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THE WARREN BUFFETT WAY

THIRD EDITION

ROBERT G. HAGSTROM

INTRODUCTIONS BY KENNETH L. FISHER AND BILL MILLER

FOREWORD BY HOWARD MARKS

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Foreword: The Exception

What accounts for Warren Buffett's exceptional investment success? That's one of the questions I'm asked most often. It's also the question I want to explore in this foreword.

When I studied for my MBA at the University of Chicago in the late 1960s, I was exposed to a new theory of finance that had been developed, largely there, in the preceding few years. One of the most important components of the "Chicago School" of thought was the Efficient Market Hypothesis. According to that hypothesis, the combined efforts of millions of intelligent, motivated, objective, and informed investors cause information to immediately be reflected in market prices such that assets will provide a fair risk-adjusted return, no more and no less. Prices are never so low or so high that they can be taken advantage of, and thus no investors can be capable of consistently identifying opportunities to benefit. It's this hypothesis that gives rise to the Chicago School's best-known dictum: You can't beat the market.

The Efficient Market Hypothesis supplies the intellectual basis for that conclusion, and there are lots of empirical data showing that, despite all their efforts, most investors don't beat the market. That's a pretty strong case for the inability to outperform.

It's not that no investors beat the market. Every once in a while some do, and just as many underperform; market efficiency isn't so strong a force that it's impossible for individual investors' returns to deviate from the market's return. It's merely asserted that no one can do it to a sufficient degree and consistently enough to disprove the Efficient Market Hypothesis. There are outliers, as in most processes, but their superior returns are described as being based on randomness and thus ephemeral. When I grew up, there was a saying that "If you put enough chimpanzees in a room with typewriters, eventually one of them will write the Bible." That is, when randomness is present, just about anything can happen once in a while. However, as my mother used to say, "It's the exception that proves the rule." A general rule may not hold 100 percent, but the fact that exceptions are so rare attests to its basic truth. Every day, millions of investors, amateur and professional alike, prove you can't beat the market.

And then there's Warren Buffett.

Warren and a few other legendary investors—including Ben Graham, Peter Lynch, Stan Druckenmiller, George Soros, and Julian Robertson—have performance records that fly in the face of the Chicago School. In short, they've outperformed by a big enough margin, for long enough periods of time, with large enough amounts of money, that the advocates of market efficiency are forced onto the defensive. Their records show that exceptional investors can beat the market through skill, not chance.

Especially in Warren's case, it's hard to argue with the evidence. On his office wall, he displays a statement, typed by him, showing that he started The Buffett Partnership in 1956 with $105,000. Since then, he has attracted additional capital and earned returns on it such that Berkshire Hathaway now has investments totaling $143 billion and a net worth of $202 billion. He's kicked the hell out of the indices for many years. And in the process, he's become the second wealthiest man in America. This last achievement wasn't based on dynastic real estate assets or a unique technological invention, as with so many on Forbes's lists, but on applying hard work and skill in investment markets that are open to everyone.

What's responsible for Warren Buffett's singular accomplishments? In my view these are the keys:

- **He's super-smart.** One of the many *bon mots* attributed to Warren is the following: "If you have an IQ of 160, sell

30 points. You don't need them." As Malcolm Gladwell pointed out in the book *Outliers*, you don't have to be a genius to achieve great success, just smart enough. Beyond that, incremental intelligence doesn't necessarily add to your chances. In fact, there are people so smart that they can't get out of their own way, or can't find the path to success (and happiness) in the real world. A high IQ isn't enough to make someone a great investor; if it were, college professors would probably be the richest people in America. It's important to also to be business-oriented and have "savvy" or "street smarts."

I have a sneaking suspicion that Warren's IQ is well above 130 . . . *and* that he hasn't made any effort to dispose of those "non-essential" extra points. His ability to cut to the core of a question, to reach a well-founded conclusion, and to hold that conclusion even if things initially go against him are all key elements in who he is and what he's accomplished. In short, he's fiercely analytical.

