

Lowly Analyst Free Newsletter

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Social Security

A great deal can be gained by smartly collecting Social Security. Right now a fantastic freebee is available. By delaying your Social Security from age 62 to 70, you can double your and your spouse's inflation adjusted Social Security for the rest of your and your spouse's life. Even better, right now you can pay back your Social Security already collected, without interest, to collect the higher Social Security later. The spouse with the lower Social Security can still collect Social Security earlier. Call me if questions.

Social Security may be modified, but it is not going away. That is a political impossibility.

The Market

The market is in a short term rally from the long term down trend. There is no danger to US and Great Britain's ability to pay, since a country can print money. The only question is the value of the money, the rate of inflation. Rating agencies are ill-equipped to estimate inflation.

Currencies. In May, Brazil up 13%, England 9%, Canada 9%, Russia 7%, Euro 7%, India 6%, Japan 4%, China 0%.

Asset Classes. In May, RAFI US1500 Small Mid up 9%, Large Val 7%, Mid Growth 5%, Large Growth 5%, Small Growth 4%, Micro 4%, Mid Val 3%, Small Val 2%.

Sectors. In May, Coal up 35%, Oil 27%, Silver 24%, Commodities 22%, Agriculture 20%, Intrnl Real Estate 20%, Metal Mining 20%, Intrnl Energy 19%, Natural Resources 19%, Oil Service 19%, Gbl Solar Energy 18%, Gbl Material 16%, Financial Srv 13%, Energy 12%, Clean Energy 11%, Intrnl Communication 10%, Basic Material 11%, Agriculture Commodities 10%, Gold 10%, Covered Calls 9%, Gaming 7%, Healthcare 6%, Utilities 4%, Software 4%, Real Estate 4%, Biotechnology 4%.

Foreign Investments. In March, Russia up 36%, India 36%, Canada 23%, Brazil 22%, BRIC 21%, Latin Am 21%, China 17%, Emerging Mkts 16%, Pac-J 16%, World-US 15%, Euro 350 13%, Japan 10%, So Korea 6%, US 6%.

Fixed Income. In March, Financial Preferreds up 21%, S&P Preferreds 19%, Hi Yld 24%, Emrg Gvmt 8%, Covered Calls 4%, Int Gvrmt 0.9%, Vngrd Intrmd 0.5%, Vngrd Total Bnd Mrkt 0.5%, Vngrd Srt Trm 0.4%.

The Warren Buffett Way

1. Introduction

[Robert G. Hagstrom's 1995 book, *The Warren Buffett Way*](#), is about the investment strategies of the world's greatest investor. Hagstrom is Senior VP of Legg Mason Focus Capital, an institutional money manager. The book covers Buffett's investments through 1994. I have included additional information through May 2009.

Part of Buffett's investment success comes from his selection of investments, but another part comes from his management of those firms. Since we cannot buy controlling shares in our portfolio, we cannot hope to duplicate his success.

2. Buffett's Life

Warren Buffett was born in Omaha, Ne in 1930. At age 8 he started reading his fathers books on the stock market. In 1943 Buffett started delivering newspapers and invested his earnings in various businesses. In his freshman year in high school, Buffet and a friend bought a pinball machine for \$25 and placed it in a barber shop. They soon owned 7 pinball machines. Later, with a friend he bought a Cadillac for \$350 and rented it out for \$35 per day. When he graduated at 16 from high school, he had \$6000, \$61,000 adjusted for inflation.

Two years Wharton School, a BS in economics from U of Nebraska at age 20; rejected for admission by Harvard Business School, MS economics Columbia at age 21. Buffett had a photographic memory.

Buffet returned to Omaha as a stock broker. At 23 he started to work in New York for Benjamin Graham, a legendary successful investor who, as is not generally known, lost all his money in the great crash. At 26 Buffett moved back to Omaha and started the Buffet Partnerships. At 32 Buffett became a millionaire. In '65 the partnership began aggressively buying [Berkshire-Hathaway](#) (BH) and soon took control. Warren Buffet is President and CEO of BH, a conglomerate with large insurance investments. Charlie Munger, his longtime partner and friend, is vice chairman. The firm receives premiums that it can invest until claims must be paid. BH also acquires whole companies. Its total return from '65 to '95 was an average of 24% per year. In the last 10 years its total return slowed to 1.9%, vs. an average drop of 2.5% per year for the US stock market, a phenomenal achievement.

One of Buffett's key characteristics is his absolute honesty, fair dealing, and personal integrity.

