

# Whitney Tilson's 2007 Wesco Annual Meeting Notes

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*Note: Words in [brackets] are my comments, edits or, when I missed something, my best guess of what was said.*

For my columns and notes on previous Berkshire and Wesco meetings, click [here](#).

## OPENING REMARKS

I note that this year we're in a tent. It's amazing that a tent can be made to work so well. It's a tribute to our civilization. If our ancestors had been in a tent, it would not be like this one, with air conditioning and so forth.

It's amazing that all you people come. You know, I didn't set out in life to become the assistant leader of a cult. [Laughter] As they say, experience is what happens when you're looking for something else.

It's amazing that many of you come to this meeting after the Berkshire meeting for so many years. It's like the person at the Catholic church who doesn't want the catechism changed.

People are obviously here to some extent to leave a little wiser than when they came. It's very hard to do this by merely hearing someone else talk. That's why most teaching is vivid. For example, when they trained soldiers for World War II, they shot real bullets above them, which really taught them to hug the ground.

That's why so many learn lessons the hard way, through terrible experience. Mark Twain once said that picking up a cat by its tail yielded better learning than was available in any other fashion. But that's a terrible way to learn things. Another comic thought man ought to learn vicariously: you shouldn't have to try it to learn not to pee on an electrified fence. [Laughter]

It's really hard to get ideas from one mind into another. That's why learning institutions are so selective.

I want to do something I haven't done before. I feel obligated because so many of you came from such great distances, so I'll talk about a question I've chosen, one that ought to interest you: Why were Warren Buffett and his creation, Berkshire Hathaway, so

unusually successful? If that success in investment isn't the best in the history of the investment world, it's certainly in the top five. It's a lollapalooza.

Why did one man, starting with nothing, no credit rating, end up with this ridiculous collection of assets: \$120 billion of cash and marketable securities, all from \$10 million when Warren took over, with about the same number of shares outstanding. It's a very extreme result.

You'll get some hints if you read [Poor Charlie's Almanack](#), which was created by my friend Peter Kaufman, almost against my will – I let him crawl around my office when I wasn't there. He said it would make a lot of money, so he put up \$750,000 and promised that all profits above this would go to the [Huntington Library](#) [one of Munger's favorite charities]. Lo and behold, that's happened. He got his money back, and the donee's receiving a large profit. Some people are very peculiar, and we tend to collect them.

A confluence of factors in the same direction caused Warren's success. It's very unlikely that a lollapalooza effect can come from anything else. So let's look at the factors that contributed to this result:

The first factor is the mental aptitude. Warren is seriously smart. On the other hand, he can't beat all comers in chess blindfolded. He's out-achieved his mental aptitude.

Then there's the good effect caused by his doing this since he was 10 years old. It's very hard to succeed until you take the first step in what you're strongly interested in. There's no substitute for strong interest and he got a very early start.

This is really crucial: Warren is one of the best learning machines on this earth. The turtles who outrun the hares are learning machines. If you stop learning in this world, the world rushes right by you. Warren was lucky that he could still learn effectively and build his skills, even after he reached retirement age. Warren's investing skills have markedly increased since he turned 65. Having watched the whole process with Warren, I can report that if he had stopped with what he knew at earlier points, the record would be a pale shadow of what it is.

The work has been heavily concentrated in one mind. Sure, others have had input, but Berkshire enormously reflects the contributions of one great single mind. It's hard to think of great success by committees in the investment world – or in physics. Many people miss this. Look at John Wooden, the greatest basketball coach ever: his record improved later in life when he got a great idea: be less egalitarian. Of 12 players on his team, the bottom five didn't play – they were just sparring partners. Instead, he concentrated experience in his top players. That happened at Berkshire – there was concentrated experience and playing time.

This is not how we normally live: in a democracy, everyone takes turns. But if you really want a lot of wisdom, it's better to concentrate decisions and process in one person.

It's no accident that Singapore has a much better record, given where it started, than the United States. There, power was concentrated in one enormously talented person, [Lee Kuan Yew](#), who was the Warren Buffett of Singapore.

Lots of people are very, very smart in terms of passing tests and making rapid calculations, but they just make one asinine decision after another because they have terrible streaks of nuttiness. Like [Nietzsche](#) once said: "The man had a lame leg and he's proud of it." If you have a defect you try to increase, you're on your way to the shallows. Envy, huge self-pity, extreme ideology, intense loyalty to a particular identity – you've just taken your brain and started to pound on it with a hammer. You'll find that Warren is very objective.

All human beings work better when they get what psychologists call reinforcement. If you get constant rewards, even if you're Warren Buffett, you'll respond – and few things give more rewards than being a great investor. The money comes in, people look up to you and maybe some even envy you. And if you buy a whole lot of operating businesses and they win a lot of admiration, there's a lot of reinforcement. Learn from this and find out how to prosper by reinforcing the people who are close to you. If you want to be happy in marriage, try to improve yourself as a spouse, not change your spouse. Warren has known this from an early age and it's helped him a lot.

Alfred North Whitehead pointed out that civilization itself progressed rapidly in terms of GDP per capita when mankind invented the method of invention. This is very insightful. When mankind got good at learning, it progressed in the same way individuals do. The main thing at institutions of learning is to teach students the method of learning, but they don't do a good job. Instead, they spoon feed students and teach them to do well on tests. In contrast, those who are genuine learners can go into a new field and outperform incumbents, at least on some occasions. I don't recommend this, however. The ordinary result is failure. Yet, at least three times in my life, I've gone into some new field and succeeded.

