

## Notes from Wesco Financial Annual Meeting -- May 11, 2006<sup>1</sup>

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Welcome to the annual meeting of Wesco, for the die-hard groupies.

[introduces directors, attends to certain meeting business matters]

When asking questions, please wait for a microphone, for anyone foolish enough to speak.

There are 7.1m shares outstanding, the same number of shares as when I started, perhaps the only company in the country with that fact. Please remain in your seats as long as anyone is up here. Meeting is adjourned.

I will proceed with somewhat extended comments by me. The reason I am making comments is that so many of you have come so far, because you are devotees of the same manner or method of life as demonstrated by Wesco and Berkshire. One unfortunate aspect of my life is that I talk to a great number of money managers, and I have very mixed feelings on this subject. The amount of brain power going into money management is a national scandal. Advanced degrees of every kind are all trying to outsmart the market. A lot of you older people can remember when none of these people existed. It was a small business, and people weren't very intelligent. Everyone is working hard now to be as good as they can be. If you are good at money management, you will know a lot about life. I like that. But when it gets carried to extent it has... I see prospectuses for funds based on systems using formulas for beating the market based on old data of the past. Each system has lots of algorithms for beating the market. One I saw was asking for \$100b. You think I am kidding. Rationality is not just something you do so that you can make more money, it is a binding principle. Rationality is a really good idea. You must avoid the nonsense that is conventional in one's own time. It requires developing systems of thought that improve your batting average over time. Regarding Wesco, there is not much to say.

Regarding money management, I will talk at length, because we are in a weird period. When I was young, investors owned some combination of bonds and equities, with bonds being respectable, and equities yielded dividends that were twice as high as bonds – profiting from the utter demoralization of the investors of the previous generation. In the last 15 years, the pension funds and investors have morphed into system which is different due to all the expert advice, because they bid stocks up to a price where all the smart people could recognize that future of stocks were about the same as bonds. If you believe stocks yield 7% extra than bonds, then you believe in the tooth fairy too. Asset classes will probably converge... Imagine the pension or foundation asset manager: Little me, with my needs running a foundation/pension fund – it doesn't work for me if I only get 5% per annum because I need it and I want it. My father's largest contempt was

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<sup>1</sup> These notes were typed by hand by yours truly, no recording device used. As such, they qualify as recollections only, not quotations. I consider this a didactic enterprise, and hope not to offend the speakers with misrepresentation. These aren't their words, they are my memory of their words.

for people who believed “I need it and I want it and therefore I should have it.” Investment world got into this mode, and compensation went up to provide for it – a big collection of consultants.

The consultancy system worked as follows. If family has a large farm extending over horizon, someone needs to decide how many corn, pigs, wheat, etc to cultivate. We will subdivide the land so that chicken-raisers will compete for the job of managing the chickens, and we will have beauty contests. It has spread so much since it coincided with a time when common stocks were collapsing. Truth is that there were remarkable opportunities to take leveraged opportunities in bonds, particularly junk (in 2002). The same thing in different forms also yielded very large profits.

I spoke to an investor the other day. He has \$5b from institutions, who use consultants to find him even though he is not that hard to find. He buys participation in lead bank loans, and gets 250 over libor, then issues bonds over purchases, 10yr bonds prepaid but no call, funding with bonds just over Libor. He gets a 2pt over-ride. There have been handsome returns for equity holders. So far, no defaults, and the man is good at what he does, and institutions have gotten 10% and man has gotten rich. So why don't we all leverage someone's high yielding loans and make 10-20% off the money? In first place, it is kind of inconvenient and there is no way to do it easily for a normal investor. I regard what he is doing as pretty intelligent – he is taking a first lien position, leverage isn't crazy. Not a bad investment. But it has created a lot of buried leverage in the system. All of these would have trouble in a convulsion. Except this is like writing earthquake insurance. If you can do it under a profit sharing formula with someone else's money, you would be very intelligent. Until there is an earthquake. High yields will all be over. Harvard who got into direct fixed income arbitrage really made money. The rest of us were asleep. They told you rates were going down. In very little investing, it involved using unconventional techniques (repo's long 2 yr and short 1 [month]). Unconventional people got very good records.

