Buffett: You put your finger on something. We think our investments are worth more than they're carried for. [If you] leave out insurance earnings from underwriting, last year and this, earnings power was below normal. We have good businesses overall. A few have problems, but many will do fabulously well. It's okay to look at Berkshire as two parts: securities, and non-underwriting earnings power. We hope both will increase over time. Berkshire is cheaper in relation to intrinsic value at the end of 2008 than 2007. That's true of most companies. Our focus is for operating earnings to rise. Everything is affected by everything else in the financial world.

Munger: Last year was a bad year for a large "float" business. But long term, having float that you're getting at less than free will be a big advantage. Some buyer bought 10,000 Berkshire shares at the absolute peak. Our casualty insurance is probably the best in the business. [So are] our utilities. Iscar is better than others. Down the list, we have extraordinary businesses, and it's not easy to collect the best businesses, but we think we've done it. If you think it's easy to get in Berkshire's position, you are living in a different world than the one I inhabit.

Buffett: The insurance business is a remarkable business. In the September 2008 meltdown, people started behaving differently, like a bell had been rung. It hurt jewelry, carpet, NetJets. But the phones started ringing at GEICO. Thousands more came to the website to save money. Saving $100 became important. We added 665,000 policyholders in 2008, and [we added] 505,000 in [just] January through April 2009. GEICO is the low-cost producer of auto insurance. It builds a lot of value over time. We had 2 – 5% market share when Tony Nicely took over; 8% now. We're the third largest auto insurer in the country, and the fundamentals are in place to take that higher.

Comment: "Float" refers to the insurance premiums Berkshire collects (and invests), before claims are paid. Although some pundits may disagree, Berkshire is much more than a number in the daily stock listings. ***It's a company***, with many excellent subsidiaries that are gradually improving their competitive positions—and their intrinsic values. When Berkshire's various operations grow profitably and its stock price declines, relax. The stock price will ultimately be determined by Berkshire's business performance. One more good reason to attend the annual meeting is to see for yourself all the examples of Berkshire's businesses that are presented in the cavernous display arena.

Reinvesting Earnings vs. Paying Dividends.

A shareholder from Yardley, Pennsylvania referred to Principle # 9 in the Berkshire Owner's Manual, which addresses the question of earnings retention versus dividend payments. He noted that from 2003 through 2008, Berkshire's market price didn't increase by the amount of retained earnings, and he asked Buffett to address Berkshire's dividend policy.

Buffett: If we had to sell our business on December 31, 2008, we would have had a loss. Reinvested earnings did not produce [gains]. We use book value as a proxy for business value. We measure against the S&P 500—our intrinsic value has never had a five-year period when we underperformed the S&P 500.

Munger: I don't get too excited about these oddball things that come along once in 50 years. I think Wells Fargo [for example] will come out of this mess much stronger.

Buffett: In a terrified market, Wells Fargo got to below $9—when aspects of their business were never better, and their business model is fabulous. Pushed by a student, I said that if I had to put all of my money in one stock, it would be Wells Fargo at $9.00. Wells will be a lot better off a couple of years from now than if all this business had never happened, unless they have to issue lots of shares, which they shouldn't. You never want to be in a position to have to sell [due to a margin call] or emotionally. Why would someone sell Wells Fargo at $9.00 when they bought it at $25.00, and now it's better off? It's crazy. I own a farm about 30 minutes from here, and if you own a farm, you don't get a price on it every day. Look at the asset for value, not the price—as you would with a farm. People let the stock price, not business results, [affect their assessment of a company]. Read Chapter 8 of *The Intelligent Investor*. The fact that a [price] quote is available every day turns into a liability.

Comment: The questioner appeared to confuse Berkshire's near-term stock price (in a highly disrupted market environment) with its true value. Taking an extreme example, if a Berkshire shareholder sold one share of Berkshire stock for $10, and that transaction turned out to be the last transaction of a given trading day, the $10 final price for that day would ***not*** mean that the real value of Berkshire had plummeted. Stock prices over the short term frequently diverge dramatically from real business values, and intelligent investors use such divergences to their advantage. As Buffett has commented many times, ***price is what you pay, value is what you get***.

The Stimulus Bill.

A shareholder from West Newton, Massachusetts asked whether more of the government's stimulus spending, which he said allocates 8% to infrastructure projects, would be better spent acquiring national infrastructure, as during the Great Depression, in order to put people to work.

Munger: Let me answer that one: Yes. [laughter]

Buffett: I certainly agree. A lot of wonderful things were done in the Great Depression. The 1930s should be the goal and model. Obviously, we want to use it intelligently. The intent is to get it into action quickly. Any time the federal government does something on a massive scale, there's going to be a lot of slop. We have a [political] system that doesn't detach the interest of individual legislators [leading to pork-barrel spending]. I am distressed when I look at what is attached to the bill. When the American public pulls back, government has to step in. There will be consequences [of the stimulus program].

Munger: One no brainer: Nationwide, we need a hugely improved electrical grid. That will help Berkshire subsidiaries, but we don't depend on it. The chance that it won't help us is zero.

Comment: The best—and normal—situation is when consumer demand (spending) stimulates production. However, when consumers are so panic-stricken over an extended period of time that there is a dramatic drop in consumer demand, then either government spending is used to augment consumer spending, or we have a depression. Depressions are unambiguously bad. Government spending can distort aspects of the economy and is subject to political corruption. Pick your poison.

Comment/short rant: We admire Buffett tremendously; however, put us down as skeptical that 1930s-era federal programs should be the model for today's economy.

Government Guarantees and the Competitive Environment.

Becky Quick relayed a question: How do U.S. government guarantees hurt Berkshire competitively?

Buffett: It hurts us that competitors can borrow, subsidized by the government—especially at Clayton Homes. The raw materials [funding] cost us more than a bank that's in trouble. There are the blessed with government guarantees and those that are not. We have no guarantees. Except for our utility business and Clayton, we don't borrow much money. Our $58 billion of float costs us less than zero, which is less than Wells Fargo's 1.12% cost of funds.

Munger: Of course we're at a funding disadvantage, but we're not regulated like a bank.

Comment: Buffett and Munger have been supportive of the government's efforts to deal with self-reinforcing consumer and investor panic, yet they clearly understand that most government actions come with a cost.

Derivatives.

A shareholder from New York City asked what Ben Graham would think about derivatives.