He's also incredibly quick. It doesn't take him weeks or months to reach a conclusion. He also doesn't need a cadre of analysts pushing numbers. He doesn't feel the need to know and consider every data point: just the ones that matter. And he has a great sense for which they are.

- **He's guided by an overarching philosophy.** Many investors think they're smart enough to master anything, or at least they act that way. Further, they believe the world is constantly changing, and you have to be eclectic and change your approach to adapt, racing to stay up with the latest wonder. The trouble with this is that no one really can know everything, it's hard to constantly retool and learn new tricks, and this mindset prevents the development of specialized expertise and helpful shortcuts.

  Warren, on the other hand, knows what he doesn't know, sticks to what he does know, and leaves the rest for others. This is essential, since as Mark Twain said, "It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so." Warren only invests in industries he understands and feels comfortable with. He emphasizes fairly prosaic fields and avoids, for example, high tech companies. He famously passes on things that are outside his philosophy and ken. Importantly, he can live with the possibility that the things he passes on will make money for others and he'll be left looking on as they do. (Most people can't.)

- **He's mentally flexible.** The fact that it's important to have a guiding philosophy doesn't mean it's never good to change. It can be desirable to adapt to significantly changed circumstances. It's even possible to come across a better philosophy. The key lies in knowing when to change and when to hold fast.

  Early in his career, Warren adopted the approach of his great teacher, Ben Graham. It's called "deep value"—buying castoffs when they're being given away, especially when companies can be bought for less than their net cash. It has sometimes been derided as "picking up cigar butts." After a while, however, with urging from his partner, Charlie Munger, he switched to emphasizing high-quality companies with protective "moats" and pricing power, led by outstanding people, at reasonable (but not necessarily giveaway) prices.

  It was long an aspect of Warren's approach to eschew companies that were capital-intensive, but he was able to overcome that bias to buy the Burlington Northern Santa Fe railway and take advantage of its economic sensitivity coming out of the 2008 financial collapse, and the outlook for increasing rail carriage.

  A philosophy should supply guidance but not rigidity. This—like many other things in investing—is a tough dilemma to master. Warren doesn't shrink from the challenge, neither changing with every new fad nor letting his thinking get stuck in cement.

- **He's unemotional.** Many of the obstacles to investment success relate to human emotion; the main reason for the failure of the Efficient Market Hypothesis is that investors rarely satisfy the requirement of objectivity. Most become greedy, confident, and euphoric when prices are high, causing them to celebrate their winners and buy more rather than take profits. And they get depressed and fearful when prices are low, causing them to sell assets at bargain prices and invariably discouraging them from buying. And perhaps worst of all, they have a terrible tendency to judge how they're doing based on how others are doing, and to let envy of others' success force them to take additional risk for the simple reason that others are doing so. Envy is enough to make people follow the crowd, even into investments they know nothing about.

Warren appears absolutely immune to these emotional influences. He doesn't get overjoyed when things appreciate, or downcast when they don't, and for him success is clearly defined by himself, not the masses or the media. He doesn't care whether others think he's right, or whether his investment decisions promptly make him look right. (He was written off as "past his prime" early in 2000 because of his failure to participate in what turned out to be the tech bubble, but he never changed his spots.) He only cares what he (and Charlie Munger) thinks . . . and whether his shareholders make money.

- **He's contrarian and iconoclastic.** Whereas the typical investor thinks he should follow the herd, despite its susceptibility to the errors of emotion, the best investors behave in a contrarian fashion, diverging from the herd at the key moments. But it's not enough to do the opposite of what others are doing. You have to understand what they're doing; understand why it's wrong; know what to do instead; have the nerve to act in a contrary fashion (that is, to adopt and hold what Yale's David Swensen calls "uncomfortably idiosyncratic positions"); and be willing to look terribly wrong until the ship turns and you're proved right. That last element can feel like it's taking forever; as the old saying goes, "Being too far ahead of your time is indistinguishable from being wrong." Take it all together and it's clear that this isn't easy.

