

Introduction: What Investors Can Learn from Warren Buffett

Berkshire Hathaway's stock has risen nearly 27 percent a year for the past 36 years. For its consistency and profitability, this company, managed by Warren E. Buffett of Omaha, has been amazing.

If you asked Buffett how you, as an individual investor, could go about imitating his spectacularly successful investment strategy, his answer would be: buy shares of Berkshire Hathaway. He happens to be an unusually sensible person, and that is clearly the best answer.

But if you buy or intend to buy other stocks on your own, either one-at-a-time or through a managed mutual fund, there is much that you can learn by studying Buffett's tactics.

Why not just do the obvious and put all your money into Berkshire Hathaway stock? One reason: It's mainly an insurance holding company—Buffett is an authority on insurance. Because of this, the stock has virtually no exposure to many areas of the stock market, such as technology and health care. A second reason: Berkshire has become so enormous that its future performance is handicapped, much like the odds-on favorite in a horse race being forced to carry extra weights.

In short, you might do better on your own. First, because you have a smaller, more nimble portfolio. And, second, because you might shoot out the lights by overweighting stocks in whatever field you're

particularly knowledgeable about—health care, technology, banking, whatever. Buffett refers to this as staying within your “circle of competence.” (There’s nothing wrong, of course, with your also buying Berkshire stock. I have. The Sequoia Fund, run by friends of Buffett’s, has one-third of its assets in Berkshire.)

While the average investor can learn a thing or two from the master, he or she simply cannot duplicate Buffett’s future or past investment performance. One obvious reason: Buffett has the money to buy entire companies outright, not just a small piece of a company. He also buys preferred stocks, engages in arbitrage (when two companies are merging, Buffett may buy the shares of one, sell the shares of the other), and buys bonds and precious metals. He’s also on the board of directors of a few companies Berkshire has invested in. Perhaps the most difficult thing for individuals to duplicate is Buffett’s small army of sophisticated investors around the country who fall all over themselves to provide him with “scuttlebutt” about any company he’s thinking of buying. Also, Buffett has the word out to family-owned businesses: “I’ll buy your company and let you keep running it” (another thing individuals can’t duplicate).

Let’s not forget, too, that Buffett also happens to be extraordinarily bright, a whiz at math, and to have spent his life almost monomaniacally studying businesses and balance sheets. What’s more, he has learned from some of the most original and audacious investment minds of our time, most notably Benjamin Graham.

Still, while it’s true that trying to emulate Pete Sampras or the Williams sisters does not guarantee that you will wind up in Wimbledon, you could very likely benefit from any of the pointers they might give—or from studying what it is they do to win tennis matches.

Buffett has often said that it’s easy to emulate what he does, and that what he does is very straightforward. He buys wonderful businesses run by capable, shareholder-friendly people, especially when these businesses are in temporary trouble and the price is right. And then he just hangs on.

There is, in fact, a whole library of books out there about Buffett and his investment strategies. There are Berkshire web sites, Internet discussion groups, and annual meetings that are beginning to resemble revival meetings. There is also a Buffett “workbook” that helps people invest like Warren Buffett. It even includes quizzes.

This book isn’t written for the Chartered Financial Analyst or the sophisticated investor (readers familiar with Graham and Dodd’s *Security Analysis*). It is for ordinary investors who know that they could do a lot better if they knew a little more. And the truth is,

much of Buffett's investment strategy is perfectly suited for the everyday investor. His advice, which he has been generous in sharing, is simple and almost surefire.

Buffett buys only what he considers to be almost sure things—stocks of companies so powerful, so unassailable, that they will still dominate their industries ten years hence. He confines his choices to stocks in industries that he is thoroughly familiar with. He will seek out every last bit of information he can get, whether it's a company's return on equity or the fact that the CEO is a miser who takes after Ebenezer Scrooge himself. He scrutinizes his occasional mistakes, quickly undoes them, and tries to learn lessons from the experience. While he is loyal to the management and employees of companies he buys, he is first and foremost loyal to his investors. To Warren Buffett, the foulest four-letter word is: r-i-s-k.

Beyond that, he avoids making the mistakes ordinary investors make: buying the most glamorous stocks when they're at the peak of their popularity; selling whatever temporarily falls out of favor and thus following the crowd (in or out the door); attempting to demonstrate versatility by buying all manner of stocks in different industries; being seduced by exciting stories with no solid numbers to back them up; and tenaciously holding onto his losers while shortsightedly nailing down the profits on his winners by selling.

In short, as Buffett has modestly confessed, the essential reason for his success is that he has invested very sensibly and very rationally.

Another way of putting it: Buffet invests as if his life depended on it.

A word of warning: Not all of Buffett's strategies should necessarily be imitated by the general investing public, in particular Buffett's penchant for buying only a relatively few stocks. A concentrated portfolio, in lesser hands, can be a time bomb.

There are some things that geniuses can (and should) do that lesser mortals should be wary of; there's a law for the lion and a law for the lamb. Ted Williams, the great baseball slugger, never tried to bunt his way onto first base, even during the days of the "Williams Shift," when players on the opposing team moved far over to the right side of the field to catch balls that Williams normally whacked down that way. He wasn't being paid to bunt toward third base and wind up with a mere single, much the way Warren Buffett isn't expected to do just okay. But you and I, not being quite in the same class as those two, should be perfectly content with getting on base consistently using such unimpressive techniques as bunt singles.

No doubt, overdiversification—owning a truckload of different se-

curities—is something that gifted investors should steer clear of. But underdiversification, owning just a few securities, is something that ungifted investors (in whose ranks I happily serve) should also avoid like the plague.

In 1996 there appeared a short, charming book with a cute title: *Invest Like Warren Buffett, Live Like Jimmy Buffett: A Money Manual for Those Who Haven't Won the Lottery* (Secaucus, NJ: Carol Publishing Group, 1996). The author is a Certified Financial Planner, Luki Vail.

The text talks about the blessings of an investor's owning a diversified portfolio, not a concentrated portfolio. Writes the author, "Diversification of your investment dollars along with appropriate time strategies are your best tactics to protect you against such things as stock market crashes." ("Time strategies" means suiting your portfolio to your needs. If you think you'll need your money in fewer than five years, go easy on stocks.)

Why buy mutual funds? "Here is your chance to own stocks in 50 to 75 companies."

"Generally, stay away from individual stocks until you have about \$250,000 to invest; then you can have a well-diversified portfolio, like your own personal mutual fund. That way when a stock takes a nose dive on you, it will only have a small position in a very large portfolio, and you will take only a small loss, which could possibly be offset by the gain of some other stock."

In brief, she is recommending that readers of her book not swing for the seats but bunt for singles. That's no doubt sensible counsel for her readers, but it is not the Warren Buffett way.

I might offer a compromise suggestion: The ordinary investor, the lesser investor, might have a core portfolio of large-company index funds composing 50 percent or more of the entire stock portfolio. (Buffett has recommended that tactic for most investors.) And outside the core portfolio, the lesser investor might swing for the seats by imitating the strategy of the man generally acknowledged to be the greatest investor of our time.

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