Buffett: He would not like them. They cause risk to run wild. They increase risks and strains, but if some were mispriced, he'd act accordingly. But he wouldn't get into a position of letting others get him in trouble. After 1929, Congress decided it was dangerous to borrow against securities, so the Fed was empowered to regulate margin levels. But derivatives made those rules a laughing stock. Derivatives came to be a way around margin regulations. They also allowed longer settlement periods, another danger. Buy Galbraith's *The Great Crash*.

Munger: There's a deeper problem. [Concerning derivatives trading] the dealer has two advantages: [1] a croupier-style house advantage, and [2] the dealer plays in the same game and is a better player and knows what the client is doing [buying and selling]. It's a dirty business. We don't need more of this kind of thing in America; we need less.

Comment: Amen, Brother Munger! The typical argument for derivatives is that they can be used to place risk where it is best shouldered, and that's a valid argument. However, some of the most vocal advocates for derivatives are those who trade derivatives from what amounts to a privileged position. We're always suspicious of the "proprietary trading" line on the income statement of an investment bank.

GM and Chrysler.

On behalf of an Illinois questioner, Andrew Ross Sorkin asked about the extent to which preferred shareholders and debt holders of GM and Chrysler should be exposed to losses in the restructurings of those companies.

Buffett: It's institution specific. There's no reason for senior debt to give up anything, if there's lots of equity and earnings power. Wells Fargo and US Bank are making lots of money, and earning power is intact. There's lots of equity beneath the preferreds. It's like a 70% LTV [loan-to-value] homeowner [shouldn't necessarily] lose because a 95%+ LTV homeowner is [losing]. I would love to buy all of US Bank or Wells Fargo. We can't, because it would make us a bank holding company. GM and Chrysler are very different. They're losing money, and there's no common equity. If equity is wiped out, then you have to decide who gets losses. Wells Fargo and US bank are very different.

Munger: I have nothing to add.

Portfolio Composition and Turnover.

A seemingly trading-oriented questioner from Illinois asked about a hypothetical investment fund: If Buffett were starting a $26 million fund, what would he do differently with a smaller asset base? How many positions would he hold, and what kind of turnover would he have? What would he do if some investments lost 50% and some gained?

> **Buffett:** We would hold the half-dozen stocks we liked best. We would do the same thing if they lost 50%. Cost has nothing to do with it. We look at price and think about what something is worth. Keep it in the few you know.
>
> **Munger:** He [Buffett] has tactfully suggested you adopt a different way of thinking. [laughter]
>
> > **Comment:** As Buffett stated, cost basis has nothing to do with investment judgment (apart from tax considerations). Nevertheless, many investors (like the questioner) pay way too much attention to what they've paid, rather than its value.

Berkshire's Advantage.

A shareholder from Portland, Oregon claimed that Buffett and Munger were Berkshire's sustainable competitive advantage, and he asked whether they would invest in Berkshire (presumably, now).

> **Buffett:** Our sustainable advantage is our deeply embedded ***culture***, which would be hard to copy, and a different shareholder base—20% turnover versus 100% turnover in the S&P 500—and a unique offer to managers. I don't see any other company in the U.S. that can adopt our model in any way. It's a very, very long-lasting advantage. It's not just us anymore. I don't know how I'd copy it if I were elsewhere. People who want to join us won't have another choice.
>
> **Munger:** Stated differently, a lot of corporations are run stupidly from headquarters, driving divisions to increase earnings every quarter. We don't do that. The stupidity of management practices in the rest of the corporate world will last long enough to give us an advantage well into the future.
>
> > **Comment:** Buffett and Munger make an impressive attempt to focus attention on Berkshire's cultural advantages, and they make very good points. Still, the loss of either of them will be a loss for Berkshire shareholders. Buffett is 78 and Munger is 85, so their eventual departures can't be very far away. That's ***another*** good reason to attend the next Berkshire annual meeting.

Holding Forever.

A shareholder from San Francisco asked Buffett why he would hold stocks forever, if the fundamentals change permanently.

Buffett: We don't—we sell plenty. If we lose confidence or conditions change, we sell. When in doubt, we keep holding. But for [our wholly-owned] companies, we hold and won't sell unless a company promises to lose money indefinitely, or there's a labor problem. We buy for keeps and won't sell, even if the offer is for more than [the company is] worth. If we were wrong, we sell. Last year, I sold a couple of billion dollars' worth of Johnson & Johnson just to raise cash for other purposes—an unusual situation. Someone asked us earlier what we'd do differently if we owned the whole company [Berkshire]. The answer is: nothing. We run Berkshire as if we owned 100%. Our peculiarity is our commitment to buy for keeps. People who sell their businesses to Berkshire know we won't hire some management consultant or leverage it up, and that's a real advantage.

Munger: The Berkshire system has legs, as they say in show business.

Comment: It is important to distinguish between investments that Berkshire makes in publicly-traded companies and purchases of whole companies. Although Buffett's turnover of publicly-traded stocks is low, it's not zero. He was willing, for example, to sell Johnson & Johnson shares in order to raise funds for other purposes. However, as Buffett will explain in more detail in his answer to a later question about newspapers, he has no intention of selling wholly-owned companies, unless they have intractable labor problems or seem destined to lose money indefinitely. One reason is that he wants to maintain his reputation as someone who won't dismantle a company or resell it to a higher bidder. Buffett's reputation is critical to Berkshire acquiring companies from company founders.

Copycat Investing.

On behalf of a Seattle questioner, Becky Quick asked why shareholders shouldn't sell their Berkshire shares and buy what Buffett's buying. Second, why not webcast the shareholders meeting?

Buffett: The meeting gets written up a lot. *Outstanding Investor Digest* [does a good job]. There is something to be gained by personal contact. I like our partners to show up and see our products. [In terms of buying what we're buying], others can't buy with free float, although they may have tax advantages we don't have. We don't quarrel with those who buy what we buy. You can piggyback, but you can't buy the [whole] businesses we do.

Munger: It's generally quite smart to copy very successful investors.

Buffett: I did the same thing when I was young.

Comment: An intelligent investor would be crazy not to watch what Berkshire does. However, just as you might watch a magician over and over without figuring out his methods, watching Buffett is no guarantee of success. Regarding webcasting the Berkshire annual meeting, we think it is doubtful investors could obtain the full impact of the meeting via a webcast—and that's still another reason to attend.

Inflation.

An 11-year-old from New Jersey asked how inflation will affect his generation. How is Buffett preparing for inflation?