  It's obvious that Warren is highly capable of contrarian behavior. In fact, he revels in it. He once wrote me that he had seen high yield bonds when the market priced them like flowers and he had seen them when they were considered weeds. "I liked them better when they were weeds." The contrarian prefers to buy things when they're out of favor. Warren does it like no one else.

- **He's counter-cyclical.** Investing consists of dealing with the future, and yet many of the best investors accept that they can't predict what the macro future holds in terms of economic developments, interest rates and market fluctuations. If we can't excel at the thing that most people want to hang their hat on, what can we do? In my view, there are great gains to be had from behaving counter-cyclically.

  It's emotionally easy to invest when the economy is improving, companies are reporting higher earnings, asset prices are rising, and risk bearing is being rewarded. But buying appreciated assets doesn't hold the key to superior investment results. Rather, the greatest bargains are accessed by buying when the economy and companies are suffering: that's more likely to be the climate in which asset prices understate their merits. However, this, too, is not easy.

  Warren has repeatedly demonstrated his ability—in fact his preference—for investing at the bottom of the cycle, when optimism is in short supply. His investments of $5 billion each in 10 percent preferred stock of Goldman Sachs and General Electric at the depths of the 2008 financial crisis, and his purchase of economically sensitive Burlington Northern for $34 billion in 2009, are emblematic of this. The wisdom of these investments is obvious today in retrospect, but how many acted as boldly when fear of a financial collapse was rampant?

- **He has a long-term focus and is unconcerned with volatility.** Over my 45 years in the business, investors' time horizons have gotten shorter and shorter. This is likely the result of increased media attention to investment results (there was none in the 1960s), its contagion to investors and their clients, and the striving for yearly gains introduced by hedge funds' annual incentive fees. But as other people allow nonsensical biases to affect their thoughts and actions, we can profit from avoiding them. Thus, most investors' excessive concern with quarterly and annual results creates profit opportunities for those who think in terms of longer periods.

Warren has famously said that his "holding period is forever," and that he "prefers a lumpy 15 percent a year over a smooth 12 percent." This allows him to stick with great ideas for long periods of time, compounding his gains and allowing profits to build up untaxed, rather than turning over the portfolio every year and paying taxes at short-term rates. It also helps him avoid getting shaken out in times of volatility, and instead lets him take advantage of them. In fact, rather than insist on liquidity and take advantage of the ability to exit from investments, Warren's actions make clear that he is happy making investments he could never shed.

- **He's unafraid to bet big on his best ideas**. Diversification has long played a leading part in so-called prudent investment management. In short, it reduces the likelihood of large individual losses (and of being sued for having had too much in a losing position). But while it reduces the pain caused by losing investments, a high degree of diversification correspondingly reduces the potential gain from winners.

As in many things, Warren takes a divergent view of diversification: "The strategy we've adopted precludes our following standard diversification dogma. Many pundits would therefore say the strategy must be riskier than that employed by more conventional investors. We believe that a policy of portfolio concentration may well decrease risk if it raises, as it should, both the intensity with which an investor thinks about a business and the comfort-level he must feel with its economic characteristics before buying into it."

Warren understands that great ideas come along only on rare occasion, so he keeps the bar high, only invests in great ideas, and bets big when he sees one. Thus, he commits significantly to the companies and people he believes in;

he doesn't hold anything just because others do and he's worried it may perform well without his being represented; and he refuses to diversify into things he thinks less of just to mitigate the impact of errors— that is, to practice what he calls "de-worstification." It's obvious that all of these things are essential if you're to have a chance at great results. But that doesn't keep them from being the exception in portfolio management, not the rule.

- **He's willing to be inactive**. Too many investors act as if there's always something great to do. Or perhaps they think they have to give the impression that they're smart enough to always be able to find a brilliant investment. But great investment opportunities are exceptional . . . and by definition, that means they're not available every day.

