



2<sup>nd</sup> May 2015

## **2015 BERKSHIRE HATHAWAY ANNUAL SHAREHOLDERS' MEETING**

**“Warren, if people weren’t so often wrong we wouldn’t be so rich.”**

**- Charlie Munger, 2<sup>nd</sup> May 2015**

We made the annual pilgrimage to Omaha, Nebraska to attend the 2015 Berkshire Hathaway Annual Shareholders' Meeting. As usual the Q&A session with Warren Buffett (age 84) and Charles Munger (age 91) lasted a marathon six hours and covered a range of topics from the partnership with 3G Capital (a private equity fund) to current stock market valuations.

An estimated 40,000 people attended the meeting this year at the Omaha Century Link Center. Questions were asked by a panel of journalists filtering questions submitted by the public, which included Carol Loomis (former Fortune magazine editor), Becky Quick (CNBC reporter) and Andrew Ross Sorkin (New York Times journalist).

We believe that the following notes are an accurate depiction of the meeting, however we have omitted discussions on topics unrelated to investing and business success.

We hope that you enjoy reading these notes as much as we enjoyed attending the meeting and putting them together!

\*\*\*\*\*

The meeting began with the annual Berkshire Hathaway film directed by John Landis (the director of *Trading Places*, *Animal House*, and *Coming to America*) featuring Warren challenging Floyd Mayweather (Warren’s favourite boxer who had a fight with Manny Pacquiao later in the day) to a boxing match.

**SYDNEY (Head Office)**

39 Phillip Street Sydney NSW 2000 Australia  
T +61 2 9237 8900  
AFSL 321789

[www.vgipartners.com](http://www.vgipartners.com)

**NEW YORK (Research Office)**

600 Madison Avenue, Suite 2101 New York NY 10022 USA  
T +1 212 937 4700



The annual video also included appearances from Arnold Schwarzenegger, Jamie Lee Curtis, Jack Nicholson, as well as the cast of the TV series *The Office* and *Breaking Bad*. The video finished with the clip of Warren's testimony as Salomon Brothers CEO - "if you lose money for the firm I will be understanding, if you lose a shred of reputation for the firm I will be ruthless."

### **Q&A Session**

**Q: What are the five characteristics you look for in a company to buy?**

**Munger:** We don't have a one-size-fits-all system to buy businesses. They're all different. Every industry is different. And we also keep learning: we hope that we do better now than 10 years ago.

**Buffett:** When looking at the BNSF railroad in 2009 or Van Tuyl in 2014, there are a lot of things that go through our minds, most of which are there to stop us from going further. There are a lot of things that we can see in a business, including who we would be dealing with, that will stop us from going to the next layer.

A key question is always whether we want to be in partnership with that person. Will they behave the same way when they don't own the business anymore as they did when they owned it?

We are looking for things that we believe we have a reasonable understanding on how they'll look in 5 or 10 years and that eliminates a great many businesses. But they're not the same questions for each business.

If we do have a list of 5 questions then Charlie has been keeping it from me.

[Laughter]

**Q: Warren, could you please comment on the recent Seattle Times article accusing Berkshire-owned Clayton Homes of predatory mortgage lending to subprime borrowers?**

**Buffett:** Clayton's practices are both exemplary and extraordinary in the housing and mortgage lending business.

Clayton, unlike virtually anybody else, offers mortgages to all buyers of our homes and we retain ~\$12 billion in mortgages on approximately 300,000 homes.



When a mortgage defaults, two people lose: the person who owns the house and the person who owns the mortgage. In our case we have an alignment of interest with the homeowner: we have no interest in selling anybody a house and having the mortgage default. It's a net loss to us and a net loss to the customer.

There's been much talk of possible changes in mortgage rules to try to get the mortgage originator to keep some skin in the game, with talk of requiring them to retain maybe 3%. We keep 100% of the mortgage, so our interests are aligned with homeowners in that we do not want to issue loans that will default.

Clayton has been exemplary in lending intelligently to people that have a good chance of making their payments and keeping their house. About 3% of Clayton's mortgages default per year, and when they do we lose money and they lose money. But 97% of our borrowers do not default, and most of those people would not be living in the kind of houses we produce without Clayton making financing available. These 97% live in a two or three bedroom house and their average principal and interest payment is a little less than \$600 per month.

I'm proud of Clayton and the fact that this year they put perhaps 30,000 people in very good homes at a very low cost, most of whom will have paid off their home in 15-20 years and have made a real bargain.

**Munger:** I've always wondered why manufactured houses don't have a bigger share of the market. It's such an efficient way to create affordable houses.

We can't have lending practices where nobody defaults, because many people who deserve financing couldn't get it.

