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MR. BUFFETT ON THE STOCK MARKET

The most celebrated of investors says stocks can't possibly meet the public's expectations. As for the Internet? He notes how few people got rich from two other transforming industries, auto and aviation.

Warren Buffett, chairman of Berkshire Hathaway, almost never talks publicly about the general level of stock prices—neither in his famed annual report nor at Berkshire's thronged annual meetings nor in the rare speeches he gives. But in the past few months, on four occasions, Buffett did step up to that subject, laying out his opinions, in ways both analytical and creative, about the long-term future for stocks. FORTUNE's Carol Loomis heard the last of those talks, given in September to a group of Buffett's friends (of whom she is one), and also watched a videotape of the first speech, given in July at Allen & Co.'s Sun Valley, Idaho, bash for business leaders. From those extemporaneous talks (the first made with the Dow Jones industrial average at 11,194), Loomis distilled the following account of what Buffett said. Buffett reviewed it and weighed in with some clarifications.

Investors in stocks these days are expecting far too much, and I'm going to explain why. That will inevitably set me to talking about the general stock market, a subject I'm usually unwilling to discuss. But I want to make one thing clear going in: Though I will be talking about the level of the market, **I will not be predicting its next moves**. At Berkshire we focus almost exclusively on the valuations of individual companies, looking only to a very limited extent at the valuation of the overall market. Even then, valuing the market has nothing to do with where it's going to go next week or next month or next year, a line of thought we never get into. The fact is that markets behave in ways, sometimes for a very long stretch, that are not linked to value. Sooner or later, though, **value counts**. So what I am going to be saying—assuming it's correct—will have implications for the **long-term results** to be realized by American stockholders.

Let's start by defining "investing." The definition is simple but often forgotten: Investing is laying out money now to get more money back in the future—more money in real terms, after taking inflation into account.

Now, to get some historical perspective, let's look back at the 34 years before this one—and here we are going to see an almost Biblical kind of symmetry, in the sense of lean years and fat years—to observe what happened in the stock market. Take, to begin with, the first 17 years of the period, from the end of 1964 through 1981. Here's what took place in that interval:

*Dow Jones Industrial Average
Dec. 31, 1964: 874.12
Dec. 31, 1981: 875.00

Now I'm known as a long-term investor and a patient guy, but that is not my idea of a big move.

And here's a major and very opposite fact: During that same 17 years, the GDP of the U.S.—that is, the business being done in this country—almost quintupled, rising by 370%. Or, if we look at another measure, the sales of the FORTUNE 500 (**a changing mix of companies**, of course) more than sextupled. And yet the Dow went exactly nowhere.

To understand why that happened, we need first to look at one of the two important variables that affect investment results: **interest rates**. These act on financial valuations the way gravity acts on matter: The higher the rate, the greater the downward pull. That's because the rates of return that investors need from any kind of investment are directly tied to the risk-free rate that they can earn from government securities. So if the government rate rises, the prices of all other investments must adjust downward, to a level that brings their expected rates of return into line. Conversely, if government interest rates fall, the move pushes the prices of all other investments upward. The basic proposition is this: What an investor should pay today for a dollar to be received tomorrow can only be determined by first looking at the risk-free interest rate.

Consequently, every time the risk-free rate moves by one basis point—by 0.01%—the value of every investment in the country changes. People can see this easily in the case of bonds, whose value is normally affected only by interest rates. In the case of equities or real estate or farms or whatever, other very important variables are almost always at work, and that means the effect of interest rate changes is usually obscured. Nonetheless, the effect—like the invisible pull of gravity—is constantly there.

In the 1964-81 period, there was a tremendous increase in the rates on long-term government bonds, which moved from just over 4% at year-end 1964 to more than 15% by late 1981. That rise in rates had a huge depressing effect on the value of all investments, but the one we noticed, of course, was the price of equities. So there—in that tripling of the gravitational pull of interest rates—lies the major explanation of why tremendous growth in the economy was accompanied by a stock market going nowhere.