Buffett: Inflation is going to affect you. Long term, even a small amount is bad. It's certain we'll have inflation over time. Volcker opined against an FOMC [Federal Open Market Committee] 2% target for inflation. It is something of a slippery slope. Current policies are bound to have inflationary consequences. Inflation is a classic way to reduce the cost of external debt. Federal revenues are going down. Politicians say that taxpayers pay for this or that, but if taxes are less now, who's paying? The real payers are [those affected by] the shrinkage of the value of the dollar down the road. The people who are really paying are those that are buying fixed income investments now—the Chinese, for example. That's the ultimate price of stimulus. The easiest thing to do [inflate] is the likeliest. The best protection from inflation is your own earning power. The second best is owning a wonderful business, such as Coke, that doesn't require capital. With Coke, you'll get your share of national earnings.

Munger: The young man should become a brain surgeon and buy Coke stock, not [government] bonds.

Buffett: I get paid by the word. He doesn't. [laughter]

Comment: Regarding protecting yourself from inflation, which Buffett emphasizes is inevitable, this is his standard (and valuable) answer. Skills, primarily, protect workers. If you are among the best surgeons, carpenters, engineers or musicians, chances are good that you will be able to command a good salary, whatever the rate of inflation. Taken to a more macro level, the best source of earnings power for Americans isn't unions, tariffs or trade barriers. Rather, it is the fundamental ***skills*** of the American workforce. If U.S. workers remain among the most productive in the world, we will continue to enjoy comparatively high wages.

Newspapers.

Andrew Ross Sorkin relayed a question from an individual in Waldorf, Maryland: Would there be a compelling price at which Buffett would add another newspaper to Berkshire's portfolio?

Buffett: There's an evolutionary situation with newspapers. I read five a day and so does Charlie. We'll be the last people reading a newspaper, with a land line by our sides. [laughter] Most newspapers in the U.S. we would not buy at any price. Twenty to forty years ago, they were essential to customers and advertisers. They had pricing power, but they've lost their essential nature—essentiality has eroded. Erosion accelerated dramatically, and it won't end based on anything on the horizon. We do not see anything to reverse it. They are essential to advertisers only as long as they're essential to readers. Ten years ago, the head of *The Buffalo News* said that on an economic basis, Berkshire should sell *The Buffalo News*. We could have sold the business for hundreds of millions. Not so today. As long as we're not losing money forever and there are no union problems, we won't sell. There are around 1,400 daily U.S. papers, and nobody has found the model that works. We'll play it out as long as we can.

Munger: One hundred percent right. Monopoly daily newspapers were impregnable. It's a national tragedy for newspapers to die off. They kept government more honest than they otherwise would be. What replaces it will be less desirable.

Comments: We don't know specifically, but we assume Buffett and Munger read *The Wall Street Journal*, *The New York Times*, *The Washington Post*, the *Financial Times* and a local newspaper. When Buffett says that he wouldn't invest in most U.S. newspapers ***at any price***, that is saying a lot, given that Buffett studied under Benjamin Graham, whose "cigar butt" approach to investing emphasized that even a marginal business can represent a good investment at some sufficiently low price. If no newspaper company stock price is low enough, Buffett apparently sees a long-term lack of profitability for newspapers.

In baseball, a batter may "take one for the team"—i.e., allow himself to be hit by a pitch in order to advance to first. In not selling *The Buffalo News* at a significantly higher price than it could command today, Buffett took one for the team. That is, he may have accepted this opportunity loss in order to advance Berkshire's reputation as a company that will not flip businesses or chop them up and sell them, thus making future acquisitions of companies (from their proud founders) more possible.

Comment/short rant: Buffett and Munger are sophisticated enough to glean important information from news reports that might otherwise mislead less sophisticated investors. Reading newspapers without a solid foundation of relevant experience is no recipe for investment success.

Outlook for Recovery.

A shareholder from Melbourne, Australia asked whether retail, manufacturing and service businesses will still be below their 2007 levels three years from now, given how they have been affected by the recession.

Buffett: I don't know. If housing starts [remain] at 500,000, we'll get [housing market] equilibrium in two years or less. The government is now unhappy that people are saving. Retailing has been hit very hard. The higher end has been the hardest hit—it will last quite a bit longer. The experience of the last couple of years will not go away [be forgotten]. Retail real estate will be a tough area for quite a while. Shopping centers will be tough for years. Cap rates of 5% will look pretty silly. Service businesses are generally the better ones, because they require less capital and can be more specialized. I would not look for a quick rebound. South Florida will be a problem for a long, long time.

Munger: I have nothing to add.

Comment: A "cap rate" is essentially the reciprocal of a price/earnings ratio, so a cap rate of 5% corresponds to a P/E of 20, which would be a rich valuation for the stock market. When it comes to assessing consumer behavior, Buffett is well situated to see a lot of meaningful data. Berkshire owns a large furniture store; an auto insurance company; jewelers at the high, mid and economy levels; the second-largest real estate brokerage operation (HomeServices of America); and many other consumer-facing companies.

Corporate Stock Buybacks.

A question relayed by Carol Loomis addressed corporate stock buybacks. The questioner noted Buffett's prior encouragement for companies to repurchase stock and asked Buffett to address the issue of Berkshire buying back its own shares.

Buffett: My comments go back a lot of years. I haven't written about other companies repurchasing in about 10 years. Repurchases in recent years were foolish, because they paid too much. They were trying to give out buy recommendations that weren't justified. In the 1970s and 1980s, we encouraged others to repurchase because [shares] were demonstrably cheaper than anything else. We only felt in 2000 that we wanted to do so, because Berkshire's intrinsic value [didn't match] its stock price. But it was self-defeating [the announcement of Buffett's intention to repurchase sent Berkshire's stock higher]. [Repurchases] should be quite compelling, and that doesn't exist now. Ninety percent of repurchases in the last five years were at silly prices and not in the interest of shareholders. Managers did it because it was what everyone else was doing. It's interesting how many companies bought at two times current prices that aren't [buying] now.

Munger: I've got nothing to add to that, either.

Comment: Amen, Brother Buffett! For a number of years now, many companies have repurchased their own stock with the flimsiest of reasons, claiming they were "returning money to shareholders." Perhaps CEOs thought repurchases were suitable ways to boost earning per share (and, ultimately, stock options). Buffett's previous arguments for share repurchases essentially provided some cover for CEOs to repurchase stock at uneconomic prices. With Buffett's comment that 90% of more recent repurchases were at silly prices, ***hopefully that cover is blown***. Share repurchases should be like any other investment decision—wise only when the price is right.

