Contact Asset Management

BERKSHIRE HATHAWAY ANNUAL MEETING - 2020

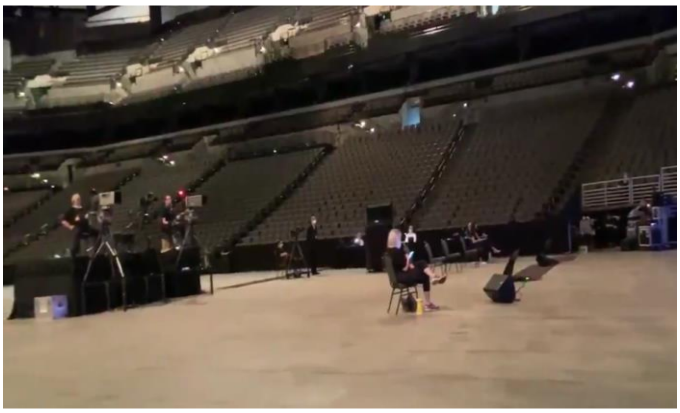
CONTACT ASSET MANAGEMENT

STAY PATIENT. STAY MEASURED. STAY CAUTIOUS

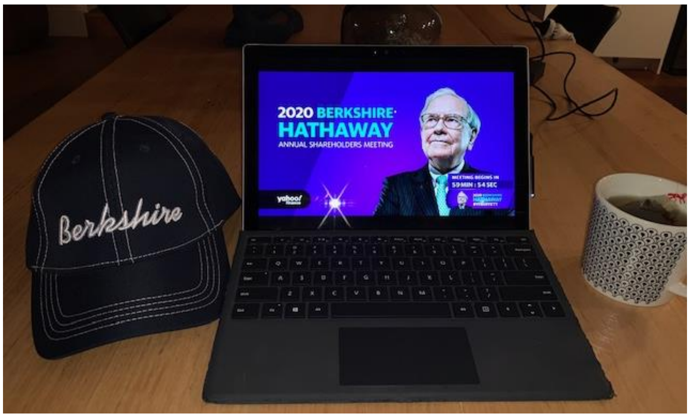
Last weekend, Berkshire Hathaway (BRK) conducted its Annual Meeting. Because of the coronavirus, Berkshire Hathaway's meeting was a shadow affair. The CHI Health Center arena was empty, save for Warren Buffett, Vice Chairman Greg Abel, CFO Marc Hamburg and a few others. As the pictures below highlight, the 40,000 people in attendance last year were replaced with less than 20 this year.

This was the CHI convention center in 2019

This was the CHI convention center in 2020



After several consecutive years of attending the meeting in Omaha, we like so many others were forced to watch the live stream of the meeting from our homes. While it was a vastly different experience and nothing like the real thing, the tyranny of distance did not take away from another insightful meeting with Warren Buffett and Vice Chairman Greg Abel, who stood in for Charlie Munger.



Observers did not know what to expect from the webcam and meeting, but our view is that it was a success. Andy Serwer, Editor-in-Chief of Yahoo Finance, which hosted the webcast, said: *"When Buffett first told me about the meeting this year, he envisioned an hour in total. Say 15 minutes of formal proceedings and 45 minutes of Q&A. Instead we got four and half hours."*

Despite not attending in person, we thought it would be useful to share some of our key takeaways with our fellow investors. The focus following the meeting has been on three key points:

1) Airlines - BRK has completely exited its stake in the Airlines. This seemed to particularly capture a lot of short-term media attention and saw the Airline sector drop more than 5% when trade opened on Monday. Buffett said that he made a mistake investing across the airline business - it has changed in a major way and the future of airlines is much less clear.

2) Stay Long America - While Buffett is bullish on America long term, he is cautious about the present. He repeated several times, "*Never bet against America*" and "*American magic has always prevailed, and it will do so again*."