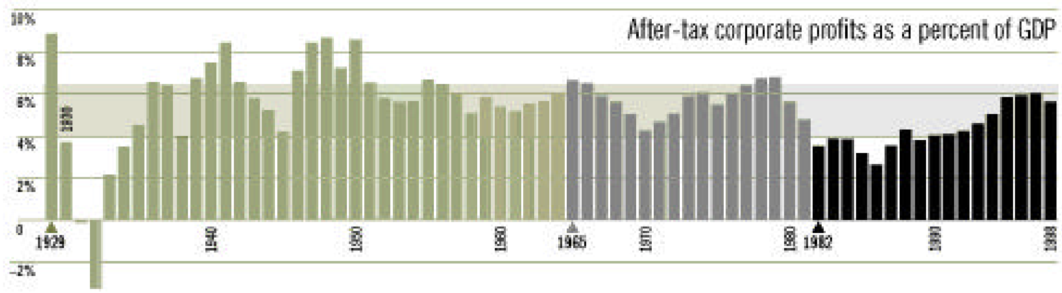
Then, in the early 1980s, the situation reversed itself. You will remember Paul Volcker coming in as chairman of the Fed and remember also how unpopular he was. But the heroic things he did—his taking a two-by-four to the economy and breaking the back of inflation—caused the interest rate trend to reverse, with some rather spectacular results. Let's say you put $1 million into the 14% 30-year U.S. bond issued Nov. 16, 1981, and reinvested the coupons. That is, every time you got an interest payment, you used it to buy more of that same bond. At the end of 1998, with long-term governments by then selling at 5%, you would have had $8,181,219 and would have earned an annual return of more than 13%.

That 13% annual return is better than stocks have done in a great many 17-year periods in history—in most 17-year periods, in fact. It was a helluva result, and from none other than a stodgy bond.

The power of interest rates had the effect of pushing up equities as well, though other things that we will get to pushed additionally. And so here's what equities did in that same 17 years: If you'd invested $1 million in the Dow on Nov. 16, 1981, and reinvested all dividends, you'd have had $19,720,112 on Dec. 31, 1998. And your annual return would have been 19%.

The increase in equity values since 1981 beats anything you can find in history. This increase even surpasses what you would have realized if you'd bought stocks in 1932, at their Depression bottom—on its lowest day, July 8, 1932, the Dow closed at 41.22—and held them for 17 years.

The **second thing** bearing on stock prices during this 17 years was **after-tax corporate profits**, which the chart, After-Tax Corporate Profits as a Percentage of GDP, displays as a percentage of GDP. In effect, what this chart tells you is what portion of the GDP ended up every year with the shareholders of American business.



The chart, as you will see, starts in 1929. I'm quite fond of 1929, since that's when it all began for me. My dad was a stock salesman at the time, and after the Crash came, in the fall, he was afraid to call anyone—all those people who'd been burned. So he just stayed home in the afternoons. And there wasn't television then. Soooo ... I was conceived on or about Nov. 30, 1929 (and born nine months later, on Aug. 30, 1930), and I've forever had a kind of warm feeling about the Crash.

As you can see, corporate profits as a percentage of GDP peaked in 1929, and then they tanked. The left-hand side of the chart, in fact, is filled with aberrations: not only the Depression but also a wartime profits boom—sedated by the excess-profits tax—and another boom after the war. But from 1951 on, the percentage settled down pretty much to a 4% to 6.5% range.

By 1981, though, the trend was headed toward the bottom of that band, and in 1982 profits tumbled to 3.5%. So at that point investors were looking at two strong negatives: Profits were sub-par and interest rates were sky-high.