Mozart is a good example of a life ruined by nuttiness. His achievement wasn't diminished – he may well have had the best innate musical talent ever – but from that start, he was pretty miserable. He overspent his income his entire life – *that* will make you miserable. (This room is filled with the opposite [i.e., frugal people].) He was consumed with envy and jealousy of other people who were treated better than he felt they deserved, and he was filled with self-pity. Nothing could be stupider. Even if your child is dying of cancer, it's not OK to feel self-pity. In general, it's totally nonproductive to get the idea that the world is unfair. [Roman emperor] [Marcus Aurelius](#) had the notion that every tough stretch was an opportunity – to learn, to display manhood, you name it. To him, it was as natural as breathing to have tough stretches. Warren doesn't spend any time on self-pity, envy, etc.

As for revenge, it's totally insane. It's OK to clobber someone to prevent them from hurting you or to set an example, but otherwise – well, look at the Middle East. It

reminds me of the joke about Irish Alzheimer's: when you've forgotten everything but the grudges.

So this is a lesson for you to draw on – and I think almost anybody can draw those lessons from Warren's achievement at Berkshire. The interesting thing is you could go to the top business schools and none are studying and teaching what Warren has done. There's nothing nutty in the hard sciences, but if you get into the soft sciences and the liberal arts, there's a lot of nuttiness, even in things like economics. Nutty people pick people like themselves to be fellow professors. It gets back to what [Alfred North Whitehead](#) talked about: the fatal unconnectedness of academic disciplines. When people are trying to recruit people to be PhDs in their subjects – the results are often poor.

On the other hand, if you have enough sense to become a mental adult yourself, you can run rings around people smarter than you. Just pick up key ideas from *all* the disciplines, not just a few, and you're immensely wiser than they are. This is not a great social advantage, however, as I can tell you from experience of the early Charlie Munger. To meet a great expert in a field and regard him as a malformed child is not a winning social grace. I got a lot of hard knocks when I was young. You could say I was forced into investing. The world will not ordinarily reward you for correcting other people in their area of expertise.

Accounting is a noble profession. It came out of Northern Italy, Venice, spread, and became part of standard accounting textbooks. The people who carry the torch in accounting are in a noble profession, yet these people also gave us Enron. You could have walked into an insane asylum, which was better than Enron, and yet accountants blessed it. So there are defects. I talked to a leading person in the accounting field and said it didn't make sense to let companies mark weird stuff to their own models – that it would lead to disaster. She looked at me like I was out of my mind and asked, "Aren't you for the most current data in accounting? My system is more current and therefore should be better." This mind would score highly on an IQ test, but is scarcely able to throw out the garbage.

There are two factors in interplay a) you need currency and b) you need to set up a system in which it's not easy for human beings to cheat or delude themselves, despite the presence of incentives to do so. If you can't perfectly weigh the relative importance of these two things in contrast, you're a horse's patoot and not qualified to set accounting standards.

If you go into liberal arts, you'll find that education isn't as good as it should be. I wish I had two or three more lives to live, one of which I could devote to fixing colleges. There is much that is good, but much that is utterly awful and only slightly improved in the 65 years since I left it.

You could say that the dysfunction of others has been an advantage to me. That's the way it is. That's really why you're all here. You all want to get more than you deserve out of life by being rational – who doesn't?

Also, an enormous pleasure in life is to be rightly trusted. One of my kids was a computer nerd and his school gave him access to the entire school computer system. He was exultant by the extreme trust. If your friends are asking you to raise their children if they die, you're doing something right. It's wonderful to be trusted. Some think if we just had more compliance checks and process, virtue would be maximized. At Berkshire, we have subnormal process. We try to operate in a web of seamless trust, deserved trust, and try to be careful whom we let in. They act like this at the Mayo Clinic. Imagine if they didn't. Most patients would die.

Well, I've fulfilled as much as I have a stomach for in making some unscripted comments.

## **QUESTION AND ANSWER PERIOD**

[My notes here are organized by topic, not the order in which the questions were asked.]

### **COMMENTS RELATED TO BERKSHIRE HATHAWAY AND WESCO**

#### **Comments on Berkshire**

The Munger family has the better part of \$2 billion in Berkshire, so there has been some thought as to whether this is a good idea. The answer is that I'm quite content to hold that position and I hope my family members will hold an overwhelming amount of that for a long time. They won't have the same kind of results that I have had getting the position to its present size from small beginnings, but they don't need the kind of results I got.

Berkshire's a very reputable place, full of the right kind of people with the right kind of values. If your expectations are moderate and you like to sleep well at night, it's not a bad place to have your money compared to other stocks. If what you need is 30% compounded for years into the future, our stock is not for you. Compared to the other stocks available to you, it's OK and will stay OK long after Warren and I are gone.

I just had breakfast with Joe Brandon. Gen Re is a hell of a good place. Joe said to me that with \$11 billion of net worth and Berkshire's name and reputation, they have lots of desirable options. They ought to do all right if they keep the faith.

We ought to be alright. Berkshire is full of places that are likely to be alright.

