

# VGI PARTNERS

12<sup>th</sup> February 2020

## 2020 Daily Journal Annual Shareholders' Meeting

*“You have to learn to change your mind when you're wrong. I actually work at trying to discard beliefs. Most people just try to cherish whatever notion they already have, because they think if it's their notion, it must be good. But you must recognise disconfirming evidence when it appears. There's hardly anything more important than being rational and objective.”*

- Charlie Munger, 12<sup>th</sup> February 2020

We were fortunate to attend the 2020 Daily Journal Annual Shareholders' Meeting with its Chairman, Mr. Charles Munger. Mr. Munger (age 96) spoke for over forty minutes before opening it up to the Q&A session, which lasted just over an hour and covered a range of topics.

An estimated 700 people attended the meeting this year in Downtown Los Angeles.

We believe 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!



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**Munger:** Annual meetings are very peculiar in America. The chief shareholder in every big company in America is now some index fund. It's weird that the voting power of America goes to a bunch of index fund operators. Nobody planned it, it just happened. God knows what the consequences will be.

I will discuss briefly the state of affairs that's reflected in our reports and then I will take questions. This company of course started as a public notice rag which made money by doing public notices and morphed into a very successful legal daily newspaper which had a monopoly in publishing the opinions of all the public courts in California, which meant that every law firm had to buy it. It was a small but very profitable paper occupying an ideal niche.

Many of the newspapers in America had similar niches where they made regular and substantial profits. It was a very simple business to run. Of course, what's happened is that technological change is destroying the daily newspapers in America, including the little ones like ours. The revenue is going away, and the expenses remain and so they're all dying. Berkshire Hathaway owns about a hundred of them. They're all going to die and there's nothing that can be done to save them.

It's a sad thing because those newspapers were an accidental part of the government. They called them the Fourth Estate. The people who ran them became very powerful people due to two great American institutions: nepotism and monopoly. And all those nepotistic monopolists, many of whom drank too much, actually morphed into a function where they were more useful than our legislators, and now we're losing them all.

What we get is these opinion services on TV that everybody watches, and everybody believes some ridiculous version of events. It's not a good thing in America that we lose Newsweek magazines and all of our daily newspapers and get opinions of celebrities instead.

Now the Daily Journal Corporation, strangely, is not going to disappear. If our business fails, we still have a lot of marketable securities, so we're going to do better than these other newspapers. I'm not counting the ones like The Wall Street Journal or the New York Times that will survive no matter what.

We also have a second business which we're trying to use to replace the economic strength of the newspaper, and that's Journal Technologies. That is a software business that helps courts and government agencies replace human procedures with software.

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That is a very difficult business because you're dealing with these huge bureaucracies. Ordinary software is a gold mine because it's just standard – you crank it out and everybody uses it. Our software is not like that. People like Google and Microsoft don't want anything to do with our branch of the software business, but I kind of like it.

By the way, I do not find venture capital's backing of software pretty because there is too much of it and there is some wretched excess. It is not a scene that attracts Berkshire Hathaway. I'm not saying it won't work for a number of them but there will also be a lot of casualties. I also don't like it when bankers talk about EBITDA, I translate that to bullshit earnings.

[Laughter]

I don't like the talk about J curves and private sales from one venture capital firm to another at mark ups. I think there is a lot of wretched excess in it. But it does have a sound basis, which is that software is changing the development of the world. It is going to have some unpleasant consequences, but I don't know what they are. I'm giving you the same service my old Harvard Law professor gave me when he said, "Tell me what your problem is, and I will try and make it more difficult for you."

[Laughter]

By the way, the guy who told me that was doing me a favour. I have this saying "A problem thoroughly understood is half solved." It is hard to understand a problem well.



**Munger:** It's obvious that I got better life outcomes than I deserve based on energy or intellect. That's an interesting process and everybody would like more of it. Who doesn't like to get a lot more than one deserves? I stumbled into a few mental tricks early in life, and I just use them over and over again. I take the high road because it's less crowded, of course. That's a smart thing to do. I was raised by people who thought it was a moral duty to make yourself as rational as you could possibly make yourself. And that notion, which was just inherited basically from my genes and my surroundings, has served me enormously well. It's like Kipling's saying: "If you can keep your head, while all others around you are losing theirs" – that is a big advantage.