Investment Opportunity Costs.

A shareholder from New Jersey asked Buffett to address his opportunity cost decisions of the past year.

> **Buffett:** Opportunity costs have been in the forefront of our minds during the last 18 months. It's tougher to calibrate A, versus B, versus C in a fast-changing environment. Tougher and possibly more profitable. We got lots of calls [for potential investments]—most we ignored. We were called by Goldman Sachs on a Wednesday for $5 billion, and we [already] had a $5 billion commitment to Constellation Energy, $3 billion on Dow Chemical, $6.5 billion on the Wrigley Mars deal. We never want to get dependent on banks. It's a good sign that we haven't had the flurry [of phone calls] like last year. Normally, we would not have sold Johnson & Johnson if it were 10 – 15 points higher, [but we wanted to have a comfortable amount of cash on hand]. Our definition of comfortable is ***very*** comfortable.
>
> **Munger:** I have nothing to add.
>
>> **Comment:** As Buffett clearly implies, the real cost of any purchase isn't the actual dollar cost. Rather, it's the opportunity cost—the value of the investment you ***didn't*** make, because you used your funds to buy something else.

GEICO Ad Spending.

Becky Quick asked a question from an individual from Columbus, Ohio: Can you quantify the return on advertising spending at GEICO?

> **Buffett:** I'm quoting someone [William Lever, founder of Lever Brothers]: "We waste half the money we spend on advertising—we just don't know which half." We spend $800 million on advertising [at GEICO], which is more than the number one and two [auto insurers], State Farm and Allstate. We will spend more and more. We want everyone in the U.S. to know we can save people money. We want to be on everyone's mind. A brand is a promise. The value of GEICO goes up by far more than its earnings each year.
>
> **Munger:** If we don't need GEICO to advertise [as much], then it's that much more profitable.
>
> **Buffett:** We're getting more than our money's worth on advertising. I'd spend $2 billion if we got the same return. We're the low-cost producer of something people ***have*** to buy.
>
>> **Comment:** A brand is a promise, and a fulfilled promise will create substantial value. That's pure Buffett.

What's in a Stock Price?

A shareholder from Savannah, Georgia noted that Wells Fargo was a good deal at $9 per share, but AIG, the Irish banks, Fannie Mae, and Washington Mutual got there, and weren't. How does Buffett know the difference?

Buffett: I couldn't have been more wrong about the Irish banks. The $9.00 price isn't the issue, it's the business model. Nobody lied to me. It was a terrible mistake by me. I just plain wasn't paying attention and should have known about their land development loans. Wells Fargo, among the largest banks, has the best competitive position. Regarding WaMu [Washington Mutual], there were a lot of signs of possible trouble if the model of ever-rising housing prices was wrong. They were doing things they shouldn't be doing with leverage. If you read the [SEC Form] 10-Ks and 10-Qs, you could spot the difference. There's no comparison between Wells Fargo versus WaMu. Banking has real differences, but people don't look at them carefully. Think of a copper producer with costs at $2.50/pound versus another with costs of $1.00/pound. One's done [if prices drop to] $1.50/pound, and the other is fine. Wells' $600 million amortization of acquired deposits is not a real cost—yet nobody notices. I think it was pretty clear regarding Freddie and Fannie. We got calls from investment bankers [looking for interest in them]. One look and we could see they were in big, big trouble. People who don't spend a lot of time investing can't differentiate financial institutions. It's easier with Coke or a utility. You have to know something about banking.

Munger: Accounting practices should not be constructed to allow banks to get into trouble with loans. GAAP [generally accepted accounting principles] allows conservative banks to increase earnings if [they] change policies to [those of] poor ones.

Buffett: Gen Re's [derivatives] division cost us $400+ million to get out of. [It was] a black box to produce all sorts of numbers. It's hard for a passive investor to discern.

Munger: A lot of new regulation wouldn't have been needed if accounting had done a better job. If accountants don't have shame, they're not thinking right.

Comment: A stock is neither a buy nor a sell just because its stock price is $29, $19, or $9. What matters is a comparison of the stock price with an ***informed*** judgment of the value that business fundamentals imply. If you sold Fannie Mae just because its stock price declined to $9, you stopped your losses at that point. However, if you sold Wells Fargo at $9, then you stopped yourself from recognizing some remarkable gains in the following weeks. The key is that Wells Fargo had strong fundamentals, and Fannie Mae did not. This is why "technical" research (the study of stock price movements) typically provides so little value. As Buffett mentioned earlier, investors need to know how to value a company, and that starts with taking the time to read company reports, such as Forms 10-K and 10-Q. Further, investors need to understand the difference between accounting earnings and real earnings.

BYD.

For the first question after a brief lunch, Andrew Ross Sorkin relayed an investor's comment that BYD [Buffett's recent Chinese investment] seems like a speculative or venture capital investment, instead of a "value" investment. Could Buffett explain?

> **Buffett:** All investments are "value" investments. What other kind can there be? You always expect to get more in the future [for what you're investing today].

> **Munger:** BYD is not some early-stage venture capital company. The founder is around 43 years old. They're a main manufacturer of rechargeable lithium batteries, from a standing start. Then they became big in cell phone components, with a huge position. They recently entered the auto industry, and from zero, rapidly made the best-selling [Chinese-manufactured] car model in China, against Chinese joint ventures with leading manufacturers. This is not unproven. It's not speculative. It's a damn miracle. They hired 17,000 engineering graduates at the top of their classes. It's a remarkable aggregation of talent. Chinese people succeed mightily. Batteries are totally needed in the future of the world. I don't think Warren and I have gone crazy. They make every part in the car, except [possibly] the windshield and the tires. I regard it as a privilege for Berkshire to be associated with BYD. I will be amazed if great things don't happen. I wouldn't bet against 17,000 Chinese engineers led by Wang Chuan-Fu. BYD is a $4 billion company—a small company, but their ambition is large.

> **Buffett:** BYD was Charlie's [idea], the Irish banks were mine.

>> **Comment:** Buffett and Munger don't make investments on a whim. As described in a *Fortune* article, they have taken the time to investigate BYD (which stands for "build your dreams"). It's rare to see Munger, who can be so skeptical that Buffett once referred to him as "the abominable 'no' man," so enthusiastic about a company. For the technically inclined, there was a cut-open model of BYD's electric car in the display area. Regarding Buffett's acknowledgment of responsibility for Berkshire's Irish bank investments, Buffett has always been quick to acknowledge his mistakes and learn from them. That's one characteristic of a savvy investor.