3) COVID-19 Uncertainty - BRK is yet to act in a meaningful way. Buffett's caution revolves around the COVID-19 uncertainty, noting that it took until 1954 for the market to recover from the Great Depression. BRK is sitting on a remarkable $137 billion in cash. Of all the wary comments from the weekend, Journalist Andrew Ross Sorkin (who incidentally is one of three journalists who ask questions during a normal meeting) wrote, *"Warren Buffett said the $137 billion he had on hand 'isn't all that huge when you think about worst-case possibilities.' Let that seep in."*

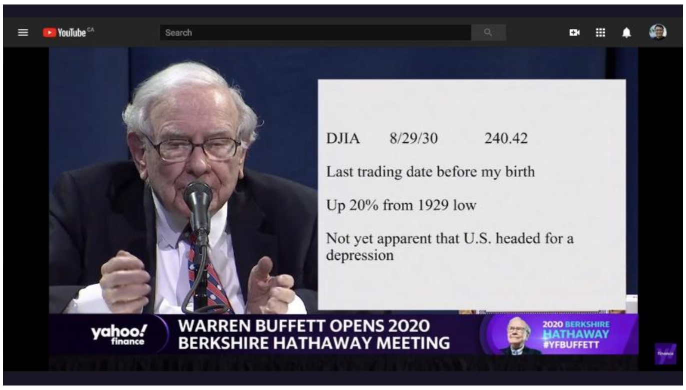
Below we share additional insights and comments from the Annual Meeting:

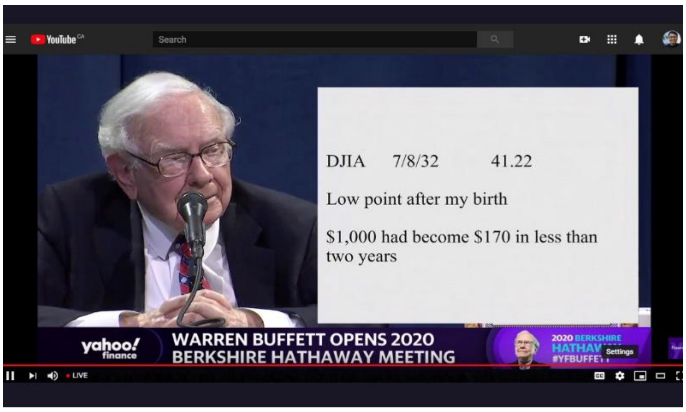
A HISTORY LESSON COMPARING NOW TO THE GREAT DEPRESSION – BUFFETT'S REASON FOR CAUTION

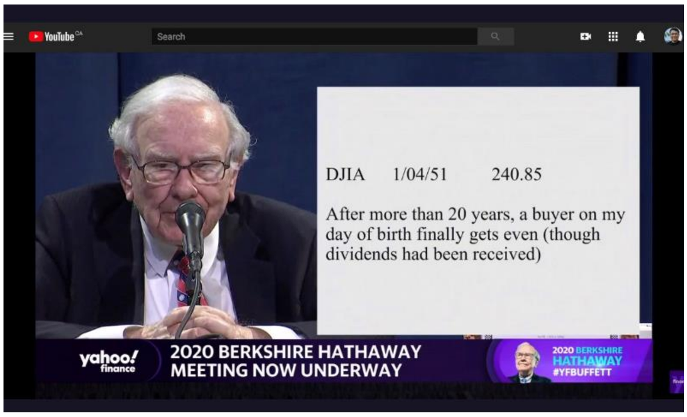
Great teachers tell great stories. Yet again, the BRK meeting was an example of great teaching. He spent over an hour providing a historical context of America's economic development using no frills PowerPoint slides.

