KIM: Walk down memory lane with “Oracle of Omaha” (Part 2)

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This year marks the 50-year anniversary of Warren Buffett acquiring control of Berkshire Hathaway (“Berkshire”) and his annual shareholder letter is chock full of timeless investing lessons learned along the journey (www.berkshirehathaway.com).

Buffett believes in America and puts his money where his mouth is. In the depths of the Great Recession, Berkshire bought rail behemoth BNSF (Burlington Northern Santa Fe), its largest purchase ever. Buffett called the transaction an “all-in wager on the economic future of the United States.” He explained he has “always considered a ‘bet’ on ever-rising U.S. prosperity to be very close to a sure thing.”

He added: “Indeed, who has ever benefited during the past 238 years by betting *against* America? My parents could not have dreamed in 1930 of the world their son would see. Though the preachers of pessimism prattle endlessly about America’s problems, I’ve never seen one who wishes to emigrate (though I can think of a few for whom I would happily buy a one-way ticket).

“The dynamism embedded in our market economy will continue to work its magic. Gains won’t come in a smooth or uninterrupted manner; they never have. ***But, most assuredly, America’s best days lie ahead.”***

Buffett defines investing as “the transfer to others of purchasing power now with the reasoned expectation of receiving more purchasing power—*after taxes*—in the future.” This means you forego purchasing X today in hopes of being able to buy 2X tomorrow. He noted from 1964-2014, the S&P 500 rose from 84 to 2059, generating a total return of 11,169%. Over the same period, the purchasing power of the dollar fell 87%, meaning what could be bought for 13 cents at the beginning costs $1 today.

A share of stock represents ownership of a business, giving the holder a perpetual claim on the profits. Buffett said: “The unconventional, but inescapable, conclusion to be drawn from the past fifty years is that it has been *far* safer to invest in a diversified collection of American businesses (i.e. stocks) than to invest in securities—Treasuries, for example—whose values have been tied to American currency.”

He said, “Stock **prices** will always be far more *volatile* than cash-equivalent holdings. Over the long-term, however, currency-denominated instruments are *far* riskier investments.” While volatility is universally used as a proxy for risk, this is dead wrong. Stocks are riskier (both in nominal and purchasing-power terms) than cash *over the short-term*, so investors should have a multi-decade horizon and build a diversified portfolio over time. Consider inevitable short-term price declines as an opportunity to accumulate, not something to fear.

Investors who erroneously view and fear price volatility as risk can end up doing some *very* risky things. For instance, when the financial markets were collapsing, there was no shortage of Chicken Littles screaming to sell stocks and seek “safety” in cash. The S&P 500 bottomed at 676.53 on March 9, 2009 and is up 200% since. Cash earned about 0%. Was it riskier to own stocks or cash?

Buffett said, “market forecasters will fill your ear but will never fill your wallet.” Further, “Ben Graham (his mentor) pinpointed the blame for investing failure, using a quote from Shakespeare: ‘The fault, dear Brutus, is not in our stars, but in ourselves.”

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