**Buffett:** The biggest causes of default are loss of a job, death, and divorce. Those happen with high-priced houses as well, but owners of manufactured houses tend to be living closer to the edge. I don't think that's a reason to deny them a house, especially when it turns out so well for so many.

The 2008-2009 recession was interesting because the default rates on securitised mortgages for houses costing hundreds of thousands of dollars were many times the rates that we saw at Clayton.



**Q: How does working with 3G Capital on Burger King, Heinz, and Kraft fit in with Berkshire's reputation of not engaging in large layoffs or aggressive cost-cutting?**

**Buffett:** I don't think Charlie or I have ever said that there should be more people working at a company, Berkshire or otherwise, than are needed. 3G has been successful in building marvellous businesses. They have entered into some purchases where there were considerably more people running the business than needed. After they reduced the headcount to the number needed, these companies have done extremely well.

I don't know of a company that has a policy to have a lot more people than needed, but a good many companies end up in that position. When 3G buys into one of them they fix it quite promptly and they treat people well in terms of severance. When they find out that 100 people are doing what 50 could do, they will get it down to 50, and that makes sense throughout American business.

**Munger:** The opposite of having companies right-sized is what eventually happened in Russia, where everybody had a job and some workers said "they pretend to pay us and we pretend to work."

[Laughter]

**Buffett:** After World War II there were 1.6 million people employed in the US railroad industry and it was a terrible business. Today there are fewer than 200,000 people, carrying more freight, more distance, in far safer conditions, than 1.6 million ever did. Efficiency is required over time in capitalism and I really tip my hat to what the 3G people have done.

You really see our view on excess people in our office here in Omaha that has 25 people and in Charlie's office in California that has 2 people, counting him.

**Munger:** There's no question that waves of layoffs frighten people. A job is a very important part of a person's life and it's no small thing to lose it. However we need our companies to be right-sized.



**Q: Is IBM similar to the doomed Berkshire textile mills in the 1960s? Did Charlie try to talk Warren out of buying IBM?**

**Munger:** The answer is no. IBM is a very interesting company. It totally dominated tabulating machines and then it dominated electronic computing for a while. It's very rare for a company to manage change as successfully as IBM. Now we have the personal computer and it's been a mixed bag.

I think IBM is a very credible company. We own a lot of companies with temporary reverses. IBM is still an enormous and admirable enterprise.

**Buffett:** Incidentally, people ask us questions about our stocks and they think we want to talk them up. We have no interest in talking up the investments we own. We are better off with lower prices because either we or the companies we own will be buying stock in the coming years – why would we want to talk it up if we are a buyer?

The whole mentality of Wall Street is that even if you or the company will buy more of a stock in the future, they think they're better off if the stock goes up the next day or the next month.

To "talk our book" from our standpoint would be to say pessimistic things about all four big holdings [Wells Fargo, Coca-Cola, American Express and IBM] that we have because all four of them are repurchasing their shares and the cheaper they repurchase them the better off we'll be. But people don't seem to understand that – Charlie, any idea why?

**Munger:** Warren, if people weren't so often wrong we wouldn't be so rich.

[Laughter]

**Q: How can outside investors judge the state of Berkshire's culture after Warren and Charlie?**

**Buffett:** You are fair to approach this issue with a cautious mindset, but I think you will be very pleased with the outcome. Berkshire's culture is as good as any culture in a large company we have seen.

Just this week we closed on a transaction with Mrs. Ute Louis from Germany. She and her husband had lovingly built their business of retail shops for motorcycle owners over 35 years. Her husband died a couple of years ago and Mrs. Louis wanted to sell to Berkshire Hathaway. She had heard about our unique culture, even in Germany. That would not have been the case 30 or 40 years ago.



The culture at Berkshire is clearly defined and deeply embedded. It's reflected in the parent company, the subsidiaries, the directors, and even the shareholders. I don't think there's another company in the world where you would have 97% of shareholders vote against receiving a dividend.

People who like our culture are attracted to us, people who dislike it shun us, and so the culture is self-reinforcing. Once Charlie and I are not around it will be clear that the culture is not because of our forces of personality but rather it's institutionalised. Nobody should doubt that the culture will continue for decades and decades to come.

**Munger:** We say in our annual report that while Berkshire will do fine after we're gone and even do better in absolute terms, percentage-wise it will never again gain anything like in the early years. That's alright. There are worse tragedies in the world than a company with Berkshire's assets growing at a slightly lower rate.

**Buffett:** Name one thing worse than that Charlie...

[Laughter]

**Q: How will the changed consumer behaviour of avoiding sugar consumption impact Berkshire and has it narrowed the competitive moats around Coca-Cola, Heinz, or Kraft?**

**Buffett:** Coca-Cola has an enormously wide moat. But I think it's also true that these trends are happening. There will be 1.9 billion eight-ounce servings of Coca-Cola Company products consumed in the world today. I don't think you're going to see anything revolutionary. You will see all food and beverage companies adjust to the expressed preferences of the consumers. No company ever does well ignoring its consumers. I predict that 20 years from now there will be more cases of Coca-Cola consumed than there are now by some margin.