Venture capital – Harvard and Yale concentrated with early VCs who got best calls and best brainpower. Very few firms made most of the money, and they made it in just a couple of different periods. Everyone else returned between mediocre and lousy. When returns happened, envy rippled through institutional money management. Those investment amounts went up 10x post 1999. That later money was lost very quickly. It will happen again. I don't know anyone who successfully resists this stuff. It becomes a new orthodoxy. Beauty contests to manage money in distressed debt, early stage VC, small caps, developing countries. People feel so busy and so virtuous -- particularly if they have been successful for a while. You can put me down as an enormous skeptic to this process. It is right to think about different lines of activity, at different times. Occasionally it is okay to find activity in different places... But the idea that you have a farm and freeze the categories and find managers through beauty contests -- that is nuts.

An introductory text in economics says people makes decisions based on their opportunity cost. There is this company in an emerging market that was presented to Warren. “I don't feel more comfortable buying that than I do of adding to Wells Fargo.”

He was using that as his opportunity cost. No one can tell me – tell me why I shouldn't buy more Wells Fargo. Warren is scanning world, and trying to get his opportunity cost as high as he can so that his individual decisions better. Why is freshman economics class so inconsistent with what so many experts are doing, and they are charging a fortune. I believe in crazy waves of mental conformity based on social approval. I believe in baptism. I've seen it done. The worshipping at the temple of diversification is really crazy. 10 securities can make you rich. Why do you need 300 securities with huge fees to get rich? How can you be so unskeptical about human nature?

Portfolio insurance died on Black Monday in one dénouement. Sales people for these new products are selected to be the most plausible people in the world, selected to tell a beguiling story. I don't think current system will die in just one dénouement. In many cases it is 3% per annum in costs, in world where bonds yield 5%, and competitive returns are likely to be converging at 5% -- so 3% can be half of natural return. Add inflation and you can have a lot of disappointment. Then Harvard can triple endowment, and spend a lot more money and stop charging tuition and many other inconvenient things. I'm all for excellence at Harvard. Others will then try to get a higher return. Since Harvard has done it. Country as a whole is in for a ride I think.

Here is a different construct. I know a man named John Ariaga. After he graduated from Stanford, he started to develop properties around Stanford. And, he just kept building buildings around Stanford. There was no better time to do it than when he did. Rents have gone up and up. Normal developers borrow borrow borrow. What John did was gradually pay off 100% of his debt, so when crash came and 3m of his 15m sq feet of buildings went vacant, he didn't bat an eyebrow. Man deliberately took risk out of his life, and he was glad not to have a lot of leveraged businesses. There is a lot to be said that when world is going a little crazy, to put yourself in a position where you take risk off the table. We might all consider imitating John.

There are obvious bubbles. Saudi Arabia – it is awash in money, new at capitalism and some price kept going up and up, South sea bubble type. It has correct 30 or 50%. It happened in Kuwait, and they were so rich they just bailed everyone out. Qatar decided it wanted a medical school, so it spent \$9b. Like petty cash. I don't think in history of earth has a people had so much money per capita. The place is like 60m square. The world is not exactly fair. In Texas, there was an old saying: "Old Charlie was out in field playing the big bass tuba the day it rained gold". A lot of people are like that. There are now many a man that want three Chagalls and a \$15m apartment. Every asset I see is priced fairly rich. Many properties yields 5% now. In Europe you yield 3%. You get very liberally valued assets in practically every class. Junk bonds today seem pretty junky. Whatever yield you can find is offset by increased risk that you might not get your principal back. Part of reason is that so many people like you can afford to come so far and think about investing.

Even small markets are priced well. I heard a presentation the other day. An investor had put \$500m into sub-Saharan Africa. He just picked a field in which no one else was interested. He went into relatively illiquid securities. If a thing is despised or ignored

enough, you can make a pass over it and make a Geiger counter click. I got feeling he had pretty much accomplished what he was going to accomplish for a while. He has big files, and knows everyone.

Warren likes examples that markets aren't all that efficient, that world isn't perfectly efficient. He gives example of looking at a Moody's manual for Korea, with chaebols that didn't care about shareholders, a huge consumer credit collapse. Flour mills trading at 2x earnings and Warren thought he was young again. He says 'see world hasn't changed'. Most ordinary people won't find a great many pockets like Korea had in 2002.

Macro scene problem. Consumer credit expanded to levels no one has seen before. People really want a particular customer, who is just crazy enough to overspend but not to go bankrupt. Like having serfs, they pay the manor at the end of month, they pay you real money. That is world of consumer credit.