And as is so typical, investors projected out into the future **WHAT THEY WERE SEEING**. That's their unshakable habit: looking into the **REAR-VIEW MIRROR** instead of through the **WINDSHIELD**. What they were observing, looking backward, made them very discouraged about the country. They were projecting high interest rates, they were projecting low profits, and they were therefore valuing the Dow at a level that was the same as 17 years earlier, even though GDP had nearly quintupled.

Now, what happened in the 17 years beginning with 1982? One thing that didn't happen was comparable growth in GDP: In this second 17-year period, GDP less than tripled. But interest rates began their descent, and after the Volcker effect wore off, profits began to climb—not steadily, but nonetheless with real power. You can see the profit trend in the chart, which shows that by the late 1990s, after-tax profits as a percent of GDP were running close to 6%, which is on the upper part of the "normalcy" band. And at the end of 1998, long-term government interest rates had made their way down to that 5%.

These dramatic changes in the two fundamentals that matter most to investors explain much, though not all, of the more than tenfold rise in equity prices—the Dow went from 875 to 9,181—during this 17-year period. What was at work also, of course, was **market psychology**. Once a bull market gets under way, and once you reach the point where everybody has made money no matter what system he or she followed, a crowd is attracted into the game that is responding not to interest rates and profits but simply to the fact that it seems a mistake to be out of stocks. In effect, these people superimpose an **I-can't-miss-the-party factor** on top of the fundamental factors that drive the market. Like Pavlov's dog, these "investors" learn that when the bell rings—in this case, the one that opens the New York Stock Exchange at 9:30 a.m.—**they get fed**. Through this daily reinforcement, they become convinced that there is a God and that He wants them to get rich.

Today, staring fixedly back at the road they just traveled, most investors have **rosy expectations**. A Paine Webber and Gallup Organization survey released in July shows that the least experienced investors—those who have invested for less than five years—expect annual returns over the next ten years of 22.6%. Even those who have invested for more than 20 years are expecting 12.9%.

Now, I'd like to argue that we can't come even remotely close to that 12.9%, and make my case by examining the key value-determining factors. Today, if an investor is to achieve juicy profits in the market over ten years or 17 or 20, one or more of **three things must happen**. I'll delay talking about the last of them for a bit, but here are the first two:

(1) **Interest rates must fall further**. If government interest rates, now at a level of about 6%, were to fall to 3%, that factor alone would come close to doubling the value of common stocks. Incidentally, if you think interest rates are going to do that—or fall to the 1% that Japan has experienced—you should head for where you can really make a bundle: bond options.

(2) **Corporate profitability** in relation to GDP must rise. You know, someone once told me that New York has more lawyers than people. I think that's the same fellow who thinks profits will become larger than

GDP. When you begin to expect the growth of a component factor to forever outpace that of the aggregate, you get into certain mathematical problems. In my opinion, you have to be wildly optimistic to believe that corporate profits as a percent of GDP can, for any sustained period, hold much above 6%. One thing keeping the percentage down will be competition, which is alive and well. In addition, there's a public-policy point: If corporate investors, in aggregate, are going to eat an ever-growing portion of the American economic pie, some other group will have to settle for a smaller portion. That would justifiably raise political problems—and in my view a major reslicing of the pie just isn't going to happen.

So where do some reasonable assumptions lead us? Let's say that GDP grows at an average 5% a year—3% real growth, which is pretty darn good, plus 2% inflation. If GDP grows at 5%, and you don't have some help from interest rates, the aggregate value of equities is not going to grow a whole lot more. Yes, you can add on a bit of return from dividends. But with stocks selling where they are today, the importance of dividends to total return is way down from what it used to be. Nor can investors expect to score because companies are busy boosting their per-share earnings by buying in their stock. The offset here is that the companies are just about as busy issuing new stock, both through primary offerings and those ever present stock options.

So I come back to my postulation of 5% growth in GDP and remind you that it is a limiting factor in the returns you're going to get: You cannot expect to forever realize a 12% annual increase—much less 22%—in the valuation of American business if its profitability is growing only at 5%. The **INESCAPABLE FACT** is that the **value of an asset**, whatever its character, **cannot over the long term grow faster than its earnings do**.