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Just think of all the dumb things that are done by our politicians and our business leaders and the wretched excess you see in the system.

I can remember one of the crazy booms that caused one of our earlier recessions. All these traders would go to Las Vegas and people would hand them free stacks of chips and strippers. That was our securities market. I mean, it was grossly awful, and a lot goes on now that is grossly awful.

[Laughter]

Well, I laugh too, but there are tears in my laughter.

[Laughter]

This business of being determinedly rational does work. One of the things that's wrong with the present system is the way the heads get cabbaged up by the activity and the owners of the heads don't know what's happening.

One of my favourite actors from when I was young was Mr. Cedric Hardwicke. Sir Cedric Hardwicke got old, but he kept acting and toward the end of his life he made one of the great statements in the history of acting. He said; "I have been a great actor for so long that I no longer know what I truly think on any subject."

[Laughter]

If you stop to think about it, that's exactly what's happened to most of our politicians, except they don't know it! Sir Cedric Hardwick at least knew his brain had turned to cabbage, whereas our politicians, they like cabbage!

Of course, the young people want to shout out their resentment of this and that, I always say what they're doing is pounding it in. Nobody's listening to them when they shout out; they're just pounding a lot of nonsense in.

It's a big mistake to pretend practically anything, because you become what you pretend to be. Ronald Reagan shifted from being a Democrat to a Republican. His acting career failed, so he was hired by General Electric to tour around and give right-wing speeches. Of course he became a Republican!

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**Q: In the past, you've referred to value investors as a group of cod fishermen and suggested that they may do well to fish in a pond outside of the US. Given that many of the highest-quality businesses are in the US, wouldn't our time be best focused analysing the quality of the businesses here? I'd also be curious to hear, in your mind, how you weigh the quality of the horse versus the odds offered on the horse?**

**Munger:** Well, both are important, but basically all investment is value investment, in the sense that you're always trying to get better prospects than you're paying for. But you can't look everywhere at once. You need some system of picking where to look, which is your hunting ground, but you're looking for value in every case.

But as to your first question, I don't agree with you. I think the strongest companies are not in America; I think the Chinese companies are stronger than ours and they're growing faster. I have investments in them, and you don't. And I'm right and you're wrong.

[Laughter]

Well, you can laugh, but I just spoke a simple truth. Li Lu is here. He's the most successful investor in the whole damn room. Where does he invest? China. And boy was he smart to do that. It really helps if you know which hunting ground to look in. In fact, we all do better hunting where the hunting is easy.

I have a friend who's a fisherman. He says I have a simple rule for success in fishing. Fish where the fish are. You want to fish where the bargains are. That's simple. If the fishing is really lousy where you are, you should look for another place to fish.

**Q: Hi Charlie, you're a testament to the idea to not be a victim, but to be a survivor. Could you perhaps expand on that idea, how it's helped you and how that is perhaps one of the greatest ways to live your life, regardless of what happens to you?**

**Munger:** It's very counterproductive for an individual to feel like a victim, even if he is. The best attitude is just to be cheerful about everything and keep plugging along.

I don't like politicians who get ahead by trying to make everybody else feel like a victim. They make my flesh crawl. Who wants to be a victim instead of a survivor?

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You can recognize your position is bad and you can try to improve it. But to have a deep feeling of 'it's all somebody else's fault' is a very counterproductive way to be. People don't even like being around it. It's really stupid, and yet our politicians build on it and make their careers work by doing something that's very bad for all the people they are talking to. It's crazy, it's absolutely crazy.

**Q: What is your view on Bitcoin and some of the other emerging financial technologies?**

**Munger:** Well, I don't know much about crypto technologies, except to avoid them. By the way, I have a lot of things at work I call the too hard pile and if it's too hard, I throw it into my too hard pile and I don't think about it.