Buffett reflected that he was born on 30 August 1930, approximately ten months after the 1929 stock market crash. Buffett said:

"The stock market had actually recovered over 20% during that 9.5-month period or thereabouts. People did not think in the fall of 1930, they did not think they were in the Great Depression. They thought it was a recession very much like that occurred at least a dozen times, although not always when stock markets were important. But we'd had many recessions in the United States over the time, and this did not look like it was something dramatically out of the ordinary. But -- and for a while, actually for about 10 days after my birth, that'd be held on it. And the stock market actually managed to go up all of 1% or 2% there in those 10 days. But that's the last day. From that point, the stock market went from a level of $240 million to $41 million, which was a noticeable decline because if somebody had given me $1,000 on the day I was born and I bought stock with it and bought the Dow Average, my $1000 would have become $170 in less than two years. And that is something that none of us here have ever experienced. We may have had it with one stock occasionally, but not in terms of having a broad range of America mark down 83% in two years and mark down 89% off the peak."







"The Great Depression went on. And it lasted a very long time, but it lasted a lot longer in the minds of people than it did in its effects. World War Two came along. And on sort of an involuntary manner, we adopted casinos. We started running fiscal deficits, of course, that were absolutely huge and took our debt up to a percentage of GDP, which we had never reached before, have never reached since. So, we had an enormous economic recovery, but the minds of people had been so scarred with memories. Parents told their children 1929 became a symbol in people's minds."

COMPARISONS TO THE GLOBAL FINANCIAL CRISIS OF 2008/9

"I would say the current range of probabilities or possibilities and -- on the economic side are still extraordinarily wide. We do not know exactly what happens when you voluntarily shut down a substantial portion of your society. In 2008 and 2009, our economic train went off the tracks, and there were some reasons why the rail bed was weak in terms of the banks. But the same way, this time, we just pulled the train off the tracks and put it on a siding. And I don't really know of any parallel of in terms of the most important country in the world, most productive, huge population, in effect, sidelining, its economy, its workforce and, obviously and unavoidably, creating a huge amount of anxiety and changing people's psyche and causing them to somewhat lose their bearings in some -- many cases, understandably. This is quite an experiment, and we may know the answer to most of the questions reasonably soon that we may not know the answers to some very important questions for many years."

"This is a very good time to borrow money, which means it may not be such a great time to lend money."

BUT HE REMAINS OPTIMISTIC ON THE LONG-TERM IF THE INVESTING PROCESS IS SENSIBLE

“You're going to get a fine result if you own equities over a long period of time. The idea is that equities will not produce better results than the 30-year Treasury bond, which yields 1.25% now. Equities are going to outperform that and they're going to outperform Treasury bills. They're going to outperform that money you stuck under your mattress. I mean they are a enormously sound investment as long as they're an investment, and they're not a gambling device or something that you think who can safely buy on margin or whatever it may be.”

“But going back to stocks. People bring the attitude to them too often because they are liquid and quoted minute by minute. That it's important that you develop an opinion on them minute by minute. Now that's really foolish when you think about it. And that's something Graham taught me in 1949. I mean that single thought stocks were parts of businesses and not just little things that moved around on charts.”

A USEFUL ANALOGY TO REMIND INVESTORS TO THINK ABOUT A COMPANY'S LONG-TERM POTENTIAL

Buffett used storytelling to provide a new take on Benjamin Graham's famous Mr. Market analogy. Instead, he asked listeners to imagine that they owned a farm and the farmer next door to you was a very peculiar character because every day that farmer with identical farm said, "I'll sell you my farm or I'll buy your farm at a certain price," which he would name.

Buffett went on to say “Now the only thing you have to do is to remember that this guy next door is there to serve you and not to instruct you. You bought the farm because you thought the farm has had the potential. You don't really need a quote on it. But basically, you bought into the business, and that's what you're doing when you buy stocks, but you get this added advantage that you do have this neighbour who you're not obliged to listen to at all, who is going to give you a price every day, and he's going to have his ups and downs and maybe he'll name his price. That they'll buy it, in which case you sell, if you want to -- or maybe I'll name a very low price, and you'll buy his farm from it. But you don't have to, and you don't want to put yourself in a position where you have to. So stocks have this enormous inherent advantage of people yelling out prices all the time to you. And many people turn that into a disadvantage. And of course, many people profit in one way or another from telling you that they can tell you what this farmer is going to be out tomorrow or next year neighbouring farmers going to be tomorrow or next week or next month. There's huge money in it. So people tell you that it's important and they know and that you should pay a lot of attention to their thoughts about what price changes should be or you tell yourself that there should be this great difference.”

