

LOCAL FIRM, NATIONAL PROMINENCE

Issue #7 • Volume 13

**The Monthly E-Newsletter**

**Kimberly Foss, CFP®, CPWA®**

PRESIDENT

Empyion Wealth Management

July 4, 2017



## **More Investment Wisdom from the "Sage of Omaha"**

Over the past several years, the annual letter to shareholders from Warren Buffett, chairman of Berkshire Hathaway, has become one of the most eagerly anticipated communications in the financial world. And with good reason: the man who is variously called "Wizard," "Sage," and "Oracle" has a track record in investment and finance that is the envy of just about everyone. Noted for his humility, wit, and, above all, his keen financial insight, Buffett dispenses in his letter to Berkshire Hathaway shareholders not just the financial results for the year, but also his unique blend of financial philosophy and self-deprecating humor, along with more than a few pieces of advice with benefits and implications that reach far beyond the annual shareholders' meeting of the organization he leads.

In his February 2017 letter, Buffett recaps his now-famous, ten-year "Long Bet" with a hedge

fund manager. In the 2005 annual report to Berkshire shareholders, Buffett made the argument that active investment management by professionals would, in the aggregate, underperform the returns achieved by those—even amateur investors—who purchased a selection of stocks and simply held them for an extended period of time (in this case, the ten years of his bet). He relates in this year's letter, "I explained that the massive fees levied by a variety of 'helpers' would leave their clients—*again, in aggregate*—worse off than if the amateurs simply invested in an unmanaged, low-cost index fund."

Why does Buffett hold such a view? His reasons are illuminated by a number of comments in his 2017 letter:

America's economic achievements have led to staggering profits for stockholders. During the 20th century, the Dow-Jones Industrials advanced from 66 to 11,497, a 17,320% capital gain that was materially boosted by steadily increasing dividends. The trend continues: By year-end 2016, the index had advanced an additional 72% to 19,763.

American business—and consequently, a basket of stocks—is virtually certain to be worth far more in the years ahead. Ever-present naysayers may prosper by marketing their gloomy forecasts. But heaven help them if they act on the nonsense they peddle.

Here is the premise of Buffett's bet: "Over a ten-year period commencing on January 1, 2008, and ending on December 31, 2017, the S&P 500 will outperform a portfolio of funds of hedge funds, when performance is measured on a basis net of fees, costs, and expenses." What Buffett proposed—and backed with a wager of \$500,000 of his own money—is that over time and net of all fees and expenses, passive investors who buy and hold a low-cost fund indexed to the S&P 500 will see the value of their investments exceed the results of high-priced, actively managed hedge funds.

The timing of Buffett's statement is interesting; the S&P 500 started January 2008, at a level of 1,378.76—the Dow was then at 12,800. As you may recall, 2008 went on to become a rather eventful year in the financial markets. In March, the Federal Reserve took an unprecedented action to prop up the venerable investment bank, Bear Stearns, due to that firm's exposure to toxic mortgage-backed securities and other collateralized debt obligations. In September, Lehman Brothers' bankruptcy triggered a global recession. Also in September, the Fed took yet another unprecedented step, buying \$100 billion in preferred stock and mortgage-backed securities and, in the process, assuming ownership—on behalf of the US Government—of Freddie Mac and Fannie Mae. That same month, the Fed effectively assumed ownership of insurance giant AIG. By the end of the year, the S&P was at 907, and the Dow Jones Industrial Average (DJIA) was at 8,817.

So, you may ask, how is Mr. Buffett's wager looking these days?, As mentioned above, the stock markets were at a low point at the end of 2016, with the Dow at 19,763 and the S&P at 2,275. As this is written, the Dow is at 21,375, and the S&P stands at 2,433. This means that at the end of 2016, Buffett's low-cost S&P index fund showed an increase of 85.4 percent from January 1, 2008 to December 31, 2016. And the hedge fund alternative? Its gain during the same period, net of expenses and fees, was 22.04 percent. While it is not impossible that the active managers will catch up and pass the performance of the index by the end of 2017, their statistics for the last nine years, five months, and two weeks (at this writing) indicate that the odds are overwhelmingly against such an event.

What should the average investor take away from this? Perhaps several concepts, not the least of which is that efficient markets are, over the long term, the investor's friend. Certainly, there will continue to be drops in the markets, some of them heart-stopping. And yet, over time, the collective effect of millions upon millions of individual investment decisions will, almost invariably, re-assert the underlying value of the well-run, visionary, innovative enterprises that make up the capital markets.

Buffett comments on the inevitable downturns and market panics, putting into perspective their effect and outcome for the individual investor:

During such scary periods, you should never forget two things: First, widespread fear is your *friend* as an investor, because it serves up bargain purchases. Second, *personal* fear is your enemy. It will also be unwarranted. Investors who avoid high and unnecessary costs and simply sit for an extended period with a collection of large, conservatively financed American businesses will almost certainly do well [italics in the original].

The "Sage of Omaha" provides wise counsel. Investors—whether those saving for retirement, planning ahead for college costs, or providing for other future needs—should always keep in mind that market fluctuations, even drastic ones, have always proven to be temporary. Moreover, the upside recovery, however gradual, has always exceeded the downturns, however steep or sudden. Those who avoid the high-priced prognostications of prophets-for-hire, and who exercise prudent diversification and patience, are consistently rewarded. Those, on the other hand, who chase the costly promises of the paid "helpers," as Buffett calls them, will almost always find their results disappointing by comparison.

***Stay Diversified, Stay the Course!***

A handwritten signature in black ink, appearing to read "Timothy". The signature is written in a cursive, flowing style with a large initial letter.

Kimberly Foss, CFP®®, CPWA®®  
Empyion Wealth Management, Inc.  
[www.empyionwealth.com](http://www.empyionwealth.com)  
(916) 786-7626  
(800) 787-7634

---

For more information on Empyion Wealth Management, visit [www.empyionwealth.com](http://www.empyionwealth.com).

To learn more about Kimberly Foss, visit [www.kimberlyfoss.com](http://www.kimberlyfoss.com).