Now, maybe you'd like to argue a different case. Fair enough. But give me your assumptions. If you think the American public is going to make 12% a year in stocks, I think you have to say, for example, "Well, that's because I expect GDP to grow at 10% a year, dividends to add two percentage points to returns, and interest rates to stay at a constant level." Or you've got to rearrange these key variables in some other manner. The Tinker Bell approach—clap if you believe—just won't cut it.

Beyond that, you need to remember that future returns are always affected by current valuations and give some thought to what you're getting for your money in the stock market right now. Here are two 1998 figures for the FORTUNE 500. The companies in this universe account for about 75% of the value of all publicly owned American businesses, so when you look at the 500, you're really talking about America Inc.

*FORTUNE 500
1998 profits: $334,335,000,000
Market value on March 15, 1999: $9,907,233,000,000

As we focus on those two numbers, we need to be aware that the profits figure has its quirks. Profits in 1998 included one very unusual item—a $16 billion bookkeeping gain that Ford reported from its spinoff of Associates—and profits also included, as they always do in the 500, the earnings of a few mutual companies, such as State Farm, that do not have a market value. Additionally, one major corporate expense, stock-option compensation costs, is not deducted from profits. On the other hand, the profits figure has been reduced in some cases by write-offs that probably didn't reflect economic reality and could just as well be added back in. But leaving aside these qualifications, investors were saying on March 15 this year that they would pay a hefty $10 trillion for the $334 billion in profits.

Bear in mind—this is a critical fact often ignored—that investors as a whole cannot get anything out of their businesses except what the businesses earn. Sure, you and I can sell each other stocks at higher and higher prices. Let's say the FORTUNE 500 was just one business and that the people in this room each owned a piece of it. In that case, we could sit here and sell each other pieces at ever-ascending prices. You personally might outsmart the next fellow by buying low and selling high. But no money would leave the game when that happened: You'd simply take out what he put in. Meanwhile, the experience of the group wouldn't have been affected a whit, because its fate would still be tied to profits. The absolute most that the owners of a business, in aggregate, can get out of it in the end—between now and Judgment Day—is **what that business earns over time**.

And there's still another major qualification to be considered. If you and I were trading pieces of our business in this room, we could escape transactional costs because there would be no brokers around to take a bite out of every trade we made. But in the real world investors have a habit of wanting to change chairs, or of at least getting advice as to whether they should, and that costs money—big money. The expenses they bear—I call them **frictional costs**—are for a wide range of items. There's the market maker's spread, and commissions, and sales loads, and 12b-1 fees, and management fees, and custodial fees, and wrap fees, and even subscriptions to financial publications. And don't brush these expenses off as irrelevancies. If you were evaluating a piece of investment real estate, would you not deduct management costs in figuring your return? Yes, of course—and in exactly the same way, stock market investors who are figuring their returns must face up to the frictional costs they bear.

And what do they come to? My estimate is that investors in American stocks pay out well over $100 billion a year—say, **$130 billion—to move around on those chairs or to buy advice as to whether they should**! Perhaps $100 billion of that relates to the FORTUNE 500. In other words, **investors are dissipating almost a third of everything that the FORTUNE 500 is earning for them**—that $334 billion in 1998—by handing it over to various types of chair-changing and chair-advisory "helpers." And when that handoff is completed, the investors who own the 500 are reaping less than a $250 billion return on their $10 trillion investment. In my view, that's **slim pickings**.

Perhaps by now you're mentally quarreling with my estimate that $100 billion flows to those "helpers." How do they charge thee? Let me count the ways. Start with transaction costs, including commissions, the market maker's take, and the spread on underwritten offerings: With double counting stripped out, there will this year be at least 350 billion shares of stock traded in the U.S., and I would estimate that the transaction cost per share for each side—that is, for both the buyer and the seller—will average 6 cents. That adds up to $42 billion.