Outlook for the U.S. Dollar.

A shareholder from Chicago asked Buffett to address his outlook on the dollar versus other major currencies.

> **Buffett:** I will guarantee you that the dollar will buy you less 5, 10, 20 years from now. The same thing is happening around the world, so it's difficult to predict [the outlook for] dollars versus other currencies. Governments around the world are running very significant deficits—appropriately—to offset the recession. So the

relative effects are unpredictable. Policymakers do not know the outcomes of today's actions. We are doing things to lose purchasing power. You can bet on inflation.

Munger: In my life I have had the most privileged era to live in. I remember 2¢ postage stamps. A little inflation won't ruin the lives of any of us. The trick is to avoid galloping inflation. That's a problem Warren and I are going to quit claim to the next generation.

Comment: Economics tells us that the currencies of countries with relatively higher rates of inflation will likely depreciate relative to countries with lower rates of inflation. However, since most countries are embarking on inflationary policies of unknown specific impact, it's hard to use inflation to assess the international values of currencies. Regarding domestic purchasing power, ***Buffett and Munger are emphatically telling us to expect more inflation*** and to hope the inflation rate remains reasonably contained.

Losing Berkshire's AAA Rating.

Carol Loomis relayed a question from an individual in Calgary, Canada: What is the impact of Berkshire losing its AAA rating? What will it take to restore it?

Buffett: We won't regain it soon, because ratings agencies won't turn around that fast, even if warranted. It has very little material effect on our borrowing cost. I very much like having a AAA rating. We didn't think we would be downgraded. We lose some bragging rights in terms of our insurance business, but nobody in insurance ranks ahead of us. We're still a AAA in my mind. Committees don't change their minds quickly. We regard meeting our obligations as sacred. It's difficult for ratings agencies to quantify commitment of management. It [the downgrade] irritates me.

Munger: At least they showed a considerable independence. [laughter] Moody's next change will be in the opposite direction, because we deserve it, and they're smart.

Buffett: [When Charlie and I disagree], Charlie says, "In the end you'll see it my way, because you're smart and I'm right!" [laughter] [Buffett continued with a discussion of how credit default swap (CDS) prices can be affected by factors other than perceived credit quality, but we don't feel confident enough of his exact wording to quote or paraphrase him, so please see the "comment" section below for a working summary of Buffett's remarks.]

Comment: Buffett noted that the ratings agencies often cite CDS prices to support their actions, but CDS prices can be affected by non-credit factors. For example, suppose that Berkshire writes an equity put option. Berkshire collects the premium and establishes a liability on its balance sheet. The other side of the transaction (the put buyer) creates an asset. Then, both sides mark the option to market. If things move in the buyer's favor, they show a gain. However, the buyer's auditors urge them to buy protection for their gain by purchasing a Berkshire CDS, since the buyer's gain represents a potential receivable from Berkshire. If Berkshire writes a relatively large dollar amount of equity put contracts, the buying of Berkshire CDSs significantly increases—and this demand pushes Berkshire CDS prices higher, which to the casual observer would suggest that there's increased risk in Berkshire. Got that? The bottom line is that the price of Berkshire CDS contracts can go higher ***without*** any increased risk associated with the company.

When Buffett says, "We regard meeting our obligations as sacred," that has real value to anyone familiar with Buffett's history. However, the ratings agencies aren't necessarily good at assessing qualitative factors. Further, as we mentioned earlier, Moody's and other ratings agencies seem to be on a mission to try to counter their (justifiable) image of having been unrealistically lenient previously. What better way to show how tough you are than to downgrade Berkshire Hathaway? Munger says Berkshire deserves to be AAA, and we believe him. He also says that Moody's is smart, and we sort of agree. However, we think the ratings agencies are in self-preservation mode for awhile. Moody's would cast doubt on their Berkshire downgrade if they reversed it quickly, so it makes sense that a return to a AAA rating isn't likely soon.

Wind Farms and Alternative Energy Sources.

A shareholder from Davenport, Iowa asked Buffett when he expected to see a return on investment in wind farms and other alternative energy sources.

Buffett: We have the largest wind farm capacity in the country. We are a net exporter of wind energy in Iowa. Iowa has been very receptive and progressive in wind energy. We haven't raised rates in Iowa in about 10 years. We can use Iowa's tax credits. We've developed a lot at PacifiCorp in wind. You'll see more and more wind generation by MidAmerican [Energy Holdings].

Munger: Berkshire subsidiaries will be leaders in practically anything that makes sense for utilities. You bought a pipeline in about two hours, didn't you?

Buffett: A durable advantage is that we can act fast. We went from a noontime phone call to a formal offer for Constellation [Energy] by that evening. It didn't work out. We don't ask the lawyers before we do it, we just do it. We can move fast when the time [is right]. We've got the money, and we've got the managers to handle the properties.

Comment: If Berkshire has the largest wind generating capacity in the country, somebody needs to tell FPL Group, which makes the same claim. To date, wind power has been the most successful among the alternative energy sources. When Buffett does something like invest in wind power, you can rest assured he's thought about the economics of the situation.

Bank of America's Purchase of Merrill Lynch.

Becky Quick relayed a question: Does protection of the banking system warrant the lack of public disclosure in Bank of America's purchase of Merrill Lynch?

> **Buffett:** That's a very tough question. It was a very fragile situation. If Bank of America backed out, it would have set things in motion. It [Merrill] could not stand on it own. The CEO was in a tough spot. Would I have behaved differently than Bernanke or Paulson? Ask Charlie what he would do. [laughter]
>
> **Munger:** You can legitimately criticize Bank of America's acquisition of Merrill Lynch. But once they signed the contract, I believe Bank of America and the Treasury acted honorably. Read the "history of the deal" [section] in the proxy statements. Bank of America got two fairness opinions in 24 hours at a cost of $20 MM. They needed a fairness opinion on the fairness opinions. [laughter]
>
> **Buffett:** I'm sure they hope you'll be on the jury. [laughter]
>
>> **Comment:** The "history of the deal" sections of proxy statements can make for fascinating reading.

How Will Government Interventions Affect Berkshire?

A shareholder from Germany asked: What do you see as the net effect of government interventions on Berkshire's business? Will there be new rules of the game?