I hate things like Bitcoin. I hate things that are intrinsically antisocial. Of course we need real currencies! One of the interesting things about the current situation is that the Americans have created the reserve currency of the world by accident, but the world needs a reserve currency.

**Q: Mr. Munger, we have record budget deficits, record employment and record expansion of the balance sheet. Why do you think we don't have inflation?**

**Munger:** The economists of the world thought they knew a lot more than they did. What has happened is weird, but in response to the Great Recession, all the nations of the world have printed money like crazy and have bought all kinds of investment assets, and they've done things that nobody in the economics profession would have recommended on this scale, even five or so years ago. Yet, inflation has been very low.

I think we all have a lot to be modest about when we talk about economics. Lyndon Johnson said that giving a talk on economics was a lot like pissing down your leg. It feels hot to you, but it doesn't influence anybody else very much.

[Laughter]

I'm afraid I can't do much better than Lyndon Johnson could.

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**Q: My question is about your outlook for the global economy, especially given the slowdown driven by China?**

**Munger:** I am mildly optimistic about China for a variety of reasons. I think they've done a lot right. I'm a big admirer of what's happened there. If you stop to think about it, they were in a Malthusian Trap and they prevented 500,000 babies from being born. They did it by methods that we wouldn't like in the United States, but I think they were doing the world a favour, and I think that what they did was admirable.

Basically, I don't have any hostility toward China. I really admire what the Chinese people have achieved. I think, considering they started as communists, their leaders are pretty good. It's amazing. Imagine a communist country creating this enormous period of growth and prosperity and lifting 800 million people out of poverty. I like what's happening in China and I think the United States ought to get along with China, and China ought to get along with the United States.

Another thing I greatly admire is, and this will strike you as very peculiar – there's one modern nation, which has had 25 years of stasis. How can anybody admire 25 years of stasis? I think the Japanese have handled 25 years of stasis with magnificent skill and philosophy. They don't like 25 years of stasis, but they don't act like victims, so I really admire the way the Japanese have handled their adversity.

I don't think the adversity came from a lot of mistakes. They were an export powerhouse and up came China and Korea. Of course they had some troubles! We'd all have troubles if we had way tougher competition. I don't think Japan's stasis was Japan's fault, I think it just happened. I think the United States has a lot to learn from Japan. Think of how everything's clean in Japan. You never see any homeless sleeping or defecating in the street, either. There's a lot to be said for Japan.

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**Q: I was hoping that you might share with us some examples of how you've used disconfirming evidence to terminate determinedly held beliefs.**

**Munger:** Being able to recognize when you're wrong is a godsend. A good bit of the Munger fortune came from liquidating things we originally purchased because we were wrong.

You have to learn to change your mind when you're wrong. I actually work at trying to discard beliefs. Most people just try to cherish whatever notion they already have, because they think if it's their notion, it must be good. But you must recognise disconfirming evidence when it appears. There's hardly anything more important than being rational and objective.

Think of all the dumb things you can do in life. Think of the brilliant people, who are just utterly brilliant, who do some of the dumbest things. You won't have any trouble thinking of examples. It's hard to be rational.

**Q: I want to ask you about Tesla. The company has a market capitalization of about one hundred and forty billion dollars. It traded last week about two hundred billion dollars in stock and traded about five hundred billion dollars in options. The stock moves about 20 percent a day. Meanwhile, Mr. Musk seems thrilled to stoke this volatility. I wanted to know what your thoughts are on this situation, and particularly what your thoughts are on Mr. Musk's behaviour.**

**Munger:** My thoughts are two; I would never buy it and I would never sell it short.

[Applause]

I have a third comment. Franklin D. Roosevelt once said something that I've taken to my heart. Never underestimate the man who overestimates himself. I think Elon Musk is peculiar and he may overestimate himself, but he may not be wrong all the time.

**Q: What can we teach children to be successful in life?**

**Munger:** The best thing we can do is be a good example, preaching doesn't work.



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**Q: There are over \$10 trillion of securities trading at a negative yield. The President wants to bring them to the U.S. Are you for or against negative interest rates?**

**Munger:** Negative interest rates make me nervous, but I don't think the authorities had much choice. It is difficult to do big stimulus rapidly and the only method they had in a crisis was to print money and change interest rates and it was probably the right thing to be done. Of course it makes me nervous. Unfortunately, once something works once, people will tend to overdo it. I don't know what to do about this.