In the late 1930s, Fortune magazine ran an article saying that the growth at Coca-Cola was over and when we bought our Coca-Cola stock in 1988 people had similar concerns. [VGI note that Buffett bought 23.4 million shares of Coca-Cola in 1988 and 1989 for \$1 billion, a position that is now worth \$15 billion after distributing \$5 billion in dividends]

In the last 30 years, one quarter of all the calories that I have consumed were Coca-Cola. That is not an exaggeration. I am one quarter Coca-Cola.

[Laughter]



I think there's a lot to be said for being happy with what you're doing. If I had been eating broccoli and Brussels sprouts all my life, I don't think I would have lived this long. Every meal I'd approach as if I was going to jail. And Charlie's habits are only slightly better than mine.

**Munger:** Sugar is an enormously helpful substance. It prevents premature softening of the arteries.

**Buffett:** I can't compare Coca-Cola to something that someone at Whole Foods would sell me. But I also don't see smiles on the faces of people shopping at Whole Foods.

[Laughter]

**Q: What advice do you have on building culture and values at a firm?**

**Buffett:** Culture has to come from the top. It has to be consistent. It has to be part of written communication. It has to be lived. It has to be rewarded when followed and punished when not. And then it takes a very long time to really become solid.

It's much easier to do if you inherit a culture you like and it's easier in smaller firms. It's like your child seeing what you do, not what you say. It's the same thing in business. People see how those above them behave and they move in that direction.

**Munger:** It's important to always keep learning. If Warren and I had frozen in time, Berkshire would have been a terrible place. It's constant learning that made it work, and I don't think that will ever stop.

**Q: Two indicators Warren has discussed in the past as a guide to the stock market's valuation, Total Market Capitalisation / GDP and Profits / GDP, are both unusually high.**

**Market Capitalisation / GDP is at 125%, the same levels as 1999, shortly before the bubble burst.**

**Profits / GDP are at 10.5%, while Warren has said that ratio ranged from 4.0% - 6.5% over a long period of time.**

**Are either of these indicators concerning about the general stock market's level?**

**Buffett:** Profits as a percentage of GDP might be a concern for other segments of society because it highlights how well US business has done over the last few years, showing that American business has prospered incredibly.



The Market Capitalisation / GDP ratio is very much affected by the current low interest rate environment. Obviously, corporate profits are worth a whole lot more if the government bond yield is 1% than if the government bond yield is 5%. For many people now the opportunity cost is owning bonds, which yield practically nothing, or owning stocks, which are trading at relatively high prices historically, but those historical prices were set when interest rates were a lot higher.

If we get back to what we thought of as normal interest rates, stocks at these prices will look pretty high. If we continue at these types of interest rates, stocks will look pretty cheap. You can take your pick depending on which way you think interest rates are going.

**Q: How should I network if I don't have access to the alumni network of a top business school?**

**Munger:** I think you should do the best you can. I didn't go to business school. Why should you?

[Laughter]

**Buffett:** Charlie is very Old Testament. He never got much past Genesis.

Actually, going to business school was a handicap 20 years ago when they were teaching efficient markets and said you shouldn't bother figuring out if a company was any good because they were already priced perfectly. Imagine paying \$30,000 or \$40,000 a year to hear that?

How do you feel about your law school education, Charlie?

**Munger:** I have a model for how modern profit-obsessed law firms work. It's like a pie eating contest, and if you win you get to eat a whole lot more pie.

[Laughter]

**Q: Will the US dollar remain the world's reserve currency over the next 50 years?**

**Buffett:** I think the dollar will be the world's reserve currency 50 years from now. Nothing's certain but I would bet a lot of money on it.

**Munger:** I'm probably more nervous than a lot of people about printing a lot of money and spending it. There are times you have to do it, and we just came through one, but I'd be happier if we used the money to improve infrastructure rather than just spreading it around from a helicopter.



**Q: What was your most memorable failure?**

**Buffett:** In the 1990s we bought the Dexter Shoe Company and paid ~\$400m for something that was worthless a few years later. Worse, I paid in stock so that is now worth \$6 billion to \$7 billion. It makes me feel a little better when Berkshire stock goes down because the mistake becomes slightly smaller.

[Laughter]

**Buffett:** We probably could have pushed harder in the earlier years. We had all of our net worth in the companies, we had a lot of our families' and friends' net worth in Berkshire. We were very, very cautious and there were probably times we could have stretched a little more. But I didn't want to take a 1% chance of wiping out my Aunt Katie's net worth. There are just some things in life for which I wouldn't be able to live with myself.