  Warren is famously willing to be inactive for long periods of time, turning down deal after deal until the right one comes along. He's famous for his analogy to one of baseball's greatest hitters, Ted Williams, standing at the plate with his bat on his shoulder and waiting for the perfect pitch; it exemplifies his insistence on making investments only when they're compelling. Who would argue that the supply of good deals is steady, or that it's always an equally good time to invest?
- **Finally, he's not worried about losing his job.** Very few investors are able to take all the actions they think are right. Many are constrained in terms of their ability to buy assets that are illiquid, controversial or unseemly; sell appreciating assets that "everyone" is sure will go further; and concentrate their portfolios in their few best ideas. Why? Because they fear the consequences of being wrong.

  "Agents" who manage money for others worry that acting boldly will expose them to the risk of being fired by their employers or terminated by their clients. Thus, they moderate their actions, doing only that which is considered prudent and uncontroversial. That's the tendency that caused John Maynard Keynes to observe, "Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally." But that tendency

> introduces an important conundrum: if you're unwilling to take a position so bold that it can embarrass you if it fails, it's correspondingly impossible to take a position that can make a real difference if it works out well. Great investors are able to follow up their intellectual conclusions with action; in short, they dare to be great.
>
> Warren obviously doesn't have to worry about being let go by his employer. His position is as close to permanent as there is, as is his capital. There are no clients able to withdraw their capital, mandating the sale of assets at bargain prices as befalls the typical money manager during market crashes. This simple fact plays a significant part in any great investor's success, and I'm sure it's no coincidence that Warren set things up this way, transitioning from a hedge fund structure to Berkshire Hathaway's corporate form. He wouldn't have it any other way.

Of course, Warren Buffett shares many other attributes of outstanding investors. He's focused, disciplined, and purposeful; he's hard working; he's highly numerate and logical; he's a voracious collector of information, through both reading and networking with people he respects; and at this point, he invests because he enjoys solving the complex intellectual problem that it represents, not to gain fame or make money. Those latter things are the by-product of his efforts, but not his goal, I'm sure.

In theory, many others could have done what Warren Buffett did over the last 60 years. The attributes listed above are rare, but not unique. And each one makes compelling sense; who would take the other side of any of these propositions? It's just that few people are able to demonstrate all of them in action. It's the combination of all of them—and the addition of that intangible "something" that makes a special person special—that has enabled Warren to succeed so exceptionally by applying The Warren Buffett Way.

Howard Marks
July 2013

Foreword to the Second Edition

When Robert Hagstrom first published *The Warren Buffett Way* in 1994, it quickly became a phenomenon. To date [2004], more than 1.2 million copies have been sold. The book's popularity is a testimony to the accuracy of its analysis and the value of its advice.

Any time the subject is Warren Buffett, it is easy to become overwhelmed by the sheer size of the numbers. Whereas most investors think in terms of hundreds or perhaps thousands, Buffett moves in a world of millions and billions. But that does not mean he has nothing to teach us. Quite the opposite. If we look at what he does and has done, and are able to discern the underlying thinking, we can model our decisions on his.

That is the profound contribution of Robert's book. He closely studied Warren Buffett's actions, words, and decisions for a number of years, and then set about analyzing them for common threads. For this book, he distilled those common threads into 12 tenets, timeless principles that guide Buffett's investment philosophy through all circumstances and all markets. In just the same way, they can guide any investor.

The enduring value of Robert's work is due to this clear focus—although the book talks about investment techniques, it is fundamentally about investment principles. And principles do not change. I can almost hear Warren saying, with his wry smile, "That's why they call them principles."

The past 10 years have given us a vivid demonstration of that basic truth. In those 10 years, the trends of the stock market changed several times over. We witnessed a high-flying bubble that made many people rich, and then a steep crash into a protracted, painful bear market before the market finally hit bottom in the spring of 2003 and started to turn back up.

All along the way, Warren Buffett's investment approach never changed. He has continued to follow the same principles outlined in this book:

- Think of buying stocks as buying fractional interests in whole businesses.
- Construct a focused, low-turnover portfolio.
- Invest in only what you can understand and analyze.
- Demand a margin of safety between the purchase price and the company's long-term value.