As I said on an earlier occasion, if you get Warren Buffett for 40 years and the bastard finally dies on you, you don't really have a right to complain. [Laughter]

#### **Berkshire vs. Wesco stock**

It's been very awkward in my position. The truth of the matter is that Berkshire is a better business operation by far. First of all, the guy there [Buffett] is 76. The momentums are way better. That advantage of Berkshire has increased. We would have long ago avoided this duplication except for people like you. You bid Wesco so high that we'd be giving more than we'd be getting if we merged Wesco into Berkshire. So people like you are responsible.

But I like you guys. It's an acquired taste. [Laughter]

#### **Do you prefer to buy equities in Berkshire or Wesco?**

Berkshire has bought somewhat faster. The two companies have never followed the same path. They have different reporting requirements. As soon as we announce, people like you follow us in. Sometimes it [whether Berkshire or Wesco buys] happens by

accident. Generally, we haven't been terribly enthusiastic about equities in recent periods. But we like the best equities better than we like bonds. In both companies we're buying more equities.

### **Constraints of Berkshire's size**

We're horribly constrained. It's hard to buy in quantity, even in a large company in a major market. It's a problem of [our] wealth. I hope that problem gets worse and worse. [Laughter] We don't have a way out of this problem. Warren occasionally buys derivatives. Just because I don't like the accounting for some of them doesn't mean we won't own them. Sometimes they're mispriced.

Look at the last 15 things we've bought – they've worked out well, but we have so much size that we haven't spent what we wanted. This won't bring tears. What may bring tears is that we're settling for lesser prospects than we did. Warren said Berkshire's portfolio will outperform the markets by about two percentage points per annum. That doesn't mean we don't find other things to do other than buy a big portfolio of securities. I'm continuously bullish. Berkshire is a great place.

### **Will Berkshire ever pay out its excess capital?**

It's very unlikely that Berkshire will be making large distributions of what you call excess capital, though we would start thinking about such things if we ever got discouraged at turning each retained dollar into more than one dollar of market value for shareholders.

The entity that should be thinking about this is Wesco. It has a lot of capital, capital gains taxes are at all-time low, and we don't have the same prospects as Berkshire, but you cult members make that hard to do because you keep bidding up its shares above intrinsic value. Anyone who wants to leave can sell above intrinsic value. Those of you holding the stock hope we can create more than \$1 of value [with each dollar of our retained earnings], and I'm hopeful we can do this, though we won't do as well as Berkshire.

If we thought most shareholders wanted Wesco to distribute capital, we'd do it so fast it would make your head spin. Let us know. I don't think most shareholders want us to do it because they're members of the cult. I don't think we will unless there's some very unusual development.

### **Can you tell us about the person you want for Berkshire's CIO?**

We don't want people who want to learn from us – not that that hasn't already happened. We want someone young enough to have a long run – if it worked with Warren, why not try to get another long run going? We are perfectly positioned to set up some people doing this and watch them for a few years. We never considered doing this until Warren

was 75, but now that he's older, we have. We like a very peculiar mindset. People chosen won't look like standard people. Obviously, we'd like to try to get somebody that reminds us of Warren.

[In response to a second question on this topic]

We're looking for a few people to manage money for a few years, hoping that one or more of them turn into the next Warren. They can be independent money managers doing their own thing. Lou Simpson manages a few billion for us and he can live wherever he wants and operates as he chooses. It makes sense to have a few more Lou Simpsons.

### **Who will make the decisions on buying entire companies?**

The independent subsidiaries [of Berkshire] can acquire companies that fit. They usually check with Warren on the big ones, but they often don't and he never says no.

We have no CIO now. The question of who would acquire whole businesses might fall more to CEO than to the manager of a portfolio and marketable securities. Wherever Berkshire has useful talent, it will use it. We don't have any military-type rigidity.

### **Buffett's getting better with age**

Warren is actually still improving. I know it's hard to believe, but he's in a field where one can actually improve at Warren's age.

Can you imagine the early Warren risking billions in a currency trade and making a couple of billion? He has also made a couple of derivative trades. Warren keeps learning. There has to be a crest to this someday, but I think it's ahead, not behind.

### **What role does the board of directors play at Berkshire?**

The board is a safety valve in case I go completely crazy and Warren doesn't do anything about it. [Laughter] They are eminent people. We're required to have a board with independent directors and since we're required to have such a board, we figured we might as well have a good one.

[He paused here, apparently debating whether to add the following:] Would we have had a board if we were allowed not to have one? No, we wouldn't have a board. [Laughter]

### **Did you sell your silver position too early because of the Salomon crisis?**

We bought it [our silver position] too soon and sold it too soon, but other than that it was the perfect investment. It was all totally voluntary and had nothing to do with Salomon.

### **Comments on the Salomon crisis**



What was interesting about that day was that it would have had reverberations that would have made the Long Term Capital Management blow-up look like nothing if the Secretary of the Treasury, Nick Brady, hadn't reversed the government's decision to suspend Salomon from participating in government Treasury auctions. Nick Brady's family was one of the original shareholders of Berkshire but sold out before Warren came on.

Nick correctly recognized that the New England textile industry was doomed and sold all of the family's Berkshire stock. His cousin held on until Warren came on and even after. By making this correct decision, one branch of the family benefited from lollapalooza effects.