**Munger:** If we had used leverage back then Berkshire would be a lot bigger now than it is today. But we would have been sweating at night. And it's crazy to sweat at night.

**Q: Do you expect inflation in the near future?**

**Buffett:** So far we have been very wrong with our predictions of inflation. I would not have predicted that you could have 5 or 6 years of zero rates in the US and now negative rates in Europe and run a large deficit and not see a lot of inflation. So far nothing bad has happened except that people who saved money are totally getting killed on their income. I think that we're operating in a world that Charlie and I don't understand very well.

Berkshire will do better than most big companies in almost any kind of environment. We'll always be prepared for anything. When we see unusual opportunities we'll also be prepared to act. We're sitting on \$60 billion of cash right now – I'd rather be sitting on \$20 billion and have made a \$40 billion acquisition. When economic turbulence occurs we'll be prepared and most people won't be.

We really haven't seen great success in people making macroeconomic predictions. They get a lot of airtime but that's about all that happens.

**Munger:** We've abdicated trying to outguess macroeconomic factors. We're just swimming with the tide and let the tide take care of itself. The trouble with making all these economic pronouncements is people gradually start to think you know something. Better to just say we're ignorant.



**Q: Can you please discuss the power of incentives for executives?**

**Buffett:** Charlie and I really believe in the power of incentives, and there are hidden incentives that we try to avoid. We've seen really decent people misbehave because they felt a loyalty to their CEO to deliver certain numbers because the CEO made forecasts about what the company would earn. I've seen a lot of misbehaviour that doesn't profit anyone financially but is meant to avoid embarrassment for the CEO because their ego is involved.

We try to avoid incentives that would cause people to misbehave not only for financial rewards but also for ego satisfaction.

You need to understand human behaviour. When National Indemnity in the 1960s was led by Jack Ringwalt, he would jokingly berate the person reporting on claims. Jack was joking, but the person processing the claims couldn't take it and started hiding claims. After we bought National Indemnity, that claims hiding caused us to misreport minor figures and to misinform our reinsurers. The fellow who was hiding the claims had no financial interest in it at all but he just tried to avoid Jack kidding him.

You really have to be very careful with the messages you send. If you tell your managers you never want to disappoint Wall Street you may find that they start fudging figures to protect your reputation. That's why we try to prevent this kind of behaviour at Berkshire but other people seem to struggle with it.

**Q: Can value investing be applied in all markets, including China?**

**Buffett:** Investment principles do not stop at borders. If I was investing anywhere else, in China, India, or the UK, I would apply the exact same principles I employ in the US. I would think of stocks as small pieces of a business. I would think of price fluctuations being there to benefit me rather than to hurt me. And I would try to focus my attention on businesses where I understood the competitive advantage that they had and what it will look like in 5 or 10 years. I don't think I'd change the principles at all.

**Munger:** The Chinese have a history of being very entrepreneurial. With the recent volatility in Chinese markets, China looks a lot like Silicon Valley. I think China would do much better if more were value investing-minded and less enamoured with risk.

There might be opportunities, but there can also be great opportunities for excess and nasty corrections. I think China is wise to stamp down on speculation.



I don't think value investing will ever go out of style. Who the hell doesn't look for value when they buy something? I don't think there's anything else that makes any sense except for value investing. People are looking for an easier way but that's a mistake. It looks easier but in fact it's harder.

**Q: How do you think of the risk from chemical, nuclear, biological, and cybersecurity issues?**

**Buffett:** They are the great threats to the United States. We have and will have a wonderful economic system, and your children will live better than we do and their children will live better than they do. There's fits and starts and ups and downs but just imagine what everything looked like in 1776. Everything from there is profit. And that's all come from unleashing the energies and brains of the American people despite all the deficiencies.

People are upset at 2% growth, but remember that 2% growth and 1% population growth equals a 20% gain in a generation, or \$10,000 in GDP per capita from current levels coming in the next generation.

We have a great system but that can all be nullified by either madmen or rogue states or religious fanatics or sociopaths who get access to weapons of mass destruction.

We need an extremely vigilant security operation for the United States. It's something to live with. But if we're able to successfully ward off those threats, I still maintain that the luckiest person ever born in history on a probabilistic basis is a baby born in the United States today.

[Applause]

**Munger:** Of course we were a favoured place and have received a favoured outcome, and we were lucky too. But I don't think we should get too smug. China has come up faster than any other nation has ever come up.

I can't think of anything more important than future close collaboration between the United States and China. You're talking about the two most important nations in the world. I think it's very important that we like and trust one another and have good relations.



**Q: What do Ted Weschler and Todd Combs bring to Berkshire?**

**Buffett:** Both Ted and Todd are very, very smart about businesses and investments. They understand the reality of business operations and what makes for competitive strength.