Move on to the additional costs: hefty charges for little guys who have wrap accounts; management fees for big guys; and, looming very large, a raft of expenses for the holders of domestic equity mutual funds. These funds now have assets of about $3.5 trillion, and you have to conclude that the annual cost of these to their investors—counting management fees, sales loads, 12b-1 fees, general operating costs—runs to at least 1%, or $35 billion.

And none of the damage I've so far described counts the commissions and spreads on options and futures, or the costs borne by holders of variable annuities, or the myriad other charges that the "helpers" manage to think up. In short, $100 billion of frictional costs for the owners of the FORTUNE 500—which is 1% of the 500's market value—

looks to me not only highly defensible as an estimate, but quite possibly on the low side.

It also looks like a horrendous cost. I heard once about a cartoon in which a news commentator says, "There was no trading on the New York Stock Exchange today. Everyone was happy with what they owned." Well, if that were really the case, investors would every year keep around $130 billion in their pockets.

Let me **summarize** what I've been saying about the stock market: I think it's very hard to come up with a persuasive case that equities will over the next 17 years perform anything like—anything like—they've performed in the past 17. If I had to pick the most probable return, from appreciation and dividends combined, that investors in aggregate—repeat, aggregate—would earn in a world of constant interest rates, 2% inflation, and those ever hurtful frictional costs, it would be **6%**. If you strip out the inflation component from this nominal return (which you would need to do however inflation fluctuates), that's **4% IN REAL TERMS**. And if 4% is wrong, I believe that the percentage is just as likely to be less as more.

Let me come back to what I said earlier: that there are **three things** that might allow investors to realize significant profits in the market going forward. The first was that interest rates might fall, and the second was that corporate profits as a percent of GDP might rise dramatically. I get to the third point now: Perhaps you are an optimist who believes that though investors as a whole may slog along, you yourself will be a winner. That thought might be particularly seductive in these early days of the information revolution (which I wholeheartedly believe in). Just pick the **obvious winners**, your broker will tell you, and ride the wave.

Well, I thought it would be instructive to go back and look at a couple of industries that transformed this country much earlier in this century: automobiles and aviation. Take **automobiles** first: I have here one page, out of 70 in total, of car and truck manufacturers that have operated in this country. At one time, there was a Berkshire car and an Omaha car. Naturally I noticed those. But there was also a telephone book of others.

All told, there appear to have been at least 2,000 car makes, in an industry that had an incredible impact on people's lives. If you had foreseen in the early days of cars how this industry would develop, you would have said, "Here is the road to riches." So what did we progress to by the 1990s? After corporate carnage that never let up, we came down to three U.S. car companies—themselves no lollapaloozas for investors. So here is an industry that had an enormous impact on America—and also an enormous impact, though not the anticipated one, on investors.

Sometimes, incidentally, it's much easier in these transforming events to figure out the losers. You could have grasped the importance of the auto when it came along but still found it hard to pick companies that would make you money. But there was one obvious decision you could have made back then—it's better sometimes to turn these things upside down—and that was to short horses. Frankly, I'm disappointed that the Buffett family was not short horses through this entire period. And we really had no excuse: Living in Nebraska, we would have found it super-easy to borrow horses and avoid a "short squeeze."

*U.S. Horse Population
1900: 21 million
1998: 5 million

The other truly transforming business invention of the first quarter of the century, besides the car, was the **airplane**—another industry whose plainly brilliant future would have caused investors to salivate. So I went back to check out aircraft manufacturers and found that in the 1919-39 period, there were about 300 companies, only a handful still breathing today. Among the planes made then—we must have been the Silicon Valley of that age—were both the Nebraska and the Omaha, two aircraft that even the most loyal Nebraskan no longer relies upon.