Because of this, Nick Brady knew all about Warren, and I think he trusted Warren. [During their phone call on that fateful Sunday afternoon,] there was a catch in Warren's voice. Faced with a decision that would have had catastrophic impact had they made the wrong decision, but when Nick heard the catch in Warren's voice, he realized how concerned Warren was and trusted him when he said he needed some reversal of an announced Treasury decision.

Getting a good reputation in life can have remarkably favorable outcomes, and not just for Warren. If Salomon had gone under, it wouldn't have been trouble for Berkshire but would have been terrible for the country and Warren.

### **Views on the insurance business and ethical limits**

I don't think the insurance business will be that great for most people in it. I think we will do way better. We have great people. When I was younger, I probably wouldn't have even tried to get into the game. It's like a juggler with milk bottles who ends up juggling ten. Before we knew it, Berkshire had 10 insurance businesses. [Munger asked Gen Re CEO Joe Brandon to comment and he said, "We have the best collection in the world." Munger continued:] That may be an absolutely correct statement. We gradually learned our way into that position. It didn't happen overnight. If you're not a learning machine, it won't happen.

My father had a friend who used to say everyone's the same over the years, only more so. To some extent we're more so. We learned good lessons when we were young. We've been more selective. I don't think we've ever regretted not making a lot of easy money when we decided it was beneath us.

Warren told the story of the opportunity to buy [Conwood](#), the #2 maker of chewing tobacco. I never saw a better deal, and chewing tobacco doesn't create the same health risks as smoking. All of the managers chewed tobacco – it was admirable of them to eat their own cooking. Warren and I sat down, said we're never going to see a better deal; it's a legal product; and we can buy it at a wonderful price; but we're not going to do it.

Another fellow did and made a couple of billion easy dollars. But I don't have an ounce of regret. I think there are a lot of things you shouldn't do because it's beneath you.

### **Comments on Gen Re**

Joe Brandon has had a job with many unpleasant aspects. There were a lot of problems, he had to do brutal, unpleasant work, and many people resisted. But now Gen Re is enormously improved – in fact, I think it's now worth the stock we gave to get it. There was a time we weren't so sure – there was a time before Joe did his work where we weren't as confident of that as we are now.

### **Comments on Iscar**

It's not a Ben Graham stock – in fact, it would be the ultimate non-Ben Graham stock. It's located a few miles from the Lebanese border in Israel. It has a high ROE, doing business all over the earth, using a certain technology to produce carbide cutting tools. The reason I got so high on it so fast was that the people are so outstandingly talented. The idea of being in business with them just struck me worth straining for. We didn't know when we were young which things to stretch for, but by the time we reached Iscar, which we never would have bought when we were young, we knew to stretch for the right people. It's a hell of a business. Everything is right there. Isn't it good that we keep learning? Better late than never.

### **Berkshire's investment in railroads**

Railroads – now that's an example of changing our minds. Warren and I have hated railroads our entire life. They're capital-intensive, heavily unionized, with some make-work rules, heavily regulated, and long competed with a comparative disadvantage vs. the trucking industry, which has a very efficient method of propulsion (diesel engines) and uses free public roads. Railroads have long been a terrible business and have been lousy for investors.

We did finally change our minds and invested. We threw out our paradigms, but did it too late. We should have done it two years ago, but we were too stupid to do it at the most ideal time. There's a German saying: Man is too soon old and too late smart. We were too late smart. We finally realized that railroads now have a huge competitive advantage, with double stacked railcars, guided by computers, moving more and more production from China, etc. They have a big advantage over truckers in huge classes of business.

Bill Gates figured this out years before us – he invested in a Canadian railroad and made eight hundred percent. Maybe Gates should manage Berkshire's money. [Laughter] This is a good example of how hard it is to change one's mind and change entrenched thinking, but at last we did change.

The world changed and, way too slowly, we recognized this.

## **Berkshire's investment in POSCO**

I would argue that what POSCO does is not a commodity business at all – it's a high-tech business. They learned from Nippon Steel and they're now even more advanced. I'd argue that if you have the most technologically advanced steel company in the world making unusual, [non-commodity] stuff, then business can be quite attractive for a long time.

## **Should USG [a Berkshire holding] have issued stock to fund a recent acquisition?**

I'm hesitating because I'm trying to decide whether to duck that question or give the correct answer. [Laughter]

That was a foolish thing to do, but they can't help it: some of them went to business school. [Laughter and applause]

## **Why don't you sell Precision Steel?**

We have this personality that we don't sell businesses because they're a bit on the difficult side. As for Precision Steel, it might even be a decent business. It's our catechism that we don't play gin rummy with our businesses. And, averaged out, the catechism has benefited shareholders because people are willing to entrust us with their businesses that we won't sell. At Precision Steel, there are a couple of good niche businesses. Holding on is a nonevent.

## **Why did you buy stock in Tesco and J&J?**

Ordinarily we don't go into reasons for buying things. Obviously, we think they're very respectable enterprises. One is the dominant grocery retailer in England and J&J has one of the great long-term records in its field.

These are just portfolio securities. We expect to moderately outperform the market with these securities.

## **Wesco's surety insurance subsidiary**

Wesco's surety insurance subsidiary [Kansas Bankers Surety] insures small banks. That is a wonderful business because it knows what it knows and knows what it doesn't know. By specializing in a particular area, it does well. It's like a specialist in an ecosystem: it occupies a tiny niche and does it well. You just have to look at the numbers – underwriting profits year after year – to know it's a very good business. We're capable of making those decisions.