On top of that they have character qualities that are terribly important to me and Charlie. Every aspect of their personalities are such that you want to be around them and hand them more responsibility. Charlie met Todd first, I met Ted first, and we talked about their records but we also talked about a whole lot more.

They have the right touch and know how to deal with people. Charlie and I have probably run into more dysfunctional people with a 160 IQ than anybody alive. Salomon gave us a head start on that.

**Munger:** The whole thing is working very well and they are already contributing to Berkshire beyond just investing. Both of them helped Berkshire buy a business recently and oversee them.

The trustworthiness is more important than the brains, not that they don't have the brains. We wouldn't hire anybody we didn't trust.

**Q: What Berkshire business is best suited to thrive during a period of high inflation? Which Berkshire business will suffer the most?**

**Buffett:** The best businesses are the ones you buy once and don't have to keep making capital investments in subsequently. You don't face the problem of continuous investment involving greater and greater dollars because of inflation. That is one reason real estate is good during inflation. If you built your own house 55 years ago like Charlie or I, it's a one-time outlay. You get an inflationary expansion in capital without replacing it yourself. If you have something that is useful to someone else it tends to be priced in terms of replacement value over time. You really get the inflationary kick.

Now, if you're in the utility business or the railroad business, it just keeps eating up more and more money and your depreciation charges are inadequate. You are kidding yourself as to your real economic profits. Any business with heavy capital investment tends to be a poor business to be in during an inflationary environment, often it's a poor business to be in generally.

A brand is a wonderful thing to own during inflation. See's Candy built their brand many years ago and we've nourished it. The value of that brand increases during inflation just as the value of any strongly branded good does during inflationary periods.



Gillette bought the entire radio rights to the World Series in 1939. As I remember it cost them \$100,000 and for this they got to broadcast to the audience of the game when the Yankees played the Reds. If you think about the number of impressions they made on minds in 1939 dollars, myself included, millions of people heard this. Getting this same impression now would cost a fortune. It was a great investment which could be made in 1939 dollars but paid off in terms of selling razors and blades in 1960 and 1970 dollars.

**Munger:** If inflation ever goes completely out of control you have no idea how it's going to end. If it weren't for the Weimar inflation, Hitler may have never come to power. It was the twosome of inflation and the Great Depression that brought us Hitler. Think of the price the world paid for that one. We don't want inflation just because it's good for See's Candy.

**Q: What mental model would you impress upon younger individuals who want to set out and build their own successful company like Berkshire?**

**Munger:** The reputation you get over a long period of time takes time to build, this is especially true in Berkshire's case. I think hardly anything is more important than reputation and behaving well. We have tried to get better over time and I think you'd be crazy if you didn't.

**Buffett:** Someone once told me that when you get old you will have the reputation you deserve. For a while you can fool people but when you get to be my age it's hard to change. The same thing is true of companies.

**Q: What should we do about corporate cash given so much is parked abroad? What can be done to simplify the tax code?**

**Buffett:** 40 years ago corporate taxes were 4% of GDP but now they are closer to 2%. They have decreased while federal taxes have increased. Once the code is in place it's very hard to change absent a major overhaul. I think the Senate finance committee can work out something we might not like but something that is better than what exists now.

It can be made considerably more rational but in the end if the country spends ~20% of GDP then we should raise a similar amount in taxes. 20% of \$17 trillion (\$3.4 trillion), is the amount we need to raise, that's real money! How much should you get from individuals? Corporations? State taxes? It's a fight up and down the chain.

Our corporate tax rate is 35% but for a good portion of our life this was 52% and later 48%. The country did well and American business prospered during this period despite high taxes.



Raising 2% of GDP from corporate taxes is much lower than it was 40 years ago. I do not think that is an onerous number. Its crazy people are getting 0.25% on their CDs and trying to retire while American businesses are getting a return on tangible equity of 15%. I think equity holders are getting treated extraordinarily well compared to debt holders.

[Applause]

**Munger:** I live in California where there is a non-deductible 13.5% tax on long term capital gains. That is a ridiculous tax to have and it drives rich people out. Florida had the good sense to know that rich people don't bring a lot of crime or burden schools. They spend their money on things like healthcare which boosts everyone's income. I think California has a really stupid tax policy.

It is amazing that Florida and California's policies differ so much. It is really dramatic! Who the hell doesn't want rich people coming in and spending money?

[Laughter and applause]

**Q: What sort of differences in performance and corporate culture do you notice between German and American companies?**

[Warren looks at Charlie]

**Buffett:** Charlie, I'm looking at you for the answer not the question, I heard the question.

[Laughter]

**Munger:** He can hear so much better than me!

Well, we've had a hard time buying companies in Europe. It's been quite rare. Family traditions are different in Germany when compared to the United States and other countries. Germany has a very long history of being good with technology and capitalism. This has been a godsend to Germany. We have always admired how they have performed. Germans work fewer hours and produce a lot more than other people. We admire the Germans on the engineering side and have always looked up to them.