Move on to failures of airlines. Here's a list of 129 airlines that in the past 20 years filed for bankruptcy. Continental was smart enough to make that list twice. As of 1992, in fact—though the picture would have improved since then—the money that had been made since the dawn of aviation by all of this country's airline companies was zero. Absolutely zero.

Sizing all this up, I like to think that if I'd been at Kitty Hawk in 1903 when Orville Wright took off, I would have been farsighted enough, and public-spirited enough—I owed this to future capitalists—to shoot him down. I mean, Karl Marx couldn't have done as much damage to capitalists as Orville did.

I won't dwell on other glamorous businesses that dramatically changed our lives but concurrently failed to deliver rewards to U.S. investors:

the manufacture of radios and televisions, for example. But I will draw a lesson from these businesses: The key to investing is not assessing how much an industry is going to affect society, or how much it will grow, but rather determining the competitive advantage of any given company and, above all, the durability of that advantage. The products or services that have wide, sustainable moats around them are the ones that deliver rewards to investors.

This talk of 17-year periods makes me think—incongruously, I admit—of 17-year locusts. What could a current brood of these critters, scheduled to take flight in 2016, expect to encounter? I see them entering a world in which the public is less euphoric about stocks than it is now. Naturally, investors will be feeling disappointment—but only because they started out expecting too much.

Grumpy or not, they will have by then **grown considerably wealthier**, simply because the American business establishment that they own will have been chugging along, increasing its profits by 3% annually in real terms. Best of all, the rewards from this creation of wealth will have flowed through to Americans in general, who will be enjoying a far higher standard of living than they do today. That wouldn't be a bad world at all—even if it doesn't measure up to what investors got used to in the 17 years just passed.

BEZOS ON BUFFETT

Skeptical of Internet mania, the founder and CEO of Amazon.com is spreading the gospel according to Buffett.

Patricia Sellers

Warren Buffett doesn't mention the Internet on these pages. But he does talk about two other transforming industries that failed to reward investors over time: autos and aviation. Only a fool would ignore his implicit warning: A lot of people will lose a lot of money betting on the Internet. Amazon.com founder and CEO Jeff Bezos was so intrigued by Buffett's talk at Herb Allen's gathering of business leaders in Sun Valley, Idaho, last July that he asked Buffett for his lists of the automakers and aircraft manufacturers that didn't make it. "When new industries become phenomenons, a lot of investors bet on the wrong companies," Bezos says. Referring to Buffett's 70-page catalog of mostly dead car and truck makes, he adds, "I noticed that decades ago, it was de rigueur to use 'Motors' in the name, just as everybody uses 'dot-com' today. I thought, Wow, the parallel is interesting."

Especially interesting to a billionaire like Bezos, who knows something about stock valuations from his previous career as a hedge fund manager. Interesting also to Bezos the history buff, who likes to talk about the Cambrian explosion about 550 million years ago, when multicelled life spawned unprecedented variation of species—and with it, a wave of extinctions. Given this perspective, Bezos says, Buffett's analogies about bankrupt businesses "resonate deeply." Now Bezos is spreading the gospel according to Buffett and urging Amazon employees to **RUN SCARED EVERY DAY.** "We still have the opportunity to be a footnote in the e-commerce industry," he says.

Warren Buffett

Buffett tells investors to scale back expectations

By Bill Rigby

OMAHA, Neb. (Reuters) - Warren Buffett told his followers to scale back unreal expectations of his firm Berkshire Hathaway Inc., as the billionaire investor **warned** that corporate America's hopes for profit growth, and investors' assumptions of returns, were entering a "**dream world**".

"The probability of us achieving 15 percent growth in earnings over an extended period of years is so close to zero it's not worth calculating," said Buffett, known as the "Oracle of Omaha" to the 5,000-or-so Berkshire shareholders packed into his home town's Civic Auditorium for the firm's annual meeting Saturday.