Now mortgage credit. This is a new world. Warren sold that house, and he asked how much could the guy borrow to pay the \$3.8m or whatever for house. He found out that he borrowed 80% in a mortgage and then the other 20% through an equity line. There are all these mortgages now where it is inconvenient to pay the principle – no problem just pay later. Not even principal is paid. Accountants let people write these mortgages and accrue income not received – just because no losses yet.

It was logical to gamble that with rates going down that prices would go up. If you got gamey, that was very clever. You could argue it was sound. People made enormous amounts of money. The rest of us were being dumb. Rates were sure to go down, value of props were sure to go up. It was a very smart thing for these people to do. Whether it is smart to continue it now, I would think not. There are plenty of periods of collapse. England had a huge collapse 10-15 yrs ago.

Extra lending in consumer, commercial, investment. Let's talk about commercial real estate lending. A friend of mine just invested in a project. The development group put up just put up \$8m in a [\$200m] project, with no downside. Leverage on that type of basis can cause a lot of pain for lenders in collapse. We are in a weird period, as everything has worked. I interviewed a woman at the height of the tech bubble. She was in her second job as a 24 year old, with stock options vesting at \$40,000 per week. She suggested I would have to compensate her at that level before she could consider changing employment. Now her brother was an economics professor, and \$40,000 per week wasn't in economics when he was learning it.

We'd rather own selected stocks than bonds at these prices. We will find occasional things to do now that may approach moderate returns of some of the things we have done in the past. The proper thing to do is look back and realize how stupid we were, we all blew an opportunity. Berkshire did do some fixed income arbitrage, and junk bonds. We could have done better in recent years. The right way to do it is scan a broad area until you find something you understand at right price and load up. We didn't scan, and I perhaps wasn't trying as hard as I was when I was young. We should have been a bit

more ambitious. I don't think it is a game that everyone will win at. Most are way worse at making decisions than people in this room. It is not a class where everyone are angels, but the class that come to our meetings are a very good class of manager who is trying to be rational and do a good job and be rationale. It is why people are here, it is a reaffirmation of the faith.

I will now open the field to questions.

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Q: I sent Warren a document about a hedge fund. Have all the derivative structures contributed to the extended cycle, or have we raised everything to full valuation?

CM: The world of derivatives has gone absolutely bonkers by standards of past. Witness Fannie Mae, a big quasi-dumb bureaucracy to start with. They were in a good position, where they got cheap funding and could lend against mortgages. Even so, they wanted more. They wanted to report 20% more every quarter. So they listened to siren song of derivative books, and when it blew – Fannie and Freddie had so many billions of derivatives. CEO now is spending hundreds of millions of dollars on fees just to try to understand what is on books. You have people inventing things to gamble on, and silver-tongued salesman with impressive slide shows. Accounting firm A says one firm made \$8m, and another firm B says the other firm made \$8m. They used to check that things were balancing, one a liability one an asset on both sides. They have given up. Really, they have sold out. Telling people to do that is too hard. It is like what doctors have to do when they withdraw tubes on terminal patients. Religions of world permit it. When you pull out plugs, guy on table shrivels up like a prune. It is the right thing to do. But the guy who pulls feels bad. I see the Wesco accountant has nothing to add.

Q: Whitney Tilson: you have said shareholders need to act like owners not renters. Also, though, you have commented that some activist hedge funds are a mixed bag. They seem to be behaving like you want them to behave. You can hold nose about fees (I run one myself), but shouldn't their be applause for the behavior of activist funds?

CM: I regard it as a mixed bag. Hollinger was a kleptocracy, and it was contrary to Tweedy Brown's interest but they did the rest of us a favor. But if you take Carl Icahn's assault on Time Warner, if you think he gives a damn about the shareholder... A lot of people just wants to raise hell, and don't care if they associate with admirable people or knaves. I think they are mixed bag negative. Not every little jump in value should be seized by shareholders. Some of these assaults, Oscar Wilde describes as he did fox hunts: the pursuit of the uneatable by the unspeakable. Not an elegant view. Governance is a very tough subject. Corporate managements and shareholders run the gamut. A big discount sometimes is justified because of the managers who are in charge of the asset. Considering the self-interested way management often runs the place, you deserve a 30-40% discount. Some companies had 50% of equity subject to options. Crazy practices drove out non-crazy practices. The accountants failed the rest of us. Never should the accountants have allowed options not to go through income statement. Most resent charge to earnings. They are still lobbying to change accounting back to former knavish state. Accounting has huge consequences. Given the incentives, there is pressure to

report every item of income. People subject to this pressure need a standardized oversight system. The profession richly deserves trouble it has had. It is a thankless job to pull plug on corpse and have it shrivel up on you. Whose bread I eat, his song I sing.