> **Munger:** It's clear there will be new rules, but it's not clear what the new rules will be. There's been awesome lobbying from financial firms. Countering this lobbying pressure, there's a climate of hatred in Washington D.C. at the financial industry that you could cut with a knife—it's that thick. I don't think you can predict. Berkshire has to adapt to whatever happens. If I had all the power, there would be a lot of government intervention.
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> **Buffett:** New rules will affect us one way or another. The biggest pressure is that the American public doesn't like bankers now. They were worried about their money market funds not that long ago. Nobody's going to jail, and that makes people mad. It's much more fun if someone's going to jail or tortured in some public fashion. People are mad at government or bankers, and you know where government wants that to go. The House 90% tax on AIG bonuses was uncontrolled fury. We'll adapt to [the situation]. I won't like it.
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>> **Comment:** Because Buffett commands so much respect and admiration from the public and politicians, it's unlikely that any legislation will be specifically aimed at "getting" Berkshire. Indeed, politicians typically consider it a feather in their cap if they can get Buffett to support something they propose.

Berkshire's Rate of Growth.

Andrew Ross Sorkin relayed a question from an individual in Oregon: Does Buffett have a target rate of growth for Berkshire, given its size? Greater than 20% seems unlikely.

Buffett: It will be absolutely impossible to come anywhere near 20%. We hope to be a few percentage points better than the S&P 500. I used to say 10% better in the 1960s. We'll use book value as a proxy for intrinsic value, [as we've] measured that way for 40 years and will continue to measure that way. If we don't beat it at all, I'll feel like I haven't added anything.

Munger: In terms of the broader contribution to civilization, the best days of Berkshire are ahead. The future will be way better than the past.

Comment: Over the long run, a few percentage points of annual outperformance compound to a ***tremendous*** advantage. For example, $1 that grows at 9% annually for 20 years becomes $5.60. However, if it grows at 12%, that $1 becomes $9.65. For the intermediate term, we think Berkshire can outperform the S&P 500 by more than 3% annually.

China.

A shareholder from Shanghai, China asked two questions: How will Buffett invest in China in the future? What will happen to the purchasing power of China's large holdings in U.S. Treasuries?

Buffett: We respond to opportunities as we see them. We will see things to do over time. Some things are restricted to U.S. [investors] in China. We can't own more than 24.9% of an insurance company in China. China is a huge market. We would have bought more than 10% of BYD, if they had let us. If we run a $250 billion trade deficit with China, they have $250 billion to do something with. The Chinese can't get rid of their dollar holdings. Chinese dollar assets will increase as long as they run a [trade] surplus with the U.S. To date, they've acquired mostly U.S. government bonds. It's a major problem for them to decide what to do with U.S. dollars. Anyone who owns dollar obligations outside the U.S. will have less purchasing power in the future.

Munger: If I were a Chinese finance minister, I would do what they're doing. China has one of the most progressive economic policies in the world. I have nothing but admiration for Chinese economic policies. They will be very hard to compete with all over the world.

Comment: In the final analysis, when the U.S. runs consistent trade deficits, which it has, our trading partners ***must*** accumulate U.S. dollar-denominated assets. The fact that China has invested many of its U.S. dollars in Treasury securities is one reason why interest rates remained low during the boom years, thus exacerbating the boom and subsequent bust. Although we greatly admire Charlie Munger, we believe there is an important linkage between economic freedom, political freedom and prosperity, so put us down as being somewhat skeptical about the progressiveness of China's economic policies.

Gen Re Post Mortem.

Carol Loomis relayed a question seeking a post mortem on the acquisition of Gen Re (a global reinsurance company).

Buffett: We believe in post mortems, but not in making them public. You won't attract businesses if you do. Charlie is a fan of rubbing their noses in what they've done. I will comment on Gen Re though. Gen Re has worked out well after a terrible, terrible start thanks to the combined work of Tad [Montross] and Joe [Brandon] who took over in 2001. I was terribly wrong in thinking it was the Gen Re of 15 years earlier. Gen Re ***now*** is the company I thought it was in 1998 when I bought it. It wasn't an easy job.

Munger: That's right. It's very important that you have the ability to turn lemons into lemonade. It wasn't pleasant, and it wasn't pretty. You had to be very tough minded to fix Gen Re. We were very lucky to have Tad and Joe.

Buffett: Post mortems are evaluating our handiwork. Acquisitions are our choices—not another department or a consultant. We made some really dumb decisions.

Munger: Joe's the hero.

Comment: Many acquisitions turn out to be disappointments for acquiring companies, but Berkshire's batting average on acquisitions is ***way*** higher than most—so we think shareholders should cut Buffet and Munger some slack on Gen Re.

Contracts.

A questioner from California asked Buffett to comment on union and other contracts at Berkshire subsidiaries.

Buffett: We don't have any. We're not big believers in contracts [when we buy businesses]. We don't want relationships that are based on contracts. We buy [businesses] based on retaining [the former owners'] passion for the business. The compensation of the top person at each company [Berkshire subsidiary] is my responsibility. We have contracts on bonuses. Some businesses are profitable, some not. We have different arrangements for different businesses. We don't try to hold people by contracts. Contracts wouldn't work.

Munger: Our model is a seamless web of trust, earned by both sides. The Hollywood model is contracts, but no trust.

Comment: We're not sure what specifically the questioner was looking for. Nevertheless, Buffett's and Munger's comments were very interesting. How many companies do you know that would describe their operations as "a seamless web of trust, earned by both sides"? There is truly something special about Berkshire Hathaway.

Berkshire Spin-offs.

Becky Quick relayed a question from an individual in Massachusetts: Would Buffett consider spinning off some companies to realize value?

Buffett: We will not be spinning off any companies. We can't wait to throw them [people who suggest spin offs] out of the office. We have a real advantage in allocating capital—moving money around. When we buy companies from people, we buy them for keeps. People can trust us to keep our word on this.

Munger: Wall Street sells that stuff [spin-offs] for fees. It doesn't really do much for anyone. Short of some regulatory change, we're unlikely to [spin something off].

Buffett: We have listened to presentation after presentation by investment bankers, but there is always a fee.

Comment: A similar question was asked and addressed earlier in the meeting. Short of indefinite operating losses or intractable labor problems, Buffett is ***not*** going to spin-off subsidiaries like some poker player passing cards to his right in hopes of "realizing value," when doing so would damage his reputation as a buyer (and keeper) of businesses.

Student Loan Industry.

A shareholder from Montclair, New Jersey asked for comments on the disarray in the student loan industry.

