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The 2020 Berkshire Hathaway Annual Meeting
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The Berkshire Hathaway annual meeting was far from usual. Warren Buffett and Vice Chairman, Greg Abel answered questions from investors via live stream on Yahoo! Finance. Charlie Munger, the 96-year old Vice Chairman stayed home in California. Instead of the normal bustling of 20,000+ people, the auditorium was empty and dark. One upshot – Austin and Patrick from our office were glad they didn't have to stand in line to save seats at 5am this year! As usual, this summary is Berkshire's/Buffett's thoughts and views and I try to keep my two cents out of it.

Buffett opened with a classic history lesson on America. He estimated real (after inflation) wealth has increased 5,000 to 1 in American since 1790. His consistent "Don't ever bet against America" from the last fifty years was repeated. He said if you had the choice of being born at any time in history and anywhere in the world, he bets most people would select America and today. He believes America is a better place to live now than any time in history – although he mentioned we still have much to improve. He continues to believe investing in US equities is a very solid long-term investment plan, but he noted US equities were flat from the day he was born in 1930 until 1954, so one needs to maintain a long-time horizon!

I will break down the summary into a few categories of questions/answers from Saturday.

1. Covid-19
2. Investment-Related
3. Stock Performance/Capital Allocation
4. Succession
5. Insurance
6. Interest Rates
7. Miscellaneous
8. Capitalism

1. **<u>Covid-19:</u>** As you'd expect, a material amount of time was spent discussing the current pandemic wreaking havoc around the world. Buffett mentioned in his opening remarks, "The medical ranges of possibilities have been reduced, while the economic possibilities are wide." He is concerned with how people and the economy will react to the virus if it dies off in the summer and comes back in the fall/winter. Buffett was born in 1930 during the Great Depression and his parents lived through the Spanish Flu pandemic in 1918. He discussed how during the Great Depression over 4,000 banks in America failed – meaning depositors lost their savings. One can imagine losing your investment savings, cash savings, and job at the same time certainly extended the depth and length of the Great Depression. Comparing to the current pandemic where the FDIC insures banks, the Fed is ensuring the flow of credit continues, and the government is sending money to individuals and businesses. Buffett isn't predicting a Great Depression outcome given the support.

2. **Investment-Related:** Buffett usually does not discuss non-public investment information and rarely comments on individual stocks, but he made a few exceptions given the current environment.
    a. Cash: surprising to many, Berkshire was actually a net-seller of stocks year-to-date through April. Berkshire now has about $140 billion in cash, yet when asked why they haven't deployed any, Buffett said, **"We haven't really found anything attractive to invest in."** Now remember, moving around tens of billions of dollars quickly is impossible, so Berkshire does need time to deploy capital. But Buffett also mentioned they were starting to get calls from potential investees before the Fed acted on March 23rd to unfreeze credit markets and add liquidity. Buffett also added there has been competition for investments which Berkshire could not get comfortable with the terms. "And then there are some pretty marginal companies that have also had access to money. So there is no shortage of funds at rates which we would not invest at." You could also piece together Buffett seemed surprised by how quickly everything snapped back (at least from a credit and equity market standpoint). Outside of the last two weeks of March, the opportunity to put significant amounts of capital to work at low prices has been limited.
    b. Airlines: Buffett disclosed for the first time **Berkshire sold all its airlines holdings in April** (owned American Airlines, Delta Airlines, Southwest Airlines, and United Airlines). He said, "The future of the industry became too difficult to predict." He wasn't disappointed with the original thesis of "invest $8 billion at 8x growing cash flow." No one is better than Buffett at being able to sell and move on. The pandemic was an unlucky event – it doesn't mean it was a mistake to buy the airlines, it was just bad luck and Buffett's ability to see that, take his loss and move on is what separates him from most. Buffett also noted Berkshire's Precision Castparts, an aviation supplier, is feeling the pain from the global airline shutdown. Buffett said, "We have too many planes (seats) and we all know what happens to price when a commodity is oversupplied." He expects fewer new planes to be delivered in the future with a domino effect on the aviation industry.
    c. Energy/Oil: Berkshire helped Occidental Petroleum (OXY) make an acquisition last year in exchange for a $10 billion preferred stock investment with warrants to purchase OXY common shares. No one predicted the oil market to collapse. Buffett quipped, **"When you make an investment in an energy company the price of oil matters, a lot and no one is making money at today's prices, which will result in lower production."** Buffett and others in the past have also noted the cure for lower oil prices is lower oil prices (lower production).
    d. Banks: a question was asked about the condition/risk in the banking system. Buffett said the banks were one of the causes to the '08-'09 recession, but are in much better shape today and "he doesn't see a lot that bothers him today, but in a worst-case scenario the banks get hurt." Berkshire owns

shares in many of the largest banks, including Wells Fargo, JP Morgan, Bank of America, Bank of NY Mellon, Goldman Sachs, US Bank, and others.