Sarbanes did give us more supervision. They are going through improving internal controls. If as an accounting employee you normally wouldn't be in much demand, you can go to work in this area. More internal control is good, but big stuff is getting ignored.

I asked group at Stanford when Enron could have been stopped. Not one stood up with correct answer. Correct answer: when Skilling went down to SEC to talk them into front ending profits from long term contracts. This set up entire daisy chain. If they had made that one decision right, it would have been changed. So much sin and error can be fixed by proper accounting. They made the exact wrong calls. It would have been so easy – how could anyone with any understanding with trading or management consulting culture believe that accounting was anything other than a disaster. There is so much skill at exposition in this country. Part of being a wise person is resisting other person's talents. If you are like me, you have secret or not so secret contempt for exposition. It reminds me of the previous Episcopal bishop of LA: "It just so happens that my scandals are heterosexual". CM: I can believe why Catholics have so much troubles, because they have so much focus on forgiveness. My view is go live somewhere else.

Q: What revenues or earnings did Iskar have? Can you tell us more?

CM: We were glad to buy it at the price we were offered. That is not just rudeness on our part. We want it to be run in the way it was run in past. They were private.

Q: Iskar founder said he learned lessons from you. What were they?

CM: He is one of smartest men I have met -- I don't have any idea what he could have learned from me.

Q: Will rate of growth of float go up as Berkshire goes more global?

CM: No, it will go down.

Q: How to compensate management when stock goes down, like Home Depot, but which paid \$35m [over x years]?

CM: Management shouldn't be blamed if stock market goes up, or goes down – on p/e multiple expansion and/or compression. Lou Simpson is here, and he owns it, but is not likely to want to comment.

Q: There is a natural tension that exists between entrenched management and corporate poison pills/unions buying large blocks of stock. Thoughts?

CM: Lots of people have incentives to be active as shareholders. Huge blocks of stock are held by labor interests. I see nothing to be gained in capitalism by having that group take labor relation angst into contested corporate management field. Other groups of entrepreneurial shareholders are like the Predators Ball, and I don't want them. I think world works better than those days. We still get takeovers, and Tweedy Brown did cure Hollinger. But generally speaking activism will be done by a group you will not admire. I don't know how we will fix corporate compensation. To get CEO rewarded in way they are – you have duty when you rise high in life to behave as an exemplar. That is how generals and judges act. Culture is horribly awry on that subject but we haven't figured out how to fix it. Not a problem at Berkshire. But, we have about two imitators.

Q: Is your opinion that most investment firms are marketing firms, even acknowledging the level of sophistication? Do you see repeat of LTCM? Why did you pass on Kmart bankruptcy – Tyco? Last good book you read?

CM: There will be some repeat of LTCM. You can count on it. But there is a lot of real brain power. Some are making high returns by being shrewd. The envy causes huge imitation and promotion. The result, like silicon valley, will be huge influx of managers and money to create a disaster. Kmart: didn't think about it. Tyco: I thought about it but passed. I won't tell you why. Last good book: Fortune's Formula. About the race track – Hong Kong operates as proxy for stock market. Odds set like stock market. But someone was able to develop algorithms in spite of croupier's take in the pari-mutuel system. Some of this is like what is going on in the hedge funds. Algorithms that outwit other algorithms.

Q: 35trillion in derivative trading. Any intellectual possibility that it might be larger threat than Al Qaeda?

CM: No, when Kuwait blew up it survived. Country will survive it. Did we need this dumb system to morph to this gigantic size? Some of our key brilliant economists reasoned as follows: it happened in a market, it lays off risk, then it must be wonderful. Munger mind doesn't agree – it perceives problems. If you are lucky you will live through to see what happens.

Q: Nuggets about compensation arrangements with local CEOs. It must be tough to manage long term contracts and payments on these contracts.

CM: No one uses formula. Ajit and Warren, like father and son, like couple of bridge players who rethink every hand. You should be so lucky to have them working in collaboration. There is no formula.

Q: Shareholder of both Berkshire and Wesco. Do you need minimum confidence level? What is level of probability?