"And nor do we think any large company in the United States is likely to (post such growth)," said Buffett, reckoning that **only two or three Fortune 500 firms** might be able to hit 15 percent profit growth consistently over a long period.

Investors, pumped up by advisers after a decade-long bull market, and led on by grand promises from companies, now have unreal expectations of returns, warned the 70-year-old Buffett, who has built up his $100 billion Berkshire by slowly patching together old-line businesses and making canny stock investments.

Fifteen percent (return on stock investments) is a dream world," warned Buffett.

Warren Buffett

"It's simply crazy to have such very high expectations," added Charlie Munger, Buffett's 77-year-old partner at Berkshire, and respected investment sage in his own right. "Years ago 15 percent return was regarded as impossible, now they say 'so what"'

Investors who want to benefit from the economy's growth, but are unsure where to put their money, should sign up for a low cost index fund, rather than an expensive mutual fund offering large returns, said Buffett, expanding his views at a media conference on Sunday.

A return of 6-7 percent a year was more realistic, the pair warned, rather than the 9 percent or more that pension fund managers now promise.

For Buffett, that means a natural slowing in the phenomenal growth of his combined insurance firm, holding company and investment vehicle that has made thousands of shareholders millionaires and made him an investing legend.

Since 1965, when Buffett bought a small textile mill called Berkshire Hathaway to use as the base for his investments, the book value of its shares has increased about 24 percent per year -- twice the rate of growth of the S&P 500.

In that time, Berkshire's stock price has risen from $12 in 1965 to $67,005 a share at the close of the New York Stock Exchange on Friday, making Buffett one of the most revered, and emulated investors.

BIG DEAL ON THE HORIZON

The problem for Berkshire now, Buffett said, is finding enough firms to buy to keep growing.

"The bigger you are, the fewer opportunities there are," said Buffett, who is now looking for a major acquisition.

"What we'd really like is a $10 or $15 billion acquisition," he said, but warned that finding good deals that size was not easy.

Buffett's only purchase that large so far was U.S. reinsurer General Re, which he bought for about $22 billion in 1998.

The U.S. utility sector was now a likely target for their money, said both Buffett and Munger, assuming that current laws restricting ownership of publicly held utilities are removed, as is expected.

"The production of electricity is an enormous business -- its not going away," said Munger. "Its not at all inconceivable that we may do something in that field."

Europe, too, was a promising place for deals, Buffett suggested, though he said that he had received no offers to buy businesses when he was in Europe last month.

"We don't have a master plan," said Buffett. "We'll do whatever comes down the pipe," adding that he expected Berkshire to make on average two deals a year as it looks to grow, envisaging as many as 40 deals over the next decade and a half. That could double the size of Berkshire, which at present owns about 40 businesses.

Buffett repeated his preference for buying whole companies rather than stocks, and took a sideswipe at the confused state of stock investing in the U.S. today.

"**Anyone who says you should be in 'growth' or 'value' (stocks) doesn't understand investing," said Buffett. "I cringe when I hear it; it just doesn't make any sense**".

Growth is a natural result of value, said Buffett, who plans to stick with his tried and tested method of buying companies with distinct advantages over competitors -- what he calls a "moat" to protect them -- and watching the value in the businesses convert itself into growth over time.

This "get rich slowly" method of investing, said Buffett, has few followers these days, as many lacked the patience, or the ability to value businesses in the right way.

ANTI-TECH TRIUMPH

One Berkshire shareholder thanked Buffett at the meeting for avoiding technology stocks, marking a reverse from last year's meeting, when some questioned Buffett's anti-tech stance, as Berkshire's returns fell way behind the soaring Nasdaq.

Since then, Berkshire's stock has climbed, while many high-flying technology stocks have lost more than 90 percent of their value.

But even if tech stocks had continued to climb, while Berkshire tanked, Munger said it would not have changed their opinion. "If someone gets richer faster, so what? Is that really a tragedy?"