“But the truth is if you own the businesses you like prior to the virus arriving. It changes prices but nobody is forcing you to sell. And if you really like the business, then you like the management you're in with and the business hasn't fundamentally changed.”

“The American tailwind is marvellous but it's going to have interruptions, and you're not going to foresee the interruptions, and you do not want to get yourself in a position where those interruptions can affect you either because you're leveraged or because you're psychologically unable to handle, looking at a bunch of numbers. If you really had a farm, and you had this neighbour and Monday, he offered you $2,000 an acre. And the next day, he offers you $1,200 an acre. And maybe the day after that, the overage $800 an acre. Are you really going to feel at $2,000 an acre when you had evaluated what the farm would produce? Are you going to let this guy drive you into thinking I better sell because this number keeps coming in lower all the time? It is a very, very, very important matter to bring the right psychological approach to owning common stocks. But I will tell you, if you bet on America and sustain that position for decades, you're going to do better than, in my view, far better than owning treasury securities or far better than following people who tell you what the farmer is going to give out next. There's huge amounts of money that people pay for advice they really don't need.”

WHY ISN'T HE BUYING MORE AGGRESSIVELY? THE FED IS DOING TOO GOOD A JOB

“We want to be in a position at Berkshire where we don't want to be dependent on the kindness of strangers. And we don't want to be dependent on the kindness of friends even because there are times when money almost stops. And we had one of those. We had it, of course, in 2008 and 2009 but right around the date to leading up to March 23. We came very close, but fortunately, we had a Federal Reserve who knew what to do.”

“We got to the point where the U.S. Treasury market, the deepest of all markets, got somewhat disorganized. And when that happens, believe me, every bank and CFO in the country knows it. And they react with fear, and fear is the most contagious disease you can imagine. It makes the virus look like a piker.”

“We came very close to having a total freeze of credit to the largest company in the world who were depending on it. And to the great credit of Jay Powell they acted in the middle of March, probably somewhat instructed by what they'd seen in 2008 and 2009. They reacted in a huge way and essentially allowed what's happened since that time to play out the way it has. March ended up being the largest month for corporate debt issuance, I believe, in history. And then April followed through with a larger month. And you saw all kinds of companies grabbing everything coming to market. And spreads actually narrowed, and every one of those people that issued bonds in late March and April sent a thank you letter to the Fed because it would not have happened if they hadn't operated with really unprecedented speed and determination.”

“We'll know the consequences of swelling the Fed's Balance Sheet. We don't know the consequences of that, and nobody knows exactly. And we don't know the consequences of what undoubtedly we'll have to do. But we do know the consequences of doing nothing. And the Fed in mid-March sort of did whatever it takes squared, and we owe them a huge thank you.”

FURTHER COMMENTS ON THE DECISION TO EXIT THE AIRLINES

"The future is much less clear to me about how the business will turn out through absolutely no fault of the airlines themselves. It's something that was a low probability event happened, and it happened to hurt particularly whether it's the travel business, the hotel business, cruise business, theme park business, but the airline business, in particular. And of course, the airline business has the problem that if the business comes back, 70% or 80%, the aircraft don't disappear. So you've got too many planes. And I didn't look that way when the orders were placed a few months ago and arrangements were made. But the world changed for airlines. And I wish them well."

