Lessons

Of course everyone will have varied tastes in books, this is only natural. Investment professionals tend to be voracious readers, finishing books covering academic ideas, books written by thought leaders, historical reviews of major market events. The spectrum is diverse, as each looks for their own edge, a nuance, and idea, which can accentuate their understanding of both stocks and the markets. A very popular book of late is Outliers, written by Malcolm Gladwell. He espoused the idea that to become truly proficient at something, a practice of about ten-thousand hours was required to become truly expert. At fifty hours each week, a probable undershoot to be honest, that is only four years in the business of the markets required to be an expert. Ten-thousand hours in the investment business is where the journey to expertise begins, and it will involve even more reading.

But what if a master class was taught, by someone who operated openly and shared their secrets? What if that person had not merely ten-thousand hours, but fifty years of experience? What if they wrote a letter telling everyone how to be a better investor? That would be something well worth reading – and for these reasons and more, everyone in the investment industry does read this one missive each year. Warren Buffett writes a shareholder letter each year, published on the Berkshire Hathaway site on the fourth Saturday in February. Each year the letter is a must-read, and in his fiftieth year at the helm of Berkshire, his retrospective letter showed the octogenarian to be very much in form. A great deal of his wisdom comes across as humble folksiness, cutting through his 'aw shucks' and drilling down into what he says – and not how he says it – provides a wealth of information for novices and professionals alike.

A highlight each year is the table of long-term investments. And this year provides many compelling lessons, one centres around good news, one around bad. When offered the chance, take the good news first.

Berkshire owns some four-hundred million shares of the Coca-Cola Corporation, at a reported cost of $1.299 billion US, or just over three dollars a share. Coke trades for around thirteen times Berkshire's cost, and pays a dividend of 33 cents per quarter, giving Berkshire an effective dividend yield at cost in the area of forty percent. The good news keeps coming though, owning over fifty-two million shares of Proctor & Gamble at a cost of $336 million US; Proctor & Gamble at today's prices represents a fourteen-fold return on the original investment, and a dividend at cost of close to forty-eight percent. Where does this kind of performance come from? Both of these companies have brand awareness and massive distribution channels, and these can both be described as part of a competitive advantage known as a moat. There is almost no chance that a new competitor will rise up to challenge Coca-Cola, and if one were to appear on the horizon, the odds it would grow large enough to compete before being bought – by Coke – puts the chance of anyone other than Pepsi challenging for dominance at pretty much zero. What lessons are available in this table of stocks? Buy quality companies, and give them time to turn into big winners.

But we can also learn from what is not there. Tesco, the largest British grocery chain made this list of core holdings in the 2014 letter, but is absent in 2015. Berkshire had taken a position of $1.7 billion US in Tesco last year, down from its one-time investment of $2.3 billion – a total of 415 million shares. Buffett candidly admits his error, *"An attentive investor, I'm embarrassed to report, would have sold Tesco shares earlier. I made a big mistake with this investment by dawdling"*; in total the loss on Tesco was about 0.2% of Berkshire's net worth, costing around $444 million US. The loss represents a tax asset, Berkshire shareholders will be able to use this against a gain somewhere, but nobody takes losses in a cavalier fashion, a loss is a loss. When Buffett first soured on Tesco and trimmed the holding, he took a trivial – for Berkshire – profit, and he provided yet another lesson for investors. When your thesis is wrong, when the economics go back, when you first see a problem – let those all be the problem of the willing buyer in the marketplace. Sell companies that have gone bad long before their stock prices also go bad.

But the lessons are not exclusive to his most recent letter, each year new ones are taught, but many are reinforced year upon year. A particular favourite is the parable of the neighbour who shouts his house price daily, offering a potential purchaser an opportunity to buy at that price. The owner who shouts his house price gains nothing by constantly evaluating the cash value of their shelter, just as investors gain nothing by constantly checking their portfolio. The neighbour will one day shout an absurdly low price, and find himself bought out on the cheap. Worrying about the price of stocks in a portfolio serves no benefit other than expending time, and if you fret over short term actions in prices and resolve to sell on every downturn, you might find yourself without your stocks - and without very much money besides.

Buffett has taught us to be brave when others are scared. In the height of the financial crisis of 2008 and 2009, he acted as bank of last resort for several pillars of the American economy. When things looked very grim, he took five-billion dollar stakes in Goldman Sachs and Bank of America. Both stocks soared on the news; a famous investor can make his own fortune, and have done nothing but rise in the last six years. Buffett extracted very healthy terms for Berkshire, no doubt leaving CEOs worried about answering their phones and hearing "hi, Warren here" and wondering what price they might have to pay him to invest.

With all this success and adulation, is the simplest course to simply buy what Buffett has bought for Berkshire? This seems a perfectly reasonable proposition; it is somewhat fraught with peril though. Much of his success has happened, it is done and over with. Berkshire is unlikely to ever sell their Coca-Cola – and many other - holdings because of tax considerations. This does not guarantee that today, right now, a more compelling case could not be made for a competitor. As an example, Pepsi has a considerable empire built in India, which might represent better long-term growth prospects. This concerns Buffett less than it concerns a typical investor, as his view tends to be America-centric, America first. This tack of America only is ill-suited for the Canadian investor; the investment style should be embraced rather than the investment action.

Distilled, the style is strikingly simple. An investment Universe should be found using very simple criteria. Does it make money? Does it make money every single day? Does it name the price for its goods or services? Is it impossible for competitor set up shop quickly and cheaply and undercut the business? Would you be happy to own a piece of that business forever? If the answer to all of those questions is yes, then you may well have a suitable stock. Investing like Buffett offers the opportunity to get rich, slowly. Few investors will have the success in their lives that early Berkshire investors have had, those fortunate enough to have held for fifty years now have $1,826,163 for each dollar they started with. That record is enviable, and unlikely to be duplicated, but those likeliest to duplicate it are the ones who are prepared to listen and learn. Reading Buffett's shareholder letters takes nowhere near the ten-thousand hours required under Gladwell's test of expertise, but it will certainly make for better investors.

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