CM: We don't do a lot of involved math. But we expect a decent return or we don't do it. We use rough calculations, based on a lot of experience and a little bit of math in our

heads. We distrust the other system. It is a unique aspect of human nature – that you trust something more, the more hard work you do on it. You get more confident the harder you work on a dumb idea. We don't like false precision.

Q: Many of leaders in reinsurance have lost 50% of share value in last 5 yrs. Lots of capital on Katrina. How do you feel about re-insurance business?

CM: Reinsurance is a very difficult business. Open the door and someone writes you very large checks in advance. It is intrinsically dangerous, and will intrinsically have bad results. It takes exceptional skill to have good results over a long term. Most won't have good results. Why are we so bold? Well, we aren't everyone else. If you stop to think about it, that is only logical answer there is. The other possibility is that we are nuts. You need to consider that.

Q: Value of dollar down by 50% vs house and gold etc.

CM: I have never believed interest rates were related to inflation. Copper stays way low for decades then suddenly copper in stratosphere. Different countries will be different. Housing prices collapse in places where people are leaving. In places between mountains and sea, prices go up because they are going up. Things stay low for long periods for ridiculous reasons. These are good for people like you, you get big swings in companies and assets. You must keep trying to learn at temple of rationality. You can miss a lot. I am quite prosperous even though I missed K-mart bankruptcy. How could we have bought 4% of Freddie instead of fannie? Cognitive failure. You must review mistakes of omission. We are better than most. I think about things I almost did, and that I didn't do.

Chris Davis has temple of shame. He celebrates the things they did that lost a lot of money. Temple of shame squared needed too for things you didn't do that would have made you rich. Forgetting your boners is a terrible error if you are trying to improve your cognition. Reality doesn't remind. Why not celebrate stupidities in both categories?

Q: Would success at limiting class actions help or hurt Berkshire's prospects?

CM: Berkshire not big at writing D&O coverage. Not big in this field if you include product liability, we do cover that. God knows asbestos field is a lot of trouble. Now silicosis. Some people rewrote complaints and witnesses. Lawyer being bothered by law society for paying for comp work said, 'if it continues I'll take all my witnesses and go to Chicago'. The behavior of class action lawyers is imperfect, but behavior of corporations is quite imperfect as well.

Q: Public governments in California have \$250b of unfunded liabilities on books, with aggressive rates of return assumptions. Any idea how we can dig ourselves out?

CM: Hope for plan A: getting lucky with investments. Plan B – taxation, with more likelihood for removal from office. Whatever disgusts you in this field, it will continue to disgust you for some time to come.

Q: Derivative counterparty risk and clearing?

CM: Counterparty risk is extreme, as accounting sort of assumes it away. There is nothing on sheets for wall street bonuses that counts counterparty risk. Pulling away punch bowl has never been a way to popularity. If you understood them [derivatives], you would find them scandalous. Think about how long there was rot in banks in Japan or China? We shouldn't rejoice, but hard to predict timing of disaster from terrible behavior. \$400m dollars disappeared when we reached for it on Gen Re derivative books. Imagine putting it on balance sheet, "Good Until Reached For.....\$400m".

Q: Purchasing power of paper assets. Non-financial claims on output high, 18% of total GDP, 3x rate of output. What is proper discount rate?

CM: No question that huge ballooning credit has caused horrible contractions, e.g. Korea 2002. Balloon of other types too. I can't predict based on figures you cited whether what I see will come sooner or later. All I can predict is that there is considerable danger.

Q: Has American society come to apex?

CM: I said we were near the apex – just behind or just ahead? Can't tell you. Warren is more optimistic than I am. My generation had most favorable hand any generation ever had. In human experience can it go on for years? Historical record would give someone caution. Whether the good behavior will outweigh the bad behavior? On way here, I paused to watch the concrete being poured into foundation of a new building being built by Wesco. Design is intelligent, the system for putting it together efficient. The skill of the crews is high, and inspector performs lots of meticulous inspection. If done right, it may outlast pyramids. It is a credit to our civilization that our buildings are as good as they are. In Japan they are tearing the buildings down in a recent scandal. We have little of that in America. In last five years, not one passenger on a major airline died. And lots of pilots are recovering alcoholics.

Q: I am a local high school student, and I heard that Berkshire is involved in Petrochina, which is providing fuel for Darfur genocide.