SELLING DISCIPLINE

"When we sell something, very often, it's going to be our entire stake. I mean we don't trim positions or like -- that's just not the way we approach it anymore than if we buy 100% of a business, we're going to sell it down to 90% or 80%. I mean if we like a business, we're going to buy as much of it as we can and keep it as long as we can. But when we change our mind, we don't take half measures or anything of sort."

IN RESPONSE TO A QUESTION "ARE YOU RECOMMENDING LISTENERS TO BUY NOW?"

"I'm not recommending that people buy stocks today or tomorrow or next week or next month. I think it all depends on your circumstances. But you shouldn't buy stocks unless you expect -- in my view, you expect to hold them for a very extended period, and you are prepared financially and psychologically to hold them the same way you would hold a farm and never look at a quote and never pay it – you don't need to pay attention to them. I mean the main thing to do -- and you're not going to pick the bottom and you're not going to -- nobody else can pick it for you or anything of the sort. You've got to be prepared when you buy a stock, have it be down 50% or more and be comfortable with it as long as you're comfortable with the holding."

"I don't know whether today is a great day to buy stocks. I know it will work out over 20 or 30 years. I don't know whether it will work out over two years at all. I have no idea whether you'll be ahead or behind on a stock you buy on Monday morning."

ON THE LACK OF BIG DEALS

Before the meeting stared, Berkshire Director Ron Olson responded to a question about why there had not been more deals yet. He said that "it is hard for both buyers and sellers to agree on valuations in this environment."

When asked about why Berkshire has not acted as a lender of support as it did in 2008/9, Buffett said: "Well, we haven't seen anything attractive. And frankly, it wasn't predicated on this, but the Federal Reserve did the right thing. And they did it very promptly, which they should have, and I salute them for it. But that means that a lot of companies that needed money and probably should have done their financing a little earlier -- but perfectly decent companies got the chance to finance in huge ways. And then there are some pretty marginal companies that have also had access to money. There is no shortage of funds at rates which we would not invest at. We have not done anything because we don't see anything that attractive to do. Now that could change very quickly or it may not change. But in 2008/2009, through this, we weren't buying those things to make a statement to the world. But we made them because they seemed intelligent things to do. And markets were such that we didn't really have much competition. Now it turned out that we would have been a lot better off if we'd waited four or five months to do similar things. My timing was actually terrible in 2008 or 2009, but the -- what was available was so attractive that even though my timing was terrible, we still came out okay, or a little bit better than okay."

ADVICE ON CREDIT CARD DEBT

"My general advice to people. I mean we have an interest in credit cards, but I think people should avoid using credit cards as a piggy bank to be raided. I had a woman come to see me here not long ago, and she'd come upon some money and not very much, but it was a lot to her. And she's a friend of mine. And she said, "What should I do with it?" And I said, well, pay off your credit card. I don't know what interest rate she was paying, but I think it was something like 18% or something. I said, I don't know how to make 18%! I mean if I owed any money at 18%, the first thing I do with any money I had would be to pay it off. It's going to be way better than any investment idea I've got. And that wasn't what she wanted to hear.

It just doesn't it doesn't make sense. You can't go through life borrowing money at those rates and be better off."

LIKELY IMPACT OF COVID-19 ON THE INSURANCE BUSINESSES

"Well, the amount of litigation that is going to be generated out of what's already happened, let alone what may happen, is going to be huge. Now just the cost of defending litigation is a huge – enormous expense, depending on how much there is."

"In what they call commercial multiple peril, which involves property losses and where some people elect to buy business interruption coverage, many policies, quite clearly in the contract language, would not have a claim for business interruption under a commercial model policy where you've elected that. The standard language says that you recover for business interruption only if there's physical damage to the property."

VIEW ON NEGATIVE INTEREST RATES

"Well, if they are going to be negative for a long time, you'd better own equities."