Buffett: I don't know much [about it].

Munger: There's been a fair amount of scandal in sales methods.

GE, Goldman Sachs Investments.

Andrew Ross Sorkin relayed a question concerning Berkshire's investments in General Electric and Goldman Sachs: GE has a history of trying to manage earnings. Does Buffett regard GE and Goldman as attractive businesses or attractive securities?

Buffett: A very substantial fraction of American businesses over the last 15 years have managed earnings. We felt good about the quality of the businesses and the quality of the managements, but it was primarily the terms of the GE and Goldman deals that made them attractive. There were no second sources to GE and Goldman. I know the GE and Goldman CEOs quite well and am very happy with the deals. We've done a lot of business with Goldman over the years.

Munger: There's been a lot of criticism of investment banking, but Berkshire has gotten help [from] investment banks. We're comfortable with these businesses.

Buffett: We've bought I don't know how many wind turbines from GE.

Comment: It is plausible that both GE and Goldman provided relatively generous terms to Berkshire because (1) it had the money, (2) it could act fast, and (3) the Buffett imprimatur can be quite valuable. Once again, Buffett's reputation works for the advantage of Berkshire shareholders.

Problems in the World.

A shareholder from San Diego asked about potential problems in the world economy.

Buffett: There's always a lot of things wrong in the world; unfortunately, it's the only world we've got. We have a great system that works very well. Over time, people will live better and better. Our system unleashes human potential like no other—we haven't reached the end of that road by a long shot. We have these interruptions in the progress of society, but we have moved ahead pretty fast. We've wasted human potential in fits and starts. There will be bad years in capitalism, but in the 20th century there's been a seven-to-one improvement in the standard of living. There is enormous human potential, and the opportunities will win in the end. Every year we meet you can name a bunch of problems. Your children and grandchildren will live better than you do.

Munger: Interestingly, now as I get closer to death, I grow more cheerful economically. I especially like that we are about to harness the direct energy of the sun and [to get drinkable water from] seawater. It's probably a mistake to think only about your probable misfortunes. You should think about your blessings as well. The main technical problem of man is about to be fixed—energy.

Comment: Given the gloomy tone of some news reports concerning the Berkshire annual meeting, the various reporters must have stepped out during this answer.

Swiss Re.

Carol Loomis relayed a question regarding Swiss Re. A questioner wanted to know about its float and risks. How can Buffett be comfortable with the situation?

Buffett: We have several arrangements with Swiss Re. We invested three billion Swiss francs [$2.6 billion] in Swiss Re, and it pays us 12%. [This is] not a junior security. Their problems are not due to their [insurance] underwriting. They develop a large amount of float relative to premiums. Swiss Re's problems were a little akin to AIG's.

Munger: If Swiss Re's a problem, we should have more [like that].

Comment: They say a stressful situation that doesn't kill you, makes you stronger. Somewhat similarly, a company's problems that prove not to be fatal can make its investment case stronger—at a sufficiently low price. Obviously, Buffett didn't view Swiss Re's problems as being ***a lot*** like AIG's.

Compensation in Capital-Intensive Industries.

A shareholder from the Philippines asked about executive compensation packages in capital-intensive companies.

Buffett: We spend a lot of time talking about compensation in capital-intensive businesses. You must include a capital cost element in a compensation system. See's Candies needs no capital. We think incentives are very important. Boards have relatively little impact on CEO compensation. The CEO has a big effect on his own compensation. They appoint their own compensation committee members, and CEOs aren't looking for Dobermans—rather they're looking for Cocker Spaniels. In my experience, boards have not thought about what to pay these people [CEOs]. There must be incentives to do the right thing and incentives ***not*** to do the wrong thing. Boards thinking like owners is ideal. Not every CEO wants a rational compensation policy. Who would, when an irrational system pays more? I don't think there should be compensation committees. [The board should]: hire the right CEO, and make sure he doesn't overreach. Boards don't care as much as the guy on the other side of the table [when it comes to CEO compensation]. Boards have gotten better in recent years, but started from a very low base.

Munger: I would argue that liberal pay for directors is counterproductive. It would be better if boards were not paid at all.

Buffett: The SEC will question a real owner's independence. To get business-savvy directors who think like real owners' representatives on the board is tough. [Board] compensation arrangements are more baloney. If compensation is too high, [the director] is not independent. Highly paid boards aren't going to argue with the CEO. It gets club-like. [Having] 100-page proxy statements explaining board compensation is wrong.

Munger: A director who has a lot to lose is loathe to be independent.

Comment: We've previously described the process by which corporate boards are elected as being akin to being "back in the USSR," where voters could vote for a Communist party's candidate or withhold their vote—that's not much of a real choice. When there are more contested corporate board elections, shareholders may begin to have better choices. Right now, a handful of the largest institutional investors could force far better corporate governance, but when these same institutional investors compete for corporations' business, their focus on the best governance practices can become compromised.

Worst-Case Scenarios.

Becky Quick relayed a question regarding the worst-case scenario for Berkshire's insurance business.

Munger: Even a catastrophe with a $2 – 3 billion loss would not be a disaster [to Berkshire]. It's a marvelous business.

Buffett: In a mega-catastrophe, at worst we'd pay 4 – 5% of the total [insurance] industry loss. We may be lower than that now, 3 – 4%. Katrina was close. There were total losses of $60 billion [for Katrina]. In a $100 billion catastrophe, we'd pay 3 – 4% of that. The worst situation would be if we ran into so much inflation that people expressed [such] outrage that we start nationalizing the insurance business. That would be a huge loss of an asset. It's not probable. If there's public outrage, politicians will do something when costs go way up on essential services.

Comment: We certainly agree with Buffett. The worst "catastrophe" would be nationalization of the insurance industry. We'd add that nationalization of ***any*** industry would not be in the best interest of Americans. The calls for "temporary" nationalization of the banking industry earlier this year undoubtedly contributed to the market turmoil into early March.

The Dollar vs. the Euro.

A shareholder from Ireland asked whether the gains from any European acquisitions could be adversely affected by a loss in value of the U.S. dollar versus the Euro.

Buffett: I'm no good at predicting the dollar versus the Euro. You can hedge currencies, but I don't recommend it.

Munger: You're pretty good.

Buffett: We did make a couple billion. [laughter] We'll keep doing things that make sense. There are a lot of companies we feel comfortable with. We have a lot of indirect sources and direct sources of earnings outside the U.S., but no predetermined goal by location. Some opportunities will be found abroad, some won't. We don't wake up in the morning saying we want to have more [investments] in Germany or Spain.