Berkshire Hathaway investors, as usual, reap the benefits of that steady approach. Since the recovery began in 2003, Berkshire Hathaway stock is up about $20,000 per share, more than 30 percent, far surpassing the returns of the overall market over the comparable period.

There is a chain of thinking for value investors that begins with Benjamin Graham, through Warren Buffett and his contemporaries, to the next generation of practitioners such as Robert Hagstrom. Buffett, Graham's best-known disciple, frequently advises investors to study Graham's book *The Intelligent Investor*. I often make the same recommendation myself. And I am convinced that Robert's work shares with that classic book one critical quality: The advice may not make you rich, but it is highly unlikely to make you poor. If understood and intelligently implemented, the techniques and principles presented here should make you a better investor.

Bill Miller
Chairman and Chief Investment Officer, LMM, LLC
October 2004

Foreword to the First Edition

One weekday evening early in 1989, I was home when the telephone rang. Our middle daughter, Annie, then 11, was first to the phone. She told me that Warren Buffett was calling. I was convinced this had to be a prank. The caller started by saying, "This is Warren Buffett from Omaha [as if I might confuse him with some other Warren Buffett]. I just finished your book, I loved it, and I would like to quote one of your sentences in the Berkshire annual report. I have always wanted to do a book, but I never have gotten around to it." He spoke very rapidly with lots of enthusiasm and must have said 40 words in 15 or 20 seconds, including a couple of laughs and chuckles. I instantly agreed to his request and I think we talked for five or ten minutes. I remember he closed by saying, "If you ever visit Omaha and don't come by and see me, your name will be mud in Nebraska."

Clearly not wanting my name to be mud in Nebraska, I took him up on his offer about six months later. Warren Buffett gave me a personal tour of every square foot of the office (which did not take long, as the whole operation could fit inside less than half of a tennis court), and I said hello to all 11 employees. There was not a computer or a stock quotation machine to be found.

After about an hour we went to a local restaurant where I followed his lead and had a terrific steak and my first Cherry Coke in 30 years. We talked about jobs we had as children, baseball, and bridge, and exchanged stories about companies in which we had held investments in the past. Warren discussed or answered questions about each stock and operation that Berkshire (he never called his company Berkshire Hathaway) owned.

Why has Warren Buffett been the best investor in history? What is he like as an individual, a shareholder, a manager, and an owner of entire companies? What is so unique about the Berkshire Hathaway annual report, why does he donate so much effort to it, and what can someone learn from it? To attempt to answer those questions, I talked with him directly, and reread the last five annual reports and his earliest reports as chairman (the 1971 and 1972 reports each had only two pages of text). In addition, I had discussions with nine individuals who have been actively involved with Warren Buffett in varied relationships and from different viewpoints during the past four to over 30 years: Jack Byrne, Robert Denham, Don Keough, Carol Loomis, Tom Murphy, Charlie Munger, Carl Reichardt, Frank Rooney, and Seth Schofield.

In terms of his personal qualities, the responses were quite consistent. Warren Buffett is, first of all, very content. He loves everything he does, dealing with people and reading mass quantities of annual and quarterly reports and numerous newspapers and periodicals. As an investor he has discipline, patience, flexibility, courage, confidence, and decisiveness. He is always searching for investments where risk is eliminated or minimized. In addition, he is very adept at probability and as an oddsmaker. I believe this ability comes from an inherent love of simple math computations, his devotion and active participation in the game of bridge, and his long experience in underwriting and accepting high levels of risk in insurance and in reinsurance. He is willing to take risks where the odds of total loss are low and upside rewards are substantial. He lists his failures and mistakes and does not apologize. He enjoys kidding himself and compliments his associates in objective terms.

Warren Buffett is a great student of business and a wonderful listener, and able to determine the key elements of a company or a complex issue with high speed and precision. He can make a decision not to invest in something in as little as two minutes and conclude that it is time to make a major purchase in just a few days of research. He is always prepared, for as he has said in an annual report, "Noah did not start building the Ark when it was raining."