**Q: Shareholder who is in his 70s mentions they applied for a GEICO quote but the price was higher than other companies. Why was GEICO unable to offer competitive rates?**

**Buffett:** We can beat people's current rates ~40% of the time. No company will be the lowest in all cases. We all have our own models and underwriting criteria that involve many variables. In your 70s age is a variable but not a dominant one. We use all of our variables just as our competitors like Allstate and State Farm use their own. Sometimes they come out the lowest.

**Munger:** If you get older and find you are not deteriorating as fast as your contemporaries you may be paying an unfair price for your insurance but it's a good trade off!

[Laughter]

**Q: [Question from an 8 year old audience member] How do you make friends and get people to like working with you?**

**Buffett:** Not a bad question!

**Munger:** I was quite obnoxious at your age. Not everybody liked me. The only way I could get people to like me was to get very rich and become very generous.

[Laughter]

**Buffett:** I was certainly on the obnoxious side early on but you will get a little smarter about human behaviour as you get older. I had wonderful teachers, not in terms of the standard definition of teacher, but they were people I admired. I asked myself, why do I admire these people? I then asked myself, why not take on some of their qualities? It's not a complicated proposition.

Look around at the people you like at your school, write down 3 or 4 things they do that you like. Then look at people that put you off and write down 3 or 4 things you don't like. Then decide to become a person who you yourself would like. You can be generous, friendly, accept things with good humour, don't take credit when it isn't due, etc. These are all possible to do. Get rid of the qualities you don't like and you'll do pretty well.

[Applause]



**Munger:** That works really well in marriages, it's much easier to change yourself than your spouse. The most important thing to look for in a spouse is not humour, intelligence or character, it's to ensure that they have low expectations!

[Laughter]

**Q: You have commented on leaving your kids enough so they can do anything but not so much they can do nothing. Can you comment on your commitment to the giving pledge? How do you balance giving money to your kids and assets to charity?**

**Buffett:** Well it all depends on an individual's situation. I promised to give over 99% in my case.

As you know the estate tax exemption has been moved up substantially in the last few years. I may have done something different if my child helped me build a small business. This can be done without estate tax planning. It's really an individual thing. When it comes down to deciding what to do with your money the options become fairly limited. As Charlie said the other day, where he is going the money won't do him much good anyway. You know, there's no Forbes 400 in the graveyard.

My advice is to start thinking about this now. When I talk to some 70 year olds they say I don't want to think about that right now. Then I say to them, are you going to make a better decision when you're 95 with a young blonde on your lap? No.

[Laughter]

**Q: Can you talk about subdued household formation in recent years? Is this more structural or cyclical?**

**Buffett:** I don't know the answer on this but I think the latter is more likely. I have heard household formation turned up in the last 6 months but I'm not sure. I should know the figures but I don't, my impression is they have turned up somewhat. I don't know what is going to happen but I expect it to turn up, it always turns down in a recession. You could argue we're still not all the way back from the recession. Your guess is as good as mine. [VGI note that US household formation has been running at a pace of 1.6m p.a. over the past six months (1.4% p.a. growth), a significant improvement from the 0.6m p.a. pace over the previous five years (0.5% p.a. growth)]

**Munger:** I feel exactly the same way. I speak for a lot of people in the audience when I say I hope my grandchildren will marry someone suitable promptly and move out.

**Buffett:** What's your interest in this Charlie?



**Munger:** I don't think it's healthy for these people to hang around looking for pie in the sky.

[Laughter]

**Q: How has the Eurozone been affected by the creation of the Euro? Do you view the Euro as a positive or negative development?**

**Buffett:** Well, this one is way too easy for me to answer so I'll give it to Charlie.

[Laughter]

**Munger:** I haven't the faintest idea.

I think they had noble motivations for creating the Euro and promised to do a lot of good. It undoubtedly did some good but it's a flawed system to put countries together that are so different. The big strain is on countries like Greece and Portugal. They created something that was unwise, there are countries in there that shouldn't be in there. You can't form a business with your drunk brother-in-law.

[Laughter]

**Buffett:** I think it's a good idea that needs a lot of work still. It is flawed and the flaws are apparent, but that doesn't mean it can't be corrected. We wrote a constitution in 1787 but that also needed a few amendments. I don't think the fact that it was not perfect at the beginning means it won't succeed. If there are flaws you just have to face up to them. Maybe the events that are happening currently will solve that. We could have created a common currency with Canada and made it work. We could have had a North American currency and we'd have worked it out, it would have been useful. We could not have had a hemisphere wide currency with the likes of Venezuela.