CM: I know exactly nothing about that. [Pause] All oil companies get involved in difficult things, and it is a classic problem. It would be hard to invest in oil without finding companies that are doing something we wouldn't do. Would you just leave your assets behind? I'm glad I don't have to take responsibility. If we had those standards, we couldn't invest in anything. Every big oil company is involved somewhere in a country which is doing something we wouldn't do.

Q: Media- newspapers. Commodities- Oil. Some saying 'it is different this time.' China, positives. What do you feel about Japan?

CM: Newspapers – future worse than past. Oil – eventually will be higher than where it is now. In between, don't know. Hydrocarbons will be increasingly difficult to extract, and the world needs a lot of it. Someday I suspect someday they will look back in wonder at our waste of hydrocarbons, to heat home, etc. And China- it is growing at 10% per annum. I would guess the government will let this tiger to continue to grow. If it grows, world will have pollution problem, and US will be way less important than it is now.

Q: USG – accounting, compensation?

CM: USG is a great success story. They benefited from construction boom. They wanted to end agonies caused by asbestos problems [through trust]. Whole thing is happening and it will come out of bankruptcy in due time. I'm not familiar with rest of it but I'd say they have done a hell of a job.

Q: You mention frequently that returns will decline? Why don't you focus on managing your own assets?

CM: Since I own Berkshire, I don't have much choice.

Q: You used to get 25% of profit as profit [at your partnership]. Is it fair for you now in terms of income?

CM: Yeah, it's fair. I like to think it is more than fair, but what the heck.

Q: You are familiar with Pat Byrne and his jihad against naked short-selling?

CM: One of privileges of being an old man in a secure place, I don't need to have an opinion on everything. My jihad calendar is full enough. I'm sorry, that is all I have to say.

Q: Seattle: safety of brokerage accounts. You have warned of possibility of cascading convulsions, safety of margin vs. street name vs. physical certificates.

CM: Cash account at really strong brokerage will be safe enough, and you have other things worth worrying about. Margin accounts – there can be real troubles there. You'll note big uproar with Refco bankruptcy. You don't want to run margin account when trusting assets to dubious firm. I wouldn't want 100% of my assets in a margin account in strongest brokerage firm in American.

Q: Error of omission: foreign stocks.

CM: We were late on foreign stocks. But we got our company from \$10m to \$100b. I don't know a lot about foreign stocks. I do think there have been opportunities on some companies. But every single one in retrospect was way too small for it to be big

opportunity in Berkshire. I don't regret it. I think US better than England in last 30 years, including in the stock market.

Q: Fortune's formula – would you use Kelly criteria to size positions?

CM: Oh, that is a very good question. The first time I had seen that sizing system discussed was in that book [Fortune's Formula]. It seemed plausible, but I will never prove it through proof. But just of it, limiting size of bet based on disaster possibilities. I won't use exact formula, but approach is same as mine. What if I offered you 4:1 on a coin toss? Would you risk your house? [Reply from questioner, after a pause, meekly: 'Maybe...'] You remind me of a man who once worked for a contractor I knew who said about an enterprising and aggressive younger man named Charlie: Old Charlie here is going to become a millionaire, several times. At least you said maybe. Money in terms of long range prospects for a fund has marginal utility. There are some limits on what you want to bet even on very good things.

Q: Patrick NYC. Learn more from mistakes from successes. Ran partnership, beat by 1000% over a number of years, down in early 1970s. What did you learn?

CM: I got hit by 1973 & 1974, worst collapse since 1930s, a one in 50 year event. Loss didn't bother me with my own money, but it was hell and agony as I thought through loss of morale of partners. It was compounded by knowledge that liquidation price was higher, and that was pure agony. You can have a period of pure agony, and you can see that you can live after it for many decades. It is test of character and endurance. A fully engaged man shouldn't get into a 1973 without agony, if not you weren't living a proper investment life. I wouldn't quarrel with someone less aggressive. It wasn't wrong but it was agony.

Q: If you look back over 15-20 years, what would you have done differently or did you miss?

CM: I wouldn't do a lot differently. I have been a very fortunate man. I shouldn't be complaining at how my life has turned out. The other day I looked at Berkshire ten years ago, 10<sup>th</sup> anniversary of baby b shares. We have added a lot of value in that time, with a tough stretch in last few years. Generally speaking I am satisfied. I do not have a lot of regrets. Only regret is that I'll soon be dead. I have Jewish system for handling that. I have humor. Some like religion, I have humor.

Q: What question would you be asking if you were in the audience?