As a manager he almost never calls a division head or the chief executive of a company but is delighted at any time of the day or night for them to call him to report something or to seek counsel. After investing in a stock or purchasing an entire operation, he becomes a cheerleader and sounding board: "At Berkshire we don't tell .400 hitters how to swing," using an analogy to baseball management.

Two examples of Warren Buffett's willingness to learn and adapt himself are public speaking and computer usage. In the 1950s Warren invested $100 in a Dale Carnegie course "not to prevent my knees from knocking when public speaking but to do public speaking while my knees are knocking." At the Berkshire annual meeting in front of more than 2,000 people, Warren Buffett sits on a stage with Charlie Munger, and, without notes, lectures and responds to questions in a fashion that would please Will Rogers, Ben Graham, King Solomon, Phil Fisher, David Letterman, and Billy Crystal. To be able to play more bridge, early in 1994 Warren learned how to use a computer so he could join a network where you can play with other individuals from their locations all over the country. Perhaps in the near future he will begin to use some of the hundreds of data retrieval and information services on companies that are available on computers today for investment research.

Warren Buffett stresses that the critical investment factor is determining the intrinsic value of a business and paying a fair or bargain price. He doesn't care what the general stock market has done recently or will do in the future. He purchased over $1 billion of Coca-Cola in 1988 and 1989 after the stock had risen over fivefold the prior six years and over five-hundredfold the previous 60 years. He made four times his money in three years and plans to make a lot more the next five, 10, and 20 years with Coke. In 1976 he purchased a very major position in GEICO when the stock had declined from $61 to $2 and the general perception was that the stock was definitely going to zero.

How can the average investor employ Warren Buffett's methods? Warren Buffett never invests in businesses he cannot understand or that are outside his "circle of competence." All investors can, over time, obtain and intensify their circle of competence in an industry where they are professionally involved or in some sector of business they enjoy researching. One does not have to be correct very many times in a lifetime, as Warren states that 12 investment decisions in his 40-year career have made all the difference.

Risk can be reduced greatly by concentrating on only a few holdings if it forces investors to be more careful and thorough in their research. Normally more than 75 percent of Berkshire's common stock holdings are represented by only five different securities. One of the principles demonstrated clearly several times in this book is to buy great businesses when they are having a temporary problem or when the stock market declines and creates bargain prices for outstanding franchises. Stop trying to predict the direction of the stock market, the economy, interest rates, or elections, and stop wasting money on individuals who do this for a living. Study the facts and the financial condition, value the company's future outlook, and purchase when everything is in your favor. Many people invest in a way similar to playing poker all night without ever looking at their cards.

Very few investors would have had the knowledge and courage to purchase GEICO at $2 or Wells Fargo or General Dynamics when they were depressed, as there were numerous learned people saying those companies were in substantial trouble. However, Warren Buffett also purchased stock of Capital Cities/ABC, Gillette, Washington Post, Affiliated Publications, Freddie Mac, or Coca-Cola (which have produced over $6 billion of profits for Berkshire Hathaway, or 60 percent of the $10 billion of shareholders' equity); these were all well-run companies with strong histories of profitability, and were dominant business franchises.

In addition to his own shareholders, Warren Buffett uses the Berkshire annual report to help the general public become better investors. On both sides of his family he is descended from newspaper editors, and his Aunt Alice was a public school teacher for more than 30 years. Warren Buffett enjoys both teaching and writing about business in general and investing in particular. He taught on a volunteer basis when he was 21 at the University of Nebraska in Omaha. In 1955, when he was working in New York City, he taught an adult education course on the stock market at Scarsdale High School. For 10 years in the late 1960s and 1970s he gave a free lecture course at Creighton University. In 1977 he served on a committee headed by Al Sommer, Jr., to advise the Securities and Exchange Commission on corporate disclosure. After that involvement, the scale of the Berkshire annual report changed dramatically with the 1977 report written in late 1977 and early 1978. The format became more similar to the partnership reports he had produced from 1956 to 1969.