**Munger:** And Argentina.

[Laughter]

**Buffett:** He loves to name names! Praise by name, criticize by category.

[Laughter]

I think it's desirable to have a Euro currency enforced so that the rules really apply. There were rules originally on the Euro which got broken very early on, not by the Greeks but by the French and Germans.

**Munger:** The investment bankers helped them prepare phony financial statements. They actually aided in fraud, it's not exactly novel.



**Buffett:** The Euro can and should survive but it's going to take some real changes. It has to go in the direction of more or less cohesion. In its present form it isn't going to work. Charlie? I don't know why I'm giving you another shot.

**Munger:** I think I have offended enough people today.

[Laughter]

**Q: Do you have advice for teaching people in developing countries the basic principles of finance?**

**Munger:** Well I failed at teaching most of my family, so no.

[Laughter]

**Buffett:** The important thing is to get good habits early on. Someone once said that the chains of habit are too light to be felt until they are too heavy to be broken. Habits make an enormous difference in your life. I help out with the Secret Millionaires Club a little bit and our goal there is to in an entertaining way present good habits to young kids through a comedy series. It has a good effect, in a few days we are going to have 8 finalists come to Omaha to pitch their businesses. I'm always impressed with these kids.

The importance of developing good habits or encouraging your children early on with respect to money can change their lives. I was \$9k-\$10k ahead when I graduated college and had kids very fast. If I hadn't had that, my life would have been vastly different. You can't start young enough working on good money habits.

**Q: What is your secret to staying so young and energetic? Also, what is your opinion on the internet?**

**Munger:** Well Warren is a big internet user.

**Buffett:** I love it! I play bridge on the internet.

[Laughter]

**Buffett:** I use search, it's been a huge change to my life. The internet costs me \$100 a year. What would I do if I had to give up a plane or the internet? Well the plane costs me \$1.5 million a year while the internet costs me only \$100. I wouldn't want to give up either but I'd have to give up the plane.

**Munger:** Seriously?

[Laughter]



**Munger:** I think we're going to do more on the internet, it's growing in importance. Like it or not it's a modern reality.

**Buffett:** Doesn't sound like he likes it, does he?

[Laughter]

**Munger:** I don't. I see people doing three things at once, what a terrible way to live. The idea of multi-tasking my way to glory has never occurred to me.

[Laughter]

We have how many Bloomberg terminals in the office?

**Buffett:** 2 or 3, they don't tell me about them. They hide them when I come in.

[Laughter]

**Buffett:** It's amazing, to think about what has happened in the last 20 years. The game is not over. All sorts of things may happen. I can turn my computer on and play bridge in 20 seconds, I think the world has improved.

**Q: What is your stance on raising minimum wage in the US? How concerned are you about income equality?**

**Buffett:** Since I was born in 1930 the average GDP per capita in the US has gone up 6:1. My parents thought they were looking at a decent economy in 1930 and here their son has lived to see the average go up 6x. If you had asked them at the time and they had known this fact I'm sure they would have said people will be much better off. I think there's a million causes for the current problems but I don't pretend to know the solution. Everyone that is going to work should have a reasonably decent livelihood in a country like the United States.

[Applause]

I'm going to write something on this soon but I don't think you can raise the minimum wage to a decent level without losing many jobs. If you were to move it up dramatically it's a form of price fixing, you would change the opportunities available to people. I am much more of a believer in reforming the earned income tax credit, it rewards people who work and rewards those whose skills don't match the current system. I don't have anything against raising the minimum wage but you can't raise it without creating distortions. I think the earned income tax credit does make a lot of sense but it can be improved. If there's anyone I haven't made mad yet I'm sure I will on the next question. Charlie?



**Munger:** Well you've heard a Democrat speak and here's a Republican agreeing with him. I think it would help the poor to improve the earned income tax credit.

[Applause]

**Q: What is your opinion on the structural changes occurring within China right now?**

**Buffett:** I think China will do very fine over some period of time.

**Munger:** Yeah I'm a big fan for what's happening in China. Lee Kuan Yew contributed very much to fixing Singapore which China then copied. One of the things he did was stop corruption. China is now doing the same thing. I think it's the smartest thing the country has done in a long time.

**Buffett:** Now we are starting to get some practical advice!

[Laughter]

What has happened in China over the last 40 years is amazing. They have come so far so fast.

**Munger:** Never in history has a country done so much in so little time. When I was a boy 80% of the population was illiterate and mired in farming. It's one of the most remarkable events to ever occur. I give the Chinese credit for copying Lee Kuan Yew. That's all Berkshire has done, copy the right people.