CM: Framing circumstances around you is useful exercise. This period is weird, we have this twin deficit. But we have favorable current economic figures – a lot going right when to us it looks like a great sin. I have friends who go overboard on excesses, and having dose of John Ariaga isn't a bad thing at a time like this. I haven't had any significant debt for a long long long time. I think the rationality that I am talking about, if you work hard enough to get it – it won't save you from death of a child, but a lot of what

bothers other people can be avoided by a combination of character and rationality. What will help the most? It isn't an extra zero on portfolio. It is playing the game to the end with rationality.

Q: Why is Ishcar CEO so smart?

CM: The paper record is a better appraisal of talent and the achievements of this man, that they couldn't have been created by an ordinary human being. Add to that the man's obvious character and intelligence. We had to pay a fair price. We wanted to pay a fair price.

Q: Wondering if you could give us thoughts – Korea examples. When do decide to decide to exit? How do you or Warren think about it?

CM: I don't know, Warren's entitled to do things at age 76. I think he was more interested in finding an inefficient market than in making the money...

Q: Game of asset allocation. Flip charts of rosy pictures of long term asset returns. There is a garbage element to data when looking at 20<sup>th</sup> century data. How do you think of years of data?

CM: Pension funds that confidently predict 9% returns from this point are highly likely to be wrong. It is foolish accounting. It delays bad news or delivers good news too early. Berkshire looks like we know more about compounding money than they do, and we put 6.5% in our assumptions. Believe the best records. Or Demosthenes, who said 'the wish is the father of the thought'. What a man hopes, he will believe.

Q: How do you value the float at Berkshire Hathaway? Characteristics of equity, or discount it?

CM: We love having the float at Berkshire. If we didn't have it, it would be worth than it is. It will grow more slowly in future than the past. Not enough float around in world casualty market [for us to grow faster]. We think it will be big advantage. We don't think it is a model that will help with other investment opportunities.

Q: Aim to destroy best loved ideas. Can you comment on some of the best loved ideas you have destroyed?

CM: I had more scorn for fixed income arbitrage than I do now. It will cause more trouble, but there were real opportunities. I have destroyed some scorn. I was more hopeful about troubles in Middle East, and so I have destroyed some of my optimism. There is not a person in room who doesn't have a better idea of problems in Middle East today than before. We all are learning, and modifying or destroying ideas all the time. Rapid destruction of your ideas when time is right is one of most valuable qualities a human can acquire. You must force yourself to consider arguments on other side. If you

can't state arguments against what you believe better than your detractors, you don't know enough. You must be willing to destroy old ideas.

Q: Bubbles: median home price in California going for 10x income. Financial market spillover?

CM: Recent transaction for \$27m for 8000sqf condo in Time Warner building, though building does have chauffeurs' lounge. I see weird transactions in really good coastal property. It can't keep bubbling up much longer. When and how far it collapses, I don't know.

Q: Do you consider buying and managing a set of businesses a more noble pursuit than portfolio investment?

CM: Hell yes. Passive investing is too unengaged a life. Like poker players -- it pays bill but not a responsible life.

Q: Does it matter if you hold and resell?

CM: Colleagues and businesses keep changing? No one admires that with wives. Why must you constantly flip the relationships of your life? I don't consider flipping a good life. We may be serving our personal idiosyncrasies, but we are entitled.

Q: Foreign investments – aren't they more complicated?

CM: Of course it is more complicated. But you can discern durable competitive position in spite of differences of religion and so on. Dictator of Indonesia once commented on embezzlement: what looks like embezzlement looks like Asian family values to us.

Q: If we had been in control of US Air, we would have sold it. Sales of controlled businesses over years have been tiny and few.

CM: What advice do you have for young money managers. Where would you focus?

Q: Many come to learn here. Value rubric – get more value than you are paying for. Value can be in lots of different places. Patent, trademark, defensive position, or even a highly talented manager. You really want one that you don't have to resell. Sit on your ass for 30 years and pay way lower taxes. Can't make a living today on such a simple formula today. Need some mumbo-jumbo if you are going to be a witch doctor.

Q: Market cap of Berkshire is about \$130b. Israel has GDP of \$140b. After cherry-picking, do you plan to explore India?

CM: You have got to understand, these people picked us, all we did was say yes. Seeing marvelous judgment, it is what we want to be affiliated with.

Q: S&P dividend payout ratio, 30% now. One of lowest. Why?