Since the early 1980s, the Berkshire annual reports have informed shareholders of the performance of the holdings of the company and new investments, have updated the status of the insurance and the reinsurance industry, and (since 1982) have listed acquisition criteria about businesses Berkshire would like to purchase. The report is generously laced with examples, analogies, stories, and metaphors containing the dos and don'ts of proper investing in stocks.

Warren Buffett has established a high standard for the future performance of Berkshire by setting an objective of growing intrinsic value by 15 percent a year over the long term, something few people, and no one from 1956 to 1993 besides himself, have ever done. He has stated it will be a difficult standard to maintain due to the much larger size of the company, but there are always opportunities around and Berkshire keeps lots of cash ready to invest and it grows every year. His confidence is somewhat underlined by the final nine words of the June 1993 annual report on page 60: "Berkshire has not declared a cash dividend since 1967."

Warren Buffett has stated that he has always wanted to write a book on investing. Hopefully that will happen someday. However, until that event, his annual reports are filling that function in a fashion somewhat similar to the nineteenth-century authors who wrote in serial form: Edgar Allan Poe, William Makepeace Thackeray, and Charles Dickens. The Berkshire Hathaway annual reports from 1977 through 1993 are 17 chapters of that book. And also in the interim we now have *The Warren Buffett Way*, in which

Robert Hagstrom outlines Buffett's career and presents examples of how his investment technique and methods evolved as well as the important individuals in that process. The book also details the key investment decisions that produced Buffett's unmatched record of performance. Finally, it contains the thinking and the philosophy of an investor who has consistently made money using the tools available to every citizen no matter one's level of wealth.

Peter S. Lynch
October 1994

Introduction

My father, Philip A. Fisher, looked with great pride on Warren Buffett's adoption of some of his views and on their long and friendly relationship. If my father had been alive to write this introduction, he would have jumped at the chance to share some of the good feelings he experienced over the decades from his acquaintance with one of the very few men whose investment star burned so brightly as to make his dim by comparison. My father genuinely liked Warren Buffett and was honored that Buffett embraced some of his ideas. My father died at 96—exactly three months before I received an unexpected letter asking if I would write about my father and Warren Buffett. This introduction has helped me to connect some dots and provide some closure regarding my father and Mr. Buffett. For readers of *The Warren Buffett Way*, I hope I can provide a very personal look into an important piece of investment history and some thoughts on how to best use this wonderful book.

There is little I will say about Mr. Buffett since that is the subject of this book and Robert Hagstrom covers that ground with grace and insight. It's well known that my father was an important influence on Warren Buffett and, as Mr. Hagstrom writes, my father's influence figured more prominently in Buffett's thinking in recent years. For his part, as my father became acquainted with Warren Buffett, he grew to admire qualities in him that he felt were essential to investing success but are rare among investment managers.

When Warren Buffett visited my father 40 years ago, in a world with relatively primitive information tools by today's standards, my father had his own ways of gathering information. He slowly built a circle of acquaintances over the decades—investment professionals he respected and who knew him well enough to understand what he was and wasn't interested in, and who might share good ideas with him. Toward that end, he concluded that he would meet any young investment professional once. If he was impressed, he might see that person again and build a relationship. He rarely saw anyone twice. Very high standards! In his mind, if you didn't get an "A," you got an "F." And once he had judged against someone, he simply excluded that person, forever. One shot at building a relationship. Time was scarce.

Warren Buffett as a young man was among the very, very few who impressed my father sufficiently in his first meeting to merit a second meeting and many more meetings after that. My father was a shrewd judge of character and skill. Unusually so! He based his career on judging people. It was one of his best qualities and a major reason why he put so much emphasis on qualitative judgment of business management in his stock analysis. He was always very proud he had picked Warren Buffett as an "A" before Buffett had won his much-deserved fame and acclaim.

The relationship between Warren Buffett and my father survived my father's occasional lapses when he would mistakenly call Mr. Buffett "Howard" (Warren's father's name). This is an unusual story that has never been told and perhaps says much about both my father and Warren Buffett.