**Q: Are our tech stocks the next Nifty 50?**

**Munger:** It's a good question. Back then a home sewing company was trading at 50x earnings – so we are not that crazy, yet. I think a lot of these companies are very valuable, though they may be selling at too high prices. But home sewing was destined to fail – not these tech companies. Nifty 50 was absolute dementia, the current situation is not nearly as crazy.

**Q: Do you think America needs to get to a positive trade balance to keep its prosperity for the next century?**

**Munger:** No

[Laughter]

**Q: I know Bill Gates has been an open proponent of nuclear energy and invested money in the space, can you give us your thoughts on nuclear power?**

**Munger:** I admire Bill Gates for being willing to throw money at stuff that is unpopular and that might possibly work. It is admirable and charitable and well suited for him. I don't know whether we will get safe nuclear plants, but it is worth thinking about. The problem is how much fissionable material do you want a bunch of crazy humans to have?

Regarding energy, we will have to start getting that from the sun. I would be in favour to get more energy from the sun and conserve hydrocarbons even if there were no global warming issues. That is not the regular view of other people.

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**Q: What is your opinion on universal basic income?**

**Munger:** If you did enough of it, you would totally ruin everything. A little of it we can afford. What the exact mix is will be determining for the political process forever.

**Q: You've talked frequently about having the moral imperative to be rational, and yet as humans we're constantly carrying this evolutionary baggage which gets in the way of us thinking rationally. Are there any tools or behaviours you embrace to facilitate your rational thinking?**

**Munger:** Of course. I hardly do anything else. One of my favourite tricks is the inversion process. To give an example: when I was a meteorologist in World War Two, they told me how to draw weather maps and predict the weather. Actually, what this is doing is clearing pilots to take flights. And I just reversed the problem; I inverted. I said suppose I wanted to kill a lot of pilots, what would be the easy way to do it? I concluded the only easy way to do it was to get the pilot into a place where he'd run out of fuel before he could safely land. So, I made up my mind, I was going to stay miles away from killing pilots by not getting them into conditions where they couldn't land. I just reversed the problem.

If somebody hired me to fix India, I would immediately say, "what could I do if I really wanted to hurt India?" I would figure out all the things that would most easily hurt India and then I'd figure out how to avoid them. It's the same thing, it's just in reverse. It works better to frequently invert the problem. You can help India the best if you understand what can hurt India the worst.

Algebra works the same way. Every great algebraist inverts all the time, because the problems are solved easier. Human beings should do the same thing in the ordinary walks of life. Constantly invert.

Peter Kaufman, who's here today, likes the idea that you want to know how the world looks from the top looking down, and from the bottom looking up. If you don't have both points of view, your reality recognition is lousy. Inversion is the same thing. Such a simple trick. All these things help you think it through. And they are such simple tricks.

And yet, our great educational institutions who give advanced degrees don't teach these people these simple tricks.

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**Q: If you were researching a company you'd never heard of, how would you approach the research process?**

**Munger:** If it's complicated technologically, I tend to leave it to others. Basically, I don't do it. I want to think about things where I have an advantage over other people – I don't want to play a game where others have an advantage over me. So if you have a pharma company and you're trying to guess what drug will work, I'm not good at that. Other people are better at that than me. I don't want to play a game where others are wise and I'm stupid. I want to play a game where I'm wise and they're stupid. Believe me, it works better that way.

That's my philosophy. You have to know the edge of your own competency. You have to know "this is too tough for me, I'll never figure this out." I'm very good at figuring out when I don't know something.

**Q: My question is about electric vehicles and BYD – why are BYD's EVs sales down 50%, while Tesla's sales are growing 50%, and what does the future hold for BYD?**

**Munger:** I'm not sure I'm the world's greatest expert on the future of electric vehicles, except they're coming, and someone's got to make them.