**Buffett:** In 1790 the United States had 4 million people, China had 290 million. They were just as smart as we were and worked just as hard in a similar climate. For close to 200 years the United States went from 4 million people to close to 25% of the world's GDP while China didn't go anywhere.

It shows you the human potential when you find a system that unleashes it. They found this system 40-50 years ago but we found it 200 years ago. It's amazing that people go nowhere for centuries and then it explodes. It's the same humans but they found a way to unlock their potential, it's amazing. China and the US will be the superpowers for as long as we can see. It's imperative for these two countries to figure out ways to see the virtue in each other rather than the flaws. On balance, we're both better off if the other is doing well.

[Applause]



**Q: How did you identify good businesses early on in your careers?**

**Buffett:** Well we looked for companies we could easily understand and ones where we could see what the future would be like. This doesn't mean we had to understand them to four decimal places. We also had to know our limitations so we stayed away from a lot of things. Prices were also very different so it was much easier than it is currently to know what value you were getting for your money.

**Munger:** That's exactly what we did and it worked wonderfully. Warren says he was lucky to go to GEICO but not every 20 year old was knocking on doors when they had questions they wanted answered. We created some of our luck by being curious. We certainly recommend this to everyone. There's nothing else like learning from your mistakes and getting your nose whacked.

**Buffett:** Yup, we thought we knew about department stores or the trading stamp business. We have had a lot of experiences with bad businesses but these experiences sharpen your ability to find good ones. As long as you enjoy what you are doing you are likely to get a good result.

**Munger:** It helps that we came from families with admirable qualities, this made it much easier to identify admirable people. My deceased wife used to say you can't accomplish much in one generation. We owe a considerable amount to the families we were raised in. Our family standards helped us identify good people.

**Buffett:** Do you still have your father's briefcase?

**Munger:** I do but I don't know where it is. [Laughter]

**Q: How were you able to persuade your early investors to invest with you and believe in what you are doing?**

**Munger:** We didn't do very well until we had a winning record.

[Laughter]

**Buffett:** I started as a stockbroker when I was 20 years old although I looked 16 and behaved like I was 12. I did not make a huge impression on people. When I came back to Omaha, the people who joined me included my sister, my college roommate and his mother, my Aunt Alice, and a few other people. They just had faith in me. My father-in-law gave me everything he had.



They knew I had done reasonably well by 1956. I had been investing 5 or 6 years and was in a position where I had \$175k and retired. They figured out I had done reasonably well if I was retired at 26. From there it just unfolded. I also got recommended when Ben Graham closed his fund which helped. A few years later another family would introduce me to Charlie. A lot of stuff just comes along so long as you keep trotting on.

**Munger:** The people who have followed the Graham Newman path have all done well. Avoid being a perfect idiot and have a good character, keep doing this day after day and it will work.

**Q: What really motivates you?**

**Munger:** Well I was always really good at figuring things out, I was never going to be an actor or a movie star. Early on I got the idea, partially from my family, that your main duty is to become as rational as you can possibly be. Rationality was worshiped by my family. I think rationality is a moral duty. That's the reason I like Confucius. I think Berkshire is a temple of rationality. I think if you have an easily removable ignorance it's dishonest. It's not honourable to stay stupider than you have to be.

**Q: What is the toughest question I could ask you?**

**Munger:** I don't think that is a very good question.

[Laughter]

**Q: Can you comment on why you think the Wall Street Journal was under monetized in the past?**

**Buffett:** Well Dow Jones owned the company during the age when financial information was growing rapidly. They had the news ticker and the Journal. They totally missed the chance to monetize on this. Bloomberg came along and stole the show. They didn't pursue many things that they should have. A family owned it and a lawyer controlled the family's behaviour, they were sitting pretty but nobody there had an imagination. Every broker had a news ticker, they couldn't have been in a better place or in a stronger position. They let the world pass them by.

Now Rupert Murdoch is changing the paper and going into competition with the New York Times. This makes for an interesting situation, but that's Rupert's game.

**Munger:** Well the family ended up with \$6 billion to \$7 billion so they didn't completely destroy their fortune.

**Buffett:** If Tom Murphy had that hand he would have turned it into a few hundred billion!



**Q: What events and personal qualities do you attribute to your early successes?**

**Buffett:** Well I had the right teacher and was very focused early on. I also had the right emotional qualities, I enjoyed the game. You do give it all back in the end, that's not the key. The game is enormously fun. It's just hard enough to be interesting but not hard enough to be too difficult. It's actually a pretty easy game but it requires a certain emotional stability. Between the ages of 7 and 19 I had the same enthusiasm but didn't have the same principles that I picked up from Graham. I was able to take my enthusiasm and create a philosophy that made total sense and made the game more fun.

Prepared by:

**VGI Partners**

Omaha, Nebraska, 2<sup>nd</sup> May 2015