## **ADVICE ON INVESTING**

## **Is value investing becoming more widespread?**

I think our way of looking at things will become more popular. In fact, it already is a lot more popular than it was decades ago. I used to look out at this group and it was 20 people. The increased popularity of the investment style will not make it easier for all of you to make a lot of money. All these smart people competing will make it harder, but that's not all a bad thing: maybe some of you will have to make money less the way we did and more the way some engineer does.

## **Efficient markets**

If markets were efficient, this tent wouldn't be so full. Some business schools are teaching properly, but the world grew up amidst a different fashion, encouraged by academics of the era. What we believe is simple, and many avoid it because of that simplicity. They want to be experts. And how can you be an expert if it's simple? Also, execution is difficult – and people don't like to fail.

The whole institutional reward system encourages different behavior and thought. If you went to work at a big firm, you'd grind your way up. It's a hierarchy. Nobody cares about how to do it better. And by the time you'd been there 10-15 years, you'd be thinking their way. This didn't happen to Warren.

[Wesco board member] Peter Kaufman came into a business [[Glenair](#)] and became the CEO in his early 30s, so he's been the CEO a long time. The whole place is twenty or more times bigger. That's a Berkshire experience, but that's not normal. Normal bureaucracy doesn't reward an attitude like ours.

## **Where are there market inefficiencies?**

Two markets are inefficient: very small ones (which are not much use to Berkshire, with its \$120 billion), and ones where crazy people are doing crazy things, especially if they're selling. From time to time, the big markets have some crazily mispriced securities in them. But there's no question that in small markets there's a lot of opportunity to find mispricings.

## **Is the Chinese stock market a bubble?**

The Chinese market is divided into two parts: Shanghai and Hong Kong. The Shanghai market shows some signs of gross excess and I have no interest in what's traded there given prices at present. But there are other parts of the Chinese market that are at least interesting. We don't comment on individual securities for obvious reasons.

## **Comments on Andy Kilpatrick**

I don't think he's the greatest Warren Buffett fan, but he's the most resolute. Andy met Warren through the Washington Post connection and Andy had the same experience that St. Paul had on the road to Damascus. Andy was decisive, he bought all the Berkshire stock he could on margin, it went up, he bought more, it went down and he sold just enough. In due course, became quite rich. He did this by making one decision.

Not only Peter Kaufman [[Poor Charlie's Almanack](#)], but Andy self-published his book [[Of Permanent Value: The Story of Warren Buffett](#)].

A lot of other people met Warren and said, "Who in the hell is this bumpkin?" Now they've had to pretend they bought Berkshire.

## **COMMENTS ON BUSINESS AND ECONOMIC MATTERS**

### **Tax rate for hedge funds and the concentration of wealth**

If you're running a hedge fund, you're paying the lowest taxes, lower than a college professor or a taxi driver. This is madness of a sort. It would not surprise me if this changed in the near future.

There's an enormous concentration of wealth in people who don't make or invent anything. It *can't* be good for our system to create this new kind of hero if our graduating brilliant young give up engineering to go into trading derivatives. This is rewarded by a peculiarity in the tax code, but it'll probably change.

If you have a Jasper Johns painting, this is the world for you. These hedge fund guys seem to like Jasper Johns paintings and what's \$120 million if you made \$1.7 billion last year? That's the world that we live in and you gotta admit it's very interesting.

### **Subprime and the rating agencies**

The rating agencies have prospered mightily, and their most likely source of embarrassment is subprime paper. Overall, they do a good job, and you always miss things with the benefit of hindsight. I would not predict they encounter great distress. If you want to pick things to disapprove of, the rating agencies would be far down on the list.

You might pick many originators of the subprime mortgages. They are some of the most disgusting people we've been able to produce, and many of them belong in the lowest circle of hell. There will always be such people, making money by misleading people. You'll always get people like the worst commissioned salespeople in the mortgage brokerage business. This isn't the real tragedy.

The real tragedy is the people higher up at the Wall Street banks who only asked if they could sell it, not if they should do it. They violated engineering principles and ethical principles.

There's nothing wrong with giving a mortgage to the deserving poor. Here's a guy who's working hard, etc., and even if you give him a 90% or 100% mortgage, he'll pay it. Making such loans worked and was good for us and the nation.

But if you look for the undeserving, dishonorable, addicted people with silly views on their own entitlement – if you start giving them phony mortgages so they can drink more, gamble more – it's like pouring gasoline on the floor and throwing a match. I would argue that in very high places in America, it's not enough to call it folly. It's sin-folly. It's sad that that much terrible behavior came in, due to the self-serving bias. Because they made easy money doing it, they rationalized it.

[Dean Kendall](#) of the University of Michigan music school once told a story: “When I was a little boy, I was put in charge of a little retail operation that included candy. My father saw me take a piece of candy and eat it. I said, “Don't worry. I intend to replace it.” My father said, “That sort of thinking will ruin your mind. It will be much better for you if you take all you want and call yourself a thief every time you do it.”

It's a good story and we need more Dean Kendalls in the high reaches of American business. This and envy cause so much trouble. They account for so much of what you see in the abuses of the subprime field.

We knew how to do it once. The subprime for the deserving poor worked, but egalitarianism and biases led to a big mess.