My father was a small man with a big mind that raced intensely. While kindly, he was nervous, often agitated, and personally insecure. He was also very, very much a creature of habit. He followed daily catechisms rigorously because they made him more secure. And he loved to sleep, because when he slept, he wasn't nervous or insecure. So when he couldn't stop his mind from racing at night, which was often, he played memory games instead of counting sheep. One sleep game he played was memorizing the names and districts of all the members of Congress until he drifted off.

Starting in 1942, he memorized the name of Howard Buffett and associated it with Omaha, over and over again, night after night, for more than a decade. His brain mechanically linked the words "Omaha," "Buffett," and "Howard" as a related series long before he met Warren Buffett. Later, as Warren's career began to build and his star rose, it was still fully two decades before my father could fully disentangle Buffett and Omaha from "Howard." That annoyed my father because he couldn't control his mind and because he was fond of Warren Buffett and valued their relationship. Father knew exactly who Warren Buffett was, but in casual conversation he often said something like "That bright young Howard Buffett from Omaha." The more he said it, the harder it became to eliminate it from his phraseology. A man of habit habitually vexed.

Early one morning when they were to meet, my father was intent on sorting out "Howard" from "Warren." Still, at one point in the conversation, my father referred to Warren as "Howard." If Warren noticed, he gave no sign and certainly did not correct my father. This occurred sporadically throughout the 1970s. By the 1980s, my father finally had purged the word "Howard" from any sentence referencing Buffett. He was actually proud when he left "Howard" behind for good. Years later, I asked him if he ever explained this to Warren. He said he hadn't because it embarrassed him so much.

Their relationship survived because it was built on much stronger stuff. I think one of the kernels of their relationship was their shared philosophy in associating with people of integrity and skill. When Mr. Buffett says in regard to overseeing Berkshire Hathaway managers, "We don't tell .400 hitters how to swing," that is almost straight from Phil Fisher's playbook. Associate with the best, don't be wrong about that, and then don't tell them what to do.

Over the years, my father was very impressed with how Mr. Buffett evolved as an investor without compromising any of his core principles. Every decade, Mr. Buffett has done things no one would have predicted from reading about his past, and done them well. Within professional investing, most people learn in craft-like form some particular style of investing and then never change. They buy low price-earnings (P/E) stocks or leading tech names or whatever. They build that craft and then never change, or change only marginally. In contrast, Warren Buffett consistently took new approaches, decade after decade—so that it was impossible to predict what he might do next. You could not have predicted his 1970s franchise orientation from his original strict value bent. You could not have predicted his 1980s consumer products orientation at above-market average P/Es from his previous approaches. His ability to change—and to do it successfully—could be a book unto itself. When most people attempt to evolve as he has, they fail. Mr. Buffett didn't fail, my father believed, because he never lost sight of who he was. He always remained true to himself.

My father was never physically far for very long from Rudyard Kipling's famous poem, "If." In his desk, by his nightstand, in his den—always close. He read it over and over and quoted it often to me. I keep it by my desk as part of keeping him close to me. Being insecure but undaunted, he would tell you in Kipling-like fashion to be very serious about your career and your investments, but do not take yourself too seriously. He would urge you to contemplate others' criticisms of you, but never consider them your judge. He would urge you to challenge yourself, but not judge yourself too extremely either way and, when in your eyes you've failed, force yourself to try again. And he would urge you to do the next thing, yet unfathomed.

It is that part about Mr. Buffett, his knack for evolving consistently with his values and past—doing the next thing unfathomed—that my father most admired. Moving forward unfettered by the past restraints, utterance, convention, or pride. Buffett, to my father's way of thinking, embodied some of the qualities immortalized by Kipling.

Unfortunately, there will always be a small percentage of society, but a large absolute number, of small-minded envious miscreants who can't create a life of their own. Instead they love to throw mud. The purpose of life for these misguided souls is to attempt to create pain where they can't otherwise create gain. By the time a successful career concludes, mud will have been thrown at almost everyone of any accomplishment. And if any can stick, it will. My insecure father always expected mud to be thrown at everyone, himself included, but for those he admired, he hoped it would not stick. And when mud was thrown, he would expect