e. Real Estate: Buffett said he expects to see Covid-19 related impacts on the retail and office real estate markets. He expects employers to use less office space and less retailers surviving.
f. Stocks in General: Buffett said just because stocks are quoted every second doesn't mean you need to have an opinion every second. If you own a business you like, you shouldn't be concerned with the ups and downs of the stock price, just like someone who owns a farm doesn't go out and get an appraisal or a quote every day. The marketability and liquidity of stocks is a huge advantage most people turn into a huge disadvantage.
g. Buybacks: some expected Berkshire to buyback significant stock in Q1 given the decline in stock price, but Berkshire purchased only $1.7 billion worth of shares (.33% of total shares), equivalent to Q1 2019. Buffett said he thinks like John Maynard Keynes, "When the facts change, I change my mind." Buffett was referring to the Covid-19 pandemic and the ensuing economic damage. He said although the stock price was down, the value he ascribes to the shares was down proportionately leaving his appetite to buyback shares equivalent to pre-Covid-19. Buffett was also asked if the buyback behavior was immoral/equivalent. He said buybacks are a form of capital return, just like dividends. They should be made with excess profits, assuming a.) a strong balance sheet, b.) after adequate growth capital is retained, and c.) IF the stock price offers a compelling investment for current shareholders. He will continue to buyback stock when advantageous. As usual, he mentioned most corporations fail to pass the third test (c above) when considering buybacks.

3. **Stock Performance/Capital Allocation:**
   a. Berkshire's stock hasn't kept up with the market over the previous five-, ten-, and fifteen-year periods. Buffett acknowledged the frustration with investors on underperforming the S&P 500. He said, "I can't guarantee Berkshire will beat the S&P 500 over the next decade and I wouldn't bet my life on it." Greg Abel chimed in and said he thinks Berkshire will outperform again, but time will tell. I wanted to share an article from the *Wall Street Journal* titled "What's Wrong, Warren?" authored in 1999. The article highlights some questions surrounding Berkshire and Buffett at the time, such as his lack of ownership in technology stocks, succession, and the acquisition of General Re (which turned out to be one the best deals Berkshire has made). Since the article publish date Berkshire's total return has been 408% compared to the S&P 500 return of 192%. [PDF LINK]
   b. A question on keeping Berkshire in its current form (conglomerate): Buffett is always asked the question; does it still make sense to keep all the disparate businesses housed under one roof? His answer was the same: Yes. He mentioned the tax costs to unbundle everything, the economies of scale and capital advantages in energy and insurance, and the tax-free capital allocation of moving profits from one business to another without having to pay taxes.
   c. Capital Allocation: Buffett believes Berkshire will get better at capital allocation after he and Charlie are gone, given Greg, Ajit, Ted and Todd are better positioned to make decisions.

4. **Succession:** Although some investors want more, a lot of visibility around succession planning has emerged. Greg Abel is clearly the heir apparent to become CEO of Berkshire after Buffett is gone. Ajit Jain will manage insurance operations and Todd Combs and Ted Weschler will run the investment portfolio. Greg sat next to Buffett on stage and answered some questions and it was nice to hear more from him. We're satisfied with the plan and think Berkshire continues in its current form, post Buffett.

5. **Insurance:** An area that we've been keenly focused on is insurance risk during the pandemic. Many businesses buy commercial insurance policies that cover damages or business interruptions related to physical damage (storms, fires, etc.). A few states (i.e. New Jersey) have decided insurance policies covering business interruption risks should cover Covid-19, even though many policies specifically carve-out pandemics. The position of the participating states, although unconstitutional and wrong, is getting a lot of attention from attorneys that see trillions of dollars of losses and big paydays. Berkshire owns large insurance and reinsurance operations, so investors were eager to understand the potential liability. Buffett believes there will be a lot of litigation and attorney fees, but doesn't foresee a large liability for Berkshire given its limited exposure. Buffett said Berkshire would have definitely written pandemic insurance if the risk/reward was adequate, although he quipped, "We would've been wrong!"

6. **Interest Rates:** Given the Fed's unprecedented policies to combat the virus, Buffett was asked about rates and monetary policy multiple times.
    a. Buffett said the current policies, including unlimited quantitative easing (bond buying), including buying US treasurys, corporate and municipal bonds and keeping rates low could have adverse effects long-term. He also said doing nothing would have adverse effects.
    b. Inflation: Buffett thinks Berkshire's portfolio of businesses is positioned well for inflation.

7. **Miscellaneous**
    a. Tax: Buffett seemed to infer he expected higher corporate tax rates the next time democrats controlled the presidency and both chambers.
    b. Capital Intensive Businesses: Buffett said, "Of course we'd prefer to own lots of businesses that require no capital, but grow rapidly!" Instead, Berkshire owns many businesses that are growing, but require lots of capital: utilities/energy and railroads. He said the insurance business actually benefits from all the retained capital and requires very little new capital.
    c. Buffett mentioned his mentor Ben Graham was one of the three smartest people he's ever met. When asked to name the other two Buffett declined but added, "I've known some really smart people. Smartness does not necessarily equate to wisdom either... But it's interesting that IQ does not always translate into rationality and behavioral success or wisdom."

8. **Capitalism:** Buffett said "Capitalism works wonders but is brutal if left to itself." He doesn't think we'd have the country we have today without it, but it needs government assistance because it creates lots of opportunities, but also destroys entire sectors of the economy.