### **Why hasn't the declining dollar led to increased inflation?**

The dollar's been going down like crazy, but the prices at Costco [Munger's on the board] have shown no inflation for many, many, many years. It's a good question. A lot of economics professors would say it couldn't happen, but it did. It's very important. There's been an unusual set of circumstances. It's easy for me to tell you it matters. But how it matters – if I were able to do that, I wouldn't be qualified to sit here. The answer is, I don't know.

### **Is there a trend in the private equity business?**

Of course there's a trend. The LBO funds get larger and larger and buy larger and larger businesses, so it's a huge trend.

It's a different lifestyle than Berkshire's. We almost never sell – we don't want to do that. We don't want to play gin rummy with our friends, dumping five businesses and getting five new ones. We aren't buying to resell.

The leveraged equity crowd is getting bigger and bigger and bigger. What's happened is endowments and pension plans are believing in the tooth fairy. With assets being bid up, they're not getting enough return from ordinary investments from stocks and bonds. Then silver-tongued people came along and said you don't have to suffer low returns. Give us the money, we'll lever up, pay us a lot of compensation and we will give you 15% not 5%. It's worked – not as well as claimed; there's dubious use of statistics – but for good shops, it works.

Then, a lot of envy sweeps the field. Yale can't stand Harvard making more. Envy is a huge motivator, though it's seldom admitted. In my whole life, I've never had someone say, "Charlie, I'm doing this out of envy."

In venture capital, except for a handful of firms at the top, the returns are lousy. This will eventually happen to the LBO firms as well. God has not decided that anyone who wants 15% can get it.

### **How do you invest the funds of the hospital you're chairman of?**

The nonprofit hospital of which I am the chair is really nonprofit. It loses so much money in a good year it's awkward and a bad year is something awful. Given the conditions under which we labor, we leave all money in short-term instruments. We need all our assets in a liquid reserve.

I'd like to have a hospital where my biggest problem is what to do with the surplus, but that has not been my lot in life.

I don't think hospitals have different investment needs than other places. I don't think the investment process would be any different.

### **Comment on UnitedHealth, its CEO and the options backdating scandal there**

It's hard to say anything but that that was very regrettable behavior. The man lost his job and he deserved to.

### **View of lawyers**

The standard way lawyers think is to weigh both sides. There's forced objectivity and a procedural system. That's a huge plus. So if that's what you're talking about regarding law practice, that's good, but there's a lot that's not good, a lot that's drifted away. It's not at all uncommon that billing rates will exhaust the amount in dispute before you get to trial. If you're doing this as a lawyer, that's a moral minefield.

The legal profession attracts a lot of smart people who can express themselves well in words and numbers. There are many good people coming out because many good people are going in. Yet much of what law schools do is a joke.

## **View of investment bankers**

At Salomon we asked, “Where is the list of things you won’t do because they’re beneath you?” We never saw it. Envy and greed lead people to doing almost anything that looks profitable and does not require use of a machine gun. Investment bankers were better when I was young. They used to care about the quality of deals – they cared a lot. Ethics attenuated a lot. This was not good.

The deterioration would be an interesting subject for social science. You’d have to understand psychology – it would be very difficult for somebody to do it.

Why is the high road the best way in investment banking? It’s not very crowded.  
[Laughter]

## **The possible rise of protectionism**

It’s hard to predict if there will be a lot of protectionism. At the current time, a flood of imports is changing the world. Some ordinary guys are having a tougher time and feel that China is oppressing them.

## **MENTAL MODELS**

### **Using mental checklists**

I’m a great believer in solving hard problems by using a checklist. You need to get all the likely and unlikely answers before you; otherwise it’s easy to miss something important.

### **Using superior thinking to get ahead**

[Referring to his opening remarks in which Munger said “At least three times in my life, I’ve gone into the other field and succeeded.” I asked what those three times were. He replied:]

The first two are easy: real estate development and managing money. I can’t claim to have clobbered the locals in the third, so I don’t want to talk about it. [Laughter]

### **Can you give an example of giving up a closely held idea?**

Even as fanatical as I am about throwing away a wrong idea and grasping a successful one, I have a hard time coming up with a recent example. Certainly I’ve become way more disenchanted with certain people and that seems to happen all the time. In that sense, I seem to keep learning a lot. I’ve discarded so many ideas long ago that I don’t have many left.



Anytime you catch something just barely, where if you hadn't caught it you'd be in terrible trouble, you're using a checklist, even if not consciously.

I'm answering the question I'm capable of answering, instead of the one you asked.

I invert: I try to figure out what I don't like and try to avoid it. It's worked wonders for me.

### **What is your favorite human misjudgment?**

My favorite human misjudgment is self-serving bias: how the brain subconsciously will decide that what's good for the holder of the brain is good for everyone else. If the little me wants it, why shouldn't the little me have it? People go through life like this. I've underestimated this phenomenon all my life. People go bonkers taking care of their own self-interest. It's a sea of miscognition. People who write the laws, people who treat patients, who experiment with rats, all suffer horribly from this bias.

Hardly anything could be more important to the study of law than the study of psychology, but there's a taboo against it. You see many people who've gotten straight A's at law school, but they screw up in dealing with self-serving bias.

