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WEALTH MANAGEMENT

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Monthly Insight

Lessons from the Oracle of Omaha: Warren Buffett's 2021 Letter to Shareholders

One of the most-anticipated events in the financial world is Warren Buffett's annual letter to the shareholders of Berkshire Hathaway, Inc., the $577 billion conglomerate that he serves as chairman of the board. Each year, Buffett's words are parsed by thousands, if not millions of investors, analysts, and others, not only for hints about the future direction of the company, but also for indications of Buffett's thinking about investment, the markets, and the economy.

In his candid, no-frills style, Buffett almost always provides some nuggets of wisdom that enter the investing lexicon: "We simply attempt to be fearful when others are greedy and greedy when others are fearful"; "If you aren't willing to own a stock for ten years, don't even think about owning it for ten minutes"; "It's better to buy a wonderful company at a fair price than to buy a fair company at a wonderful price"; "When it rains gold, put out the bucket, not the thimble."

Buffett's 2021 edition, released February 27, offers several insights that investors of all experience levels should take to heart. In addition to discussing at some length his thoughts on the benefits to shareholders of the $25 billion repurchase of Berkshire Hathaway shares, Buffett's narrative offers some interesting "between-the-lines" takeaways, which we offer for your consideration.

1. **Companies create value by being well-run**. Near the opening of his letter, Buffett emphasizes the prime importance of earnings from operations: "Operating earnings are what count most, even during periods when they are not the largest item in our [accounting] total." He goes on to admit that Berkshire Hathaway fell short in this area in 2020, with operating earnings falling by 9%. But he quickly extols the virtues of owning shares in firms that operate efficiently and retain a portion of their profits in order to reinvest in ways that improve the company. "What's out of sight, however, should not be out of mind: Those unrecorded retained earnings are usually building value—*lots* of value—for Berkshire. Investees use the withheld funds to expand their business, make acquisitions, pay off debt and, often, to repurchase their stock (an act that increases our share of their future earnings). As we pointed out in these pages last year, retained earnings have propelled American business throughout our country's history. What worked for Carnegie and Rockefeller has, over the years, worked its magic for millions of shareholders as well." In other words, the best indicator of the long-term performance of a company's share price is how well it operates its business.

2. **Don't duck your mistakes**. Buffett is quite forthcoming when he characterizes the company's 2016 purchase of Precision Castparts. "... I paid too much for the company. No one misled me in any way—I was simply too optimistic about PCC's normalized profit potential. Last year, my miscalculation was laid bare by adverse developments throughout the aerospace industry, PCC's most important source of customers." Notice that Buffett makes no attempt to shift the blame for his miscue. In fact, he avoids taking aim at what some might consider an easy target: the purchased company and its leadership. Indeed, he says much the opposite: "In purchasing PCC, Berkshire bought a fine company—the best in its business. Mark Donegan, PCC's CEO, is a passionate manager who consistently pours the same energy into the business that he did before we purchased it. We are lucky to have him running things."

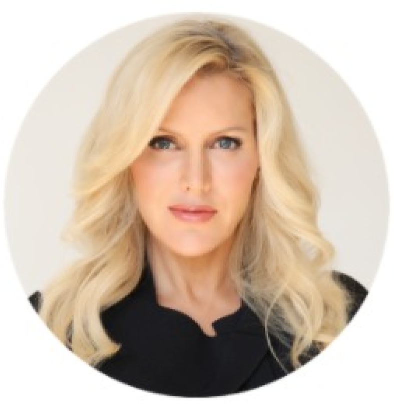
3. **Fixed-income may underperform for some time**. Buffett notes in his letter, "... bonds are not the place to be these days. Can you believe that the income recently available from a 10-year US Treasury bond—the yield was 0.93% at year-end—had fallen *94%* from the 15.8% yield available in September 1981?" He is of course referencing the major secular shift in fixed-income assets that has been underway, with minor stops and starts, since the early 1980s, when bond yields began falling from their then-current rates of around 15% to where they are today (remember: as bond prices rise, bond yields decrease). The near-evaporation of meaningful yields from fixed-income investments has forced investors in two directions: greater reliance on dividend-paying stocks, and extending into higher-risk bonds, with correspondingly higher yields. But Buffett goes on to caution against chasing yield at the expense of safety: "Some ... may try to juice the pathetic returns now available by shifting their purchases to obligations backed by shaky borrowers. Risky loans, however, are not the answer to inadequate interest rates. Three decades ago, the once-mighty savings and loan industry destroyed itself, partly by ignoring that maxim."

4. **It's all about the people**. Sometime around 1863, a Jesuit priest called Father Strickland is recorded as saying, "A man may do an immense deal of good if he does not care who gets the credit for it." Versions of this proverb have been attributed to individuals as varied as clergyman Edward Everett Hale and President Harry S Truman. Buffett clearly subscribes to this sentiment, as evidenced by his generous praise of the leaders and founders of the companies under the Berkshire Hathaway umbrella. We've already seen this illustrated in his firm support for the CEO of Precision Castparts, even though the company has, to this point, underperformed as an investment. But Buffett doesn't stop there. For example, when discussing the venerable confectioner See's Candy, he gives a little history lesson centered around the energy and dedication of the founder, Mary See. "A full century ago, Mary See set out to deliver an age-old product that she had reinvented with special recipes. Added to her business plan were quaint stores staffed by friendly salespeople. Her first small outlet in Los Angeles eventually led to several hundred shops, spread throughout the West. Today, Mrs. See's creations continue to delight customers while providing life-long employment for thousands of women and men. Berkshire's job is simply not to meddle with the company's success." He goes on to recommend the peanut brittle. Similarly, Buffett praises the foresight and tenacity of Leo and Lillian Goodwin of Washington, DC, who, in 1936, had a vision for a different way to do the insurance business. The Goodwins founded the company now known as GEICO. Buffett says, "You know the rest of the story: Berkshire eventually became the 100% owner of GEICO, which at 84 years of age is constantly fine-tuning—but not changing—the vision of Leo and Lillian." Jack Ringwalt of Omaha, founder of National Indemnity, Rose Blumkin, who started Nebraska Furniture Mart, and others from all across the country come in for similar notice from Buffett. He concludes his tour of outstanding, visionary companies and their origin stories by saying, "*Never* bet against America." What a tribute to our national ideals of self-sufficiency, ingenuity, and perseverance—and a tribute, as well, to these founders who embodied those ideas.

In my work with advising, counseling, and directing the investments of my clients, I am constantly on the lookout for the best research, the most valuable ideas, and time-tested wisdom. In his annual letter to shareholders, Warren Buffett has, for decades, consistently been a source for some of the best, most market-tested financial wisdom that I have found.

If I can place my knowledge, skill, and dedication in the service of your financial plans and long-term goals, please contact Empyrion Wealth Management. And to learn more about how I work with investors to deliver solid strategies for success, click here to read my whitepaper, "The Informed Investor."

Stay Diversified, Stay YOUR Course!



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