3. Efficient Market Theory

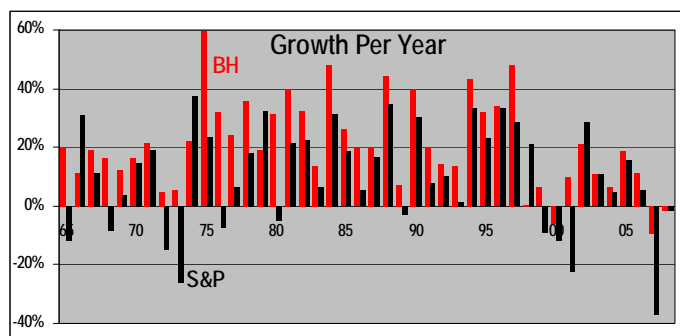
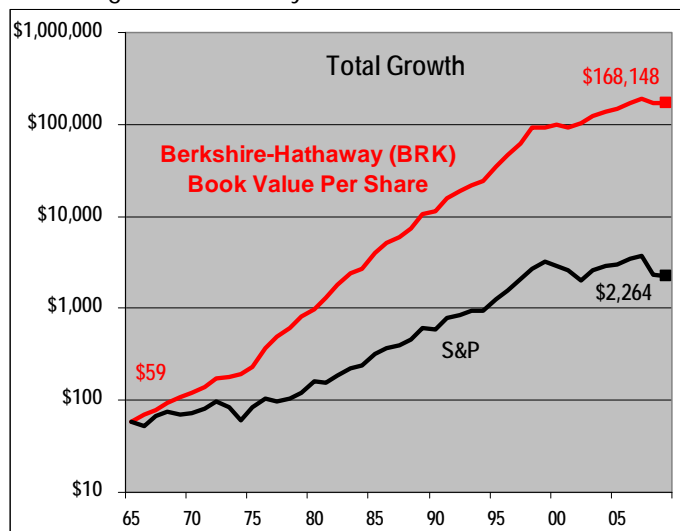
Buffett does not believe in the [efficient market theory](#) which states that markets are efficient in that asset prices reflect all publicly known information. Therefore it is impossible to outperform the market consistently. Any outperformance is luck. Future prices fluctuate randomly. The theory is currently the predominant academic theory.

The hypothesis has never caught on with the public who try an infinite number of schemes. Behavioral finance has shown that investors do not behave like rational economists. The hypothesis is a good first approximation working only where good information is present and where the cost of trading is relatively small.

Buffett's own performance contradicts the efficient market hypothesis.

4. Buffett's Investment Performance

By any measure Buffett's investment performance was phenomenal both in his early days and after he took over BH. Buffett measures his performance in [book value per share](#). (The previous percentages used price per [A share](#)). BH grew in book value per share from \$59 in 1965 to \$168,148 in May 2009, an average of 20.1%/Yr vs 8.8%/Yr for S&P. Since 1998 it slowed down to 5.9%/Yr.. Buffett had his share of failures but overall he was phenomenally successful as indicated in the graphs below. The first graph is on a log scale for clarity.



The following table shows Buffett's major Investments and their performance through May 22, 2009.

Company	% of Portfolio	Gain to 5/22/09	2009 Gains
American Express	3%	182%	29%
Coca Cola	3%	636%	6%
ConocoPhillips	18%	-45%	-12%
Johnson & Johnson	5%	-10%	-7%
Kraft Foods	11%	-22%	-4%
POSCO	2%	66%	7%
Proctor & Gamble	2%	670%	-13%
Sanofi-Aventis	5%	211%	0%
Swiss RE	2%	450%	20%
TESCO plc	3%	-10%	0%
US Bankcorp	6%	-42%	-28%
Wal-Mart	2%	5%	-11%
Washington Post	23%	-6%	-6%
Wells Fargo	15%	-32%	-16%
Totals	100%	31%	-7.3%
Total US Market		-1.8%	0.3%

5. Buffett's Investment Philosophy

The following summarizes Buffett's Investment Philosophy:

- Ignore daily price fluctuations. Stocks are not always priced fairly.
- Ignore the economy. No one can predict the economy.
- Invest only if you would buy the business.
 - Invest only in businesses you can understand.
 - Buy only businesses that have a consistent operating history.
 - Invest only in businesses that own a franchise, have no substitute, and no government regulation. (Warren did however buy insurance companies.)
 - Invest only in businesses with management that communicates honestly with shareholders.

6. Derivatives

Buffett invests in [long-term derivatives](#) that can be traded only at expiration. He bought them because he considered them to be mispriced. Pricing derivatives is very difficult and controversial. At the moment they have a book loss. They could remain a loss or turn vastly profitable. In any case, most individual investor could not buy these derivatives.

7. Bottom Line

- Only buy stocks if you can buy at less than the discounted cash flow.
- Ignore daily price fluctuations.
- Ignore the unpredictable economy.
- Buy stocks if you would buy the business.

If you have questions write to curtfey@curtfey.com