I would say that the current head of the World Bank [Paul Wolfowitz] had an elementary question: as head of the Bank, a lot of people hate you, so how bright do you have to be to distance yourself from a question of a large raise from your live-in girlfriend? He sent it to the lawyers, they hemmed and hawed, and he lost his moorings. Even a child shouldn't make his obvious mistake. Similarly, I'd guess President Clinton would have had a better record if he'd had better insight on certain subjects. Note that I carefully picked one from each party. [Laughter]

### **Nuttiness in the world**

I once asked a doctor why he was still doing an obsolete cataract operation when a new, better one had been developed. He said, "Because it's so wonderful to teach!" He only changed when patients voted with their feet. And this was at one of the best medical schools!

There's a lot of miscognition. If you can just tune out all of the big folly, you'd be surprised how well you can do. There's a lot of nuttiness. Who gives up an operation he likes doing and is really good at? It's a really human thing to cling to things most practiced. This happens even in physics. A lot of people cling to bad ideas. If the brightest people in the world do this, imagine everyone else.

If you can train yourself not to do this, you'll be way ahead. If you come all the way to Pasadena from New Delhi to hear a guy well into his 84<sup>th</sup> year say something so obvious, not everyone would agree this is wise. [Laughter]

## **Opportunity costs**

I just wanted to do the best I could reasonably do with the talent, time and resources I had available. That's what I was doing then and now. Everything is based on opportunity costs. Academia has done a terrible disservice: they teach in one sentence in first-year economics about opportunity costs, but that's it. In life, if opportunity A is better than B, and you have only one opportunity, you do A. There's no one-size-fits-all. If you're really wise and fortunate, you get to be like Berkshire. We have high opportunity costs. We always have something we like and can buy more of, so that's what we compare everything to.

All of you are in the game of taking the lot you have right now and improving it based on your opportunity costs. Think of how life is simplified if you approach it this way.

## **ADVICE ON LIFE AND OTHER COMMENTS**

[After his microphone stopped working temporarily:] I've worn out the patience of my listeners, but I've never worn out a microphone before. [Laughter]

### **Munger's need for "glorious independence"**

There's a poem by Burns, the great Scottish poet, where he urges Scots to work hard, even connive, to get a glorious independence. You don't have to listen to me very long to know my views wouldn't be welcome everywhere, so I decided I needed glorious independence, which required that I be a man of independent means. I didn't buy a new car until I was about 60 and I was very rich before then. I wanted independence for the same reason George Bernard Shaw sent his mom out to work: I wanted to make a mental man of myself. Warren kids me about this.

I said I would sell the best hour of the day to myself in order to improve myself. Only then would I sell the rest of my time to my clients. Of course, when I was in a demanding situation, I'd make an exception. To make a man of yourself intellectually, you need to work at it. I don't think even [famed mathematician] [Johnny von Neumann](#) did it naturally.

For many people it's good that they're extra busy. They're not good thinkers, so you get more out of them if they just keep doing what they're doing. But if you're a person of good cognition, you can learn a lot more if you put your mind to it. I don't think there's any substitute for just sitting and thinking.

### **Nature vs. nurture**

In nature vs. nurture, nature is way more important than people give it credit for. That's not to say people can't improve, but nothing on earth could make me succeed in music or basketball. You need to recognize where nature has been kind and play a game where

nature has given you the greatest talent. Man is the prisoner of his talents. I'm afraid that's the hand we're given to play in life. If you're 5' 2", I don't think you want to play basketball.

### **People who are a credit to our civilization**

I don't know much about Whole Foods or Google. I tend to think there's a fair amount of puffery when it comes to organic claims. Yet I read a very interesting article in Harvard Magazine about how modern cows, with artificial insemination, are kept pregnant 300 days a year and their hormones go into the milk. Is this a problem? That's an interesting question. It's a credit to Harvard to publish it. It's not a problem with skim milk. The kind of person writing that article is a credit to the civilization.

I went to the University of Michigan a few months ago and went to the Biology Department, including the medical school and hospital. They decided they'd go totally self-insured. If they made a mistake, they'd admit it – no hiding stuff. They'd go to the bedside and admit it. They did what they probably should have done from the beginning. Now their malpractice costs are lower. The guy who runs this is a credit to the civilization. This is not present in the hospital of which I'm chair. I can't get there from where we are, but I'd like to.

There are lots of people like this. I live in a state where they gerrymandered districts so that, mostly, only certified nuts can win the primary, and once they're elected, can't be voted out. How bad is this system? I'd like a world with more people like those in the [University of Michigan] hospital.

### **Global warming**

Warren has never had any scientific training and he avoids these questions because he says, "I have no specific aptitude and I won't make a fool of myself." I'm almost as ignorant as Warren, but I am a Cal Tech-trained meteorologist, though it was a long time ago and this subject was then a very empirical activity.

My own view is that it's overwhelmingly likely that increased concentration of CO<sub>2</sub> is leading to some warming. For Al Gore, once he has this insight, he thinks we should do a lot about it right now, even though he has a house with 20 rooms.

For me, what we should do about it right now is a very complicated question. The prognosis for a decline in CO<sub>2</sub> emissions from China and India – which have many, many people who want to live more like we do – is zero. Before we are done, I suspect we'll change the reflectivity of the earth and play a lot of other tricks. But there's no simple answer like just sign treaties with people who are going to hugely multiply their own emissions.