BYD's sales went down because the Chinese reduced the incentives they were offering for electric vehicles. Tesla's sales went up because he's convinced people he can cure cancer.

[Laughter]

**Q: One of the more surprising opinions I've heard this year is that we've never really had journalistic ethics and that the news has always been coloured yellow with the voice of their proprietors. Does this ring true to you?**

**Munger:** I think those old proprietors, those people that owned the network news, Time Magazine, Newsweek and the monopoly newspapers were pretty good.

I think the current bunch are deliberately lying because it sells better. I like the old products of nepotism and monopoly. They were better for us than these new guys.

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They are so good at marshalling hatred. Politics was once called the “art of marshalling hatred.” Now some hatred may have some constructive use, but they are overdoing it. The hatred is too intense, it’s cabbaging up the minds. It already cabbaged up the minds of the broadcasters and now its cabbaging up the minds of those who watch.

**Q: There’s this common sentiment that technology is accelerating change but also usurping traditional moats. Do you think that traditionally “moaty” industries are being undermined at a pace different from the past?**

**Munger:** Yes, I think the moats have been breached. Imagine the Eastman chemical company going broke? Imagine all these great department stores going out of business? Imagine the monopoly newspapers going down? Look at the strength of the American auto industry compared to 1950. I think the moats are disappearing rapidly. I think that’s a natural part of modern economics – all moats stop working.

**Q: I’d like to get your thoughts on Boeing?**

**Munger:** I don’t want to jump on Boeing. Boeing is a great company that had one of the great successes and great safety records. They lost their way, they made some dumb mistakes. That’s the nature of things when you’re trying to do things with hundreds of thousands of people. Occasionally there will be some slip ups. In most places, you’ll have some near misses.

Boeing actually had a near miss a couple of years ago when the rudder technology failed, and they had a few crashes. I was on the safety committee at US Air when that happened, and no one could figure it out for months. Something in the rudder was not working and it caused three crashes. It took them six months to figure it out and they put an army on it. But they survived that one and no doubt they’ll survive this one, but it’s really expensive to make a big safety mistake.

**Q: What tricks and tips do you have for us to be more rational?**

**Munger:** It’s a long process. Rationality is something you get slowly, and it has a variable result, but it’s better than not having it.

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**Q: Could you elaborate a little bit on the project Haven (the partnership between Berkshire, Amazon and JP Morgan to address US healthcare)?**

**Munger:** Well that's a very interesting subject. If you take American healthcare – in many ways, it's the best in the world. We have more brains in our medical schools and pharma companies than anywhere in the world per capita. We may have more brains than the rest of the world put together.

On the other hand, if you actually went into American hospitals offices you would find a huge amount of counterproductive activity, that costs a lot and does no good.

Some of what pharmaceutical companies are doing is downright outrageous. To have a diabetes drug and charge someone \$10,000 a month – it's ridiculous. I'll go further – I think it's evil.

I think the system should be changed and I think it will be changed. I think there's too much wretched excess in the healthcare system. The really sad part is the people who are doing it have no conscious malevolence. They didn't decide to do murders and maiming to make money. They think it's good for the patients. In other words, they've turned their brains into cabbage.

You have to change the incentives. There are places in America that are very admirable that don't do a lot of unnecessary stuff but there are lots of places that do. We have to change the system. If you took the medical system of Singapore, it costs 20% of what ours costs and has better statistics. It's not opaque, it's open. We have a whole system that tries to make things opaque to take advantage of patients. I think its evil.

**Q: Do you believe younger people should start investing now and how would you convince your friends to start investing?**

**Munger:** It's obvious that deferred gratifiers do better in the long run than impulsive people who need to spend money on the latest Rolex watch and other folly.

I think everyone should save money and defer gratification and not be stupid and spend money. The odd thing about it is that people are either born deferred gratifiers or not. They've done psychological studies on it.

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If you're an impulsive person who needs to be satisfied immediately, you're probably not going to have a great life and we can't fix you. But if you have a slight tendency to defer gratification and you can feed that tendency, you're on the way to achieving happiness.

Prepared by

**VGI Partners**

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