

July 20, 2011

## **A Morning with Charlie**

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How would you like to learn from one of the few investors who actually taught Warren Buffett a couple of tricks? That's what I did a couple of weeks ago, and boy, was it a blast.

Charlie Munger has been Buffett's partner since the 1960s, and Buffett credits Munger with teaching him the importance of evaluating the quality of a business prior to making an investment decision. This turned out to be a key insight, and led to Buffett making fewer investments in low-quality, super-cheap businesses, and more investments in high-quality businesses like Coca-Cola and See's Candy. Given how much long-term holdings like See's and Coke have added to Berkshire Hathaway's success over the years, you can see that Munger's contribution to Berkshire has been a big one.

However, Munger has always preferred to let Buffett stand in the limelight. His comments at the annual Berkshire Hathaway shareholders' meeting are relatively terse, and he's far less visible in the media. So, it was a real treat to hear Munger give his thoughts on investing, life, and everything in between for three hours in Pasadena a couple of weeks ago. I've posted [detailed notes](#) to the Trust Company website, and I'll hit the highlights below.

### Never Stop Learning

If there was one big theme, it was the importance of constantly improving one's mind and learning from mistakes. Munger told a story about he and Buffett buying three of the four largest department stores in Baltimore many years ago: "It's a pretty competitive business, and three in one city...it was the dumbest thing. But we recognized our folly, sold them quickly for about what we paid for them, and used the money we had borrowed (on very easy terms) to buy securities at giveaway prices during a subsequent market panic. Being an active and continuous learner means you can profit from your own asinities. That's what we did."

Along the same lines, this comment really struck me: "I sometimes say "Pay yourself first," and the way you pay yourself is by protecting your own mind and making it better. I'd go so far as to say that's a moral duty. Rationality, the increase in rationality, is not just something you choose or don't choose, it's a moral duty to keep up as much as you possibly can. It worked so well at Berkshire, not because we were so darned smart to start with...we were massively ignorant...but many of the great successes of Berkshire started with stupidity and failure."

It's quite something to hear half of one of the world's all-time great investment partnerships describe he and his partner as having been "massively ignorant" earlier in their careers. It's a powerful reminder of the value of both humility and self-reflection in investing. In my experience, the best investors have a surfeit of both, and notably low levels of hubris.

At Morningstar, where I led the equity research team for about a decade, I would always ask analyst candidates about their investing mistakes during interviews. Almost invariably, candidates who could clearly articulate their biggest investment mistakes, and what they had learned as a result, turned out pretty well as analysts. And the few times I let other strengths outweigh a poor answer to my questioning about mistakes – well, let’s just say that I remember those analysts to this day, and not because I covered myself in glory by hiring them.

If you have just one question to ask a potential investment manager, I would say that it should be about their investment errors – of both commission and omission – and what that manager learned as a result. The answer will tell you a lot about both the manager’s process and their personality.

### Berkie is Cheap

In my [commentary](#) about the Berkshire Hathaway annual meeting, I noted that I thought Buffett was practically shouting from the rooftops that he thought Berkshire shares were undervalued. Interestingly, Munger seconded the notion in Pasadena. In discussing Berkshire’s acquisition of Wesco, which was paid for in Berkshire shares, Munger said that he thought Wesco shareholders did quite well out of the deal: “Because Berkshire had a spate of losses from earthquakes and whatnot ...Berkshire’s stock stayed at a price, and went to a price, that was far lower than either Warren or I ever had anticipated, so Wesco shareholders got more Berkshire stock than we really had intended.”

Though my vote doesn’t count as much as Warren or Charlie’s, I’d agree. As of the end of the first quarter, Berkshire’s investments (stocks, bonds, and cash equivalents) were worth about \$65 per B share. The non-insurance operation of Berkshire earned roughly \$2.75 in 2010, and Berkshire’s B shares currently trade for about \$75. So, a \$75 share price less \$65 in investments = \$10 per share for \$2.75 in earnings power. Four times earnings for Burlington Northern rail, Marmon Industries, MidAmerican Energy, and all the rest? I’ll take it.

### The Macro Scene

Like Buffett, Munger appears to expect higher inflation down the road, but not to be too troubled by it. (At the Berkshire meeting, Buffett noted that a dollar printed in the year he was born is worth six cents today, but he’s still done all right.) At the meeting in Pasadena, a questioner noted that a local deli had a 1955 menu on its wall, and back then, corned beef sandwiches sold for 55 cents. The same sandwich now sells for \$13. Munger responded:

“I think it’s pretty obvious that we’re like to have some more inflation, on the scale of 50-100 year periods. ...But we have had growth of roughly 2% per person per annum for decades, in spite of the inflation that bothers you ...that is not failure, it is success. Huge success. Success with little precedent in the long history of mankind. Failure is way worse than that. That was a very good period for your darned corned beef sandwich. In that exact same period, think what happened in Italy. I once paid a hotel bill in Venice in billions of lira...you think you have a little inflation.”

The point here, made in typically blunt Munger style, is simply that economies can grow, and wealth can be created, even if prices rise eightfold over fifty years. (Note that the Pasadena deli must have some pricing power, since a 55-cent sandwich in 1955 inflated at CPI would only cost about 4.70 today, rather than \$13. And who pays \$13 for a corned beef sandwich, anyway?)

Munger also noted that he would be “flabbergasted” if unemployment just bounces back, and he characterized the investment scene as “very difficult – bonds are lousy, but carefully selected stocks may produce decent results.”

#### A Final Thought

The meeting was full of wonderful quotes, but I’ll leave you with just one: “A combination of patience and opportunism will serve you well. The opportunities in my long life have been infrequent, and you just have to be ready. I recommend to you all the basic idea that when a major opportunity comes along, don’t be timid.”

#### **About the Company**

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