It's a problem I'm not going to have to deal with personally. I'll bequeath it. It's very important, but it's not the end of the world if the world warms a few degrees. If some

islands have to be depopulated, and if it happens over 100 years, with population growth of 1-2% per annum, it can be dealt with. As I said at the Berkshire meeting, with enough time, these things can be adjusted to. I don't think this is likely to be an utter calamity for mankind. It is something that we can deal with.

### **Book recommendations**

Peter Bevelin, the author of [Seeking Wisdom](#), is here and he sent me the book [The Martians of Science](#). It's a hell of a book about five Hungarian physicists, driven to the United States by Hitler, who contributed much to science here. I can't recommend it enough.

I read the new biography of Einstein by Isaacson [[Einstein: His Life and Universe](#)]. I've read all the Einstein biographies, and this is by far the best – a very interesting book.

### **What do you think Ben Franklin's greatest regret was?**

Well, his wrong medical decision killed his only son. But, mostly, he didn't allow himself much regret. Franklin made a very ill-advised marriage. He married someone who wasn't suited to the life he ended up living. That's hugely important. All honorable people will do the best they can with the bed they've made. Franklin did that and did not allow himself to feel regret. All in all, he had a fabulous life.

### **Thoughts on his advancing age**

I'm getting more experienced at aging. I'm like the man who jumped off the skyscraper and at the 5<sup>th</sup> floor on the way down says, "So far this is not a bad ride." [Laughter] I'm getting better with aging. I'm not going to complain about age because if I didn't have it, I'd be dead.

### **Can you tell us about your worst experience and how you dealt with it?**

I'm not going to answer that.

### **Career advice**

[The questioner asked Munger for advice on which of two career choices he should pursue – I forget what they were.]

A lot of people who follow either of the courses will find it very difficult. You're a young person. You can't give that kind of answer in a one-size-fits-all way. It depends on your talents. The decision may be forced on you. If you can work with people you really admire, role models, then that's where you should go.

Ideally, you would have figured it out by now. If you're only now asking that question well along in your business school career, then your business school is about as effective as I would have guessed. [Laughter]

### **The importance of reading**

It's a good question, which brings up a very interesting fact. How did Berkshire's track record happen? If you were an observer, you'd see that Warren did most of it sitting on his ass and reading. If you want to be an outlier in achievement, just sit on your ass and read most of your life. But they fire you for that!

Look at this generation, with all of its electronic devices and multi-tasking. I will confidently predict less success than Warren, who just focused on reading. If you want wisdom, you'll get it sitting on your ass. That's the way it comes.

### **Deserve what you want**

The best legal experience I ever got when I was very young. I asked my father why he did so much work for a big blowhard, an overreaching jerk, rather than for his best friend Grant McFaden. He said, "That man you call a blowhard is a walking bonanza of legal troubles, whereas Grant McFaden, who fixes problems promptly and is nice, hardly generates any legal work at all." My dad was teaching me a lesson and it worked.

Considering its size, Berkshire has supported fewer lawyers than any company I can think of. We've gone through the world like Grant McFaden, the pioneering Omaha Ford dealer.

Figure out what you don't want and avoid it and you'll get what you do want. Warren had the same instincts I had. We haven't had our share of disappointed, angry people that ruin so many lives. It's easy to get into that position. Ask the question: How can you best get what you want? The answer: *Deserve* what you want! How can it be any other way?

### **Views on Social Security**

In the U.S., I think we'll meet the Social Security problem. As long we can keep GDP per person growing at, say, two percent per annum, I think we can meet this problem by allocating a little bit bigger slice of a growing pie. I differ with most of my Republican friends on this.

In New Zealand, they had a rebellion and a counter-rebellion. And New Zealand's working. I don't think we'll have a big problem.

### **The U.S. role in the world**

We're used to being the most important place in the world. Every previous country in this position lost it. We'll be the same. Why not? Sure, the leadership of the world will eventually change.

### **What are the world's greatest dangers?**

The biggest problem is obviously some sort of war that goes nuclear or pathogenic. That problem is so hard that most people shove it to the side and hope it works out.

I would argue it's probably not a good idea for the human population to double from here. I read some paper that expressed a lot of confidence that this won't be a problem, but put me down as dubious. And having all of the nondeveloped populations grow to our living standard will have all sorts of environmental consequences.

I think you can get civilizations that can deteriorate into god-awful conditions, where you have a government of kleptocracy, an awful, corrupt, brutal, stupid system, full of intramural hatreds. Our third problem is that we get a lot more of that. Look at the craziness in the Middle East. A lot of people are not just ideological, but religious. There are a whole lot of young men with not much hope, future or much to do. This is very explosive and dangerous and there are not many examples where this is getting fixed. Maybe Turkey?

But the world has always had these sorts of defects. It makes us treasure what we have. This room is full of extraordinarily fortunate people. If you think you're having a hard life, you got on the wrong planet.

### **More on terrorism**

I think we've been very lucky that the terrorism in the U.S. has been as low as it's been, and the future probably will be worse. There's a lot of terrorism in the Middle East. It's a very serious problem, and I don't think it'll go away. What you can't fix you have to live with. We're trying to fix it as best we can, though I question when [at airport security] an old lady with her kids gets frisked and a guy with a bushy beard and a thick accent goes right through, but it's politically incorrect to give special attention in a logical fashion.