Munger: There's plenty of wrong on both sides of the Atlantic; plenty wrong and plenty right. It's not clear that our messy details are any worse than Europe's messy details.

Comment: U.S. economic problems include an aging population, entitlement spending, stresses in the financial system, federal spending deficits and potential inflation. However, most European countries have these same problems—sometimes to a greater degree than we do.

Possible Berkshire Layoffs.

Andrew Ross Sorkin relayed a question from "anonymous employees" of a Berkshire subsidiary: Could Buffett share his attitude toward layoffs and job security at Berkshire subsidiaries?

> **Buffett:** Business conditions can change dramatically. [If businesses] permanently contract, it leads to permanent layoffs. Sometimes it's temporary. GEICO will hire around 1,000. Some people resist layoffs, [but] if the business changes in a material way, you'd better change your business model or someone else will cause you to. You tend to do it a little late even. On balance, we hope to avoid businesses that have those problems, but [sometimes] there are no alternatives. In the textile business, we ultimately laid off everyone. Sometimes you're on the short end of creative destruction.
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> **Munger:** Some of our businesses have a shared-hardship model, but it's not always easy to do. Ben Franklin said, "It's hard for an empty sack to stand upright." Sometimes you have to amputate a limb to save a life.
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>> **Comment:** "Creative destruction," a term coined by economist Joseph Schumpeter, refers to the process by which more advanced and efficient methods of production replace older ones. It is understandable that employees are concerned about job security; however, a dynamic economy often leads to growth in some industries and decline in others. Efforts to maintain employment when the economic situation dictates otherwise (buggy whips, television vacuum tubes, etc.) typically result in only short-term employment relief. Further, such efforts can stymie economic growth and ultimately lead to higher overall levels of unemployment.

Executive Compensation.

A shareholder from Greenwich, Connecticut asked how shareholders can influence executive compensation.

> **Buffett:** The AIG outrage was probably disproportionate, but it doesn't matter. You can't legislate compensation. In the early Clinton administration, they legislated a cap on salaries, with unintended results. The Clinton administration attempt to do so was the worst legislation ever and resulted in much higher executive compensation. The result was taxes paid by shareholders and all kinds of counterproductive compensation arrangements. All you need is for the top half-dozen investment managers to speak out against the most egregious executive compensation arrangements. That would change behavior. The way to change big shots is to embarrass them. Directors don't like to look foolish and see their names in the paper. There is no constraining factor now. Every compensation committee hires a consultant, who raises the recommended compensation. It ratchets up executive compensation. We have the honor system—shareholders have the honor, and the executives have the system. [laughter]

Munger: The manager is like the guy in a glass house throwing stones. Sometimes the cure is worse than the disease.

Comment: If every share of stock were voted in the best interest of its ultimate owner, a good number of problems in corporate governance would disappear. However, many shares are voted by intermediaries, such as mutual funds and pension funds, that don't necessarily have the same incentives as shareholders. Further, individual investors who do have direct voting authority sometimes fail to vote or simply go along with management, without giving the issues much thought.

Selecting Berkshire Managers.

Carol Loomis relayed a request for Buffett to describe the interview process for Berkshire managers.

Buffett: We hire people who typically have proved themselves already. We find people who love their business. [We ask ourselves,] will they feel the same the day after the deal? We have no retirement age. The toughest problem is when managers lose their abilities. That's the only part of my job I don't like.

Munger: We've been very slow every time on these.

Buffett: I love Berkshire. I go to work every day and am excited about it.

Comment: In this short answer, Buffett made two important points. First, nothing succeeds like success, so he looks for people who have ***already*** proven themselves. Second, there is no mandatory retirement age at Berkshire. This policy is apt to become far more widely followed among American corporations in the future, as we get used to longer working careers and as we recognize that age 65 isn't as old as it once seemed. Think what a waste it would have been if Buffett had retired 13 years ago, when he was 65.

Buffett's *New York Times* piece and the Current Downturn.

A shareholder from Dayton, Ohio referred to Buffett's op-ed piece in *The New York Times*, wherein Buffett said he was moving toward a 100% investment in U.S. stocks, and asked him to comment on the relative severity of the current downturn.

Buffett: Stocks got much cheaper in 1974, about four times earnings, than now, but interest rates were far higher, so maybe they were not really cheaper. It's not as dramatic as in 1974 in terms of buying opportunities—that was the best period I've seen. I bought some equities and bonds, too. I like when things get cheap, as long as the value's in the business. I'd much rather pay half of X than X.

Munger: It's nothing like 1973 – 74. I knew at the time that was my time [to invest], but I had no money—but that's part of the way it happens. 1974 was obvious. If I were you, I wouldn't try to wait for 1973 – 74 [conditions].

Buffett: What I paid yesterday doesn't matter. Picking bottoms is not our game—that's impossible. I spend 99% of my time thinking about Berkshire [not my separate money]. We had the chance to buy great corporate bonds. Our idea is not to tiptoe into anything.

Munger: Sometimes opportunities are under shell A when [you're] looking under shell B.

Comment: It doesn't make much sense to adopt a strategy of waiting for stocks to be the cheapest in, say, 30 or 40 years before you buy. You may get to buy real bargains if you wait for such opportunities, but they may not appear again in your lifetime. Even if they did appear, you would likely achieve returns that were inferior to those of investors who were mostly invested most of the time. The key for long-term oriented investors is whether or not you can find reasonable opportunities. If you can, buy them without regard to whether they may get even cheaper. More often than not, reasonably-priced investment opportunities will appreciate, not depreciate.

Earnings Quality.

Becky Quick asked a question from a shareholder in Costa Mesa, California: Would Buffett comment on the quality of earnings in capital-intensive businesses, like utilities.

Buffett: Capital-intensive industries ***outside*** the utility sector scare me more. We get decent returns on equity. You won't get rich, but you won't go broke either. You are better off in businesses that are not capital intensive.

Munger: A lot of moats have been filling up with sand lately.

A Personal Proposal.

The last "question" was asked by Buffett's nephew, Alex, and after a set-up reply from Buffett concerning "family formation," Alex proposed to his girlfriend. (She said yes.)

Final Comment: According to a headline published in *The Wall Street Journal*, the annual meeting ended on "a somber note." Further, another *Journal* headline read, "Buffett Withholds Hoopla, Hope." We have no idea what meeting these journalists attended.