"So if the world turns into a world where you can issue more and more money and have negative interest rates over time, I'd have to see it to believe it, but I've seen a little bit of it. I've been surprised. I don't see how you can have negative interest rates and pour out money and incur more and more debt relative to productive capacity – you'd think the world would have discovered in the first couple of thousand years rather than just coming on to it now, but we will see."

"It's one of the -- it's probably the most interesting question I've ever seen in economics."

HIGH RETURN ON CAPITAL BUSINESSES

"You really want a business and everybody wants a business that doesn't take any capital to speak of and keeps growing. It doesn't take more capital as it grows. Now our energy business requires more capital as it grows. Our Railroad business, to some extent, requires more capital if it doesn't grow even. So capital-intensive businesses, by their nature, are not as good as something where people pay advance, and you don't need the capital."

"I mean if you look at where the top market value is in a $30 trillion market, if you take the top four or five companies that account for maybe $3 trillion, $4 trillion of -- or so of that $30 trillion. Basically, they don't take much capital. And that's why they're worth a lot of money because they make a lot of money, and they don't require the money to any great extent in the business. We own some businesses like that, but it's certainly not the railroad, and it's not the energy business. They're good businesses. We love them. But they didn't take any capital, they'd be unbelievable. They're -- but that's just -- that's what we've learned from 50 or 60 years of operating businesses that if you can find a great business that doesn't require capital when it grows, you've really got something."

OTHER COMMENTS RELATED TO THE CURRENT UNCERTAINTY

"We don't know how long this period lasts and no one knows. Most people think that the virus will decline in its spread during the summer months and then may come back. We don't know how people will react to a reopening and we don't know how people will react if it comes back. The unknowns in the health aspect creates unknowns in the economy. I hope that once suppressed it doesn't come back - but we are dealing with a huge unknown. The way that it has changed the world indicates that you shouldn't be too sure of yourself about what happens in the next six months."

"I don't know anything you don't know about health matters. But I do think the range of possibilities has narrowed down somewhat in that respect. We're not getting a best case, and we know we're not getting the worst case. The possibility initially of the virus was hard to evaluate, and it's still hard to evaluate."

"If you own a shopping center, you've got a bunch of tenants who don't want to pay you right now. And the supply and demand for retail space may change fairly significantly. The supply and demand for office space may change significantly. A lot of people learned that they can work at home or that there's other methods of conducting their business. And they might have thought that -- from what they were doing a couple of years ago. When change happens in the world, you adjust to it."

"Some people are more subject to fear than others. It's like the virus. It strikes some people would much greater ferocity than others. And fear is -- there is something I really never felt financially, but I don't think Charlie's felt it either. But some people can handle it psychologically. If they can't handle psychologically, then you really shouldn't own stocks because you're going to buy and sell at the wrong time."

CONCLUSION

We have travelled to Omaha for the Berkshire Hathaway meeting for the last seven years. To quote Sir John Templeton, "The four most dangerous words in investing are: this time it's different." However, as for the Berkshire meeting of 2020, it was different. Not just for the lack of fanfare or the big crowds. More so, for the lack of conviction from Mr. Buffett himself.

In late April, Howard Marks co-founder of Oaktree Capital Management, said there is a sharp disconnect between the stock market and the reality the world is facing amid the coronavirus outbreak. "We're only down 15% from the all-time high of February 19th," Marks said on CNBC's "Halftime Report." But "it seems to me the world is more than 15% screwed up." This meeting suggests that Warren Buffett would agree with Howard Marks.

While there seems to be widespread short-term investor optimism that the world economy will bounce back in a much anticipated "V-shape" recovery as politicians push for re-opening, this meeting will be remembered for Buffett sounding a note of realism about the challenges ahead.

However, one constant remains: long-term investing works: "I don't know whether today is a great day to buy stocks. I know it will work out over 20 or 30 years."

Will Culbert and Tom Millner
Contact Asset Management

Tom and Will catching up with Berkshire Vice-Chairman Greg Abel in May 2019.


2020 BERKSHIRE HATHAWAY
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