CM: I wish I was 60-something like Bob (Bob keeps repeating hard-to-hear questions to CM). I don't have an opinion. It is probably within hailing distance of reasonable. That is all I have to say.

Q: Given your feelings on corporate governance, what about medical insurance company United Health – and backdating of stock options? Also, currency of oil is in USD, might it become Euros?

CM: Backdating stock options is embezzlement. If it happened it is criminal. If they did it, I assume they thought they were doing God's work. I bet there was no cognitive drift or that they thought anything wrong. Human mind can play such ghastly tricks. Oil. I love it, a very sophisticated crowd [and questions] here. At rate we are going, we can get fiscal deficit up to 8%, while Europeans sworn 3% though they are cheating. I am conservative. I would put 10% optional blank space on tax returns and publish name of those who didn't pay. I should have been in United Jewish Appeal. In long term, people will curse the way we used so much of it [oil] now.

Q: Allocation decision on intellectual capital of country into finance – what can we do to change or modify incentives?

CM: Incentives work best to change behavior, so you are asking right questions. Samsung's last meeting of engineers is at 11pm. Our engineers are working too at that time, pricing derivatives. It is crazy to drive all the most intelligent people into a gaming system. A rich civilization can afford a lot. We can afford a fair amount of waste and slush. But do we want our auto industry to crumble away and someone else's to take over because they do it better? I'm not sure we can stand this diversion of our best minds into hedge funds.

Q: I am an engineer, and I know that Samsung do have meetings late at night and that they also provide dormitories. In your lifetime, is this the most unusual economic time today? And what is biggest threat?

CM: All these things involve some threat vs. basic resilience of economy. I have not made my way in life by gambling on my macroeconomic predictions. We are guessing that the stuff we invest on will swim better, and we don't bet on the tides. There is enough that is a little crazy now. Not a time to put yourself in a position where you could have a disaster. Margin debt I would be a little goosey about. If we found a good business tomorrow, we would buy it. We've been doing it that way all along.

Q: You promised words of wisdom about Wesco. How do you divide your responsibility to Wesco and Berkshire?

CM: Yeah, it's complicated. You people are here because you like the value system, because you trust us, and subsequently you bid the price of Wesco higher than

liquidation. You can always sell stock for more than asset value of company. And I kind of like you all. It has its inefficiencies.

Q: Audited statements of foreign companies less accurate than local companies?

CM: We've been looking at financial statements for a long time. We get a good grip on a foreign statement sometimes. Would we be more confident in our own currency? Yes. Do we feel delinquent in foreign company? Sometimes, but not crucial.

Q: Lead paint an issue for Berkshire, insurance or Benjamin Moore?

CM: Lead paint case based on clean-up from paint 40-50 years ago. Berkshire has subsidiary. Benjamin Moore has tiny subsidiary. I would be amazed if anything significant came out of this.

Q: Wesco and Daily Journal?

CM: In Manhattan, land recently changed hand for \$800 for every saleable sq foot of condo. An incredible price for land. Prices have already crested in Florida. LA not quite crested. I'm not sure it is crazy. If you are offered a really wonderful house which after costs will pay 4.5%? Why not a reasonable investment for fund or family? I don't think it is crazy. It may be a world where prices are crazy. 3% yields in Europe. Strange things have happened.

Q: Mr. Buffet....

CM: My name is Munger.

Q: I'm from Singapore. There are many situations where I try to give managements copies of the essays of Warren Buffett. Is there a better way to change managements?

CM: We are trying to have some influence on others. Berkshire Hathaway is the ultimate didactic enterprise. In terms of changing other people, influence is tiny, esp. when incentives they are under are opposite. People write me to say they give copies of Poor Charlie's Almanack to their children. If that really worked, there would be a line out the door to Denver. In first 30 years we didn't get any sound thinking in corporate finance departments. At least they no longer believe 100% in flat earth in academia. What changes people's view are incentives. The directors will intervene against management when they look ghastly in the press. Excepting that, CEO can be an axe murderer and be regarded as highly competitive.

Q: Advice to average investor?

CM: There are lots of honorable investment managers. Judging expertise in field you are not an expert is hard to do. Have no one sentence formula for doing that. I prefer systems where they are eating their own cooking. If private partnership, partner must

have large portion of net worth in partnership. That is one flag. Other is high commission. If person selling it is getting high commission, I would pass. That is an iron rule. Then it takes a long time to recognize it.

We have to have a directors meeting.