Buffett defended his position by saying **very few internet-based firms will generate any real wealth over the long term** -- beyond the instant riches nabbed by promoters and Wall Street.

Many new tech firms simply "monetized the hopes and dreams of millions of people," said Buffett, as they raised huge amounts of cash from the stock market. "**Lots of money was transferred from the gullible to the promoters**," he said, as investors chased after "easy money".

To invest properly, Buffett said Sunday, people need to learn how to value businesses, pick stocks they understand, and forget market performance.

"**If you are looking to the market for guidance, that's a terrible way to approach it**." he said. "People who bought tech stocks, or any any other kind of stocks, because they think it's going to go up next year, or because their neighbor told them to do it -- they should get out of the investment world. That is not a way to make money over time."

Wall Street was the main benefactor of this "huge trap", said Buffett. "Not by great performance, but by great promotion".

Warren Buffett

THE SUCCESSION PLAN

Buffett told his shareholders not to worry about his health, and said even if he should die, the business was in safe hands.

Rumors that Buffett was seriously ill spooked investors last year, though he only had an operation to remove a benign colon polyp.

"I feel great," Buffett answered one shareholder, who quizzed him about his cholesterol level, given his steady diet of Dairy Queen ice cream, See's candies and Coke.

Even if he were to die, Buffett told shareholders that his succession plan -- revealed to a select few last year -- would ensure the future of the business.

Under that plan, his joint role of overseeing Berkshire's operating subsidiaries and looking after investments would be split into two jobs, thought the likely successors were not named.

"There's no point saying who those people would be," Buffett said. "It might change."

Berkshire watchers expect Lou Simpson, the 64-year-old controller of investments at GEICO, Berkshire's cut-price car insurer, to take over the all-important role of looking after Berkshire's $30 billion or so in stock investments.

Whatever happens, the majority of Berkshire's investments would do well, said Munger, who at 77, is not part of any succession plan. "We have a lot of momentum that would go on very nicely with the present management gone."

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Buffett scolds 'giddy' tech investors, Wall Street

By Bill Rigby

NEW YORK, March 10 (Reuters) - Warren Buffett, billionaire investor and champion of the old economy, scolded "giddy" investors and a greedy Wall Street on Saturday for creating the overblown market for technology stocks last year.

"It was as if some virus, racing wildly among investment professionals as well as amateurs, induced hallucinations in which the values of stocks in certain sectors became decoupled from the values of the businesses that underlay them," wrote Buffett in his annual letter to shareholders of his company, Berkshire Hathaway (BRKa.N), posted on the firm's Web site.

The year-long plunge in the tech-heavy Nasdaq has been a vindication for 70-year-old Buffett, who plays bridge with

Microsoft's Bill Gates, but won't invest in tech companies that he doesn't understand.

Berkshire's stock has risen 74 percent from its 52-week low a year ago today. In the same time, the tech-heavy Nasdaq (.IXIC) has plunged 59 percent.

"Last year, we commented on the exuberance -- and, yes, it was irrational -- that prevailed, noting that investor expectations had grown to be several multiples of probable returns," said Buffett.

The whole fairy tale ended badly, said Buffett.

"After a heady experience of that kind, normally sensible people drift into behavior akin to that of Cinderella at the ball. They know that overstaying the festivities -- that is, continuing to speculate in companies that have gigantic valuations relative to the cash they are likely to generate in the future -- will eventually bring on pumpkins and mice."

Buffett's Omaha, Nebraska-based firm -- whose main business is insurance but also has subsidiaries in a range of sectors, from furniture to jewelry to plane leasing -- on Saturday reported a 113 percent leap in profits for 2000 to $3.328 billion.

The jump in profit marks a comeback for Buffett from last year -- which he called the worst ever for the firm -- when poor returns on his old-economy investments led to accusations that Buffett had erred in missing the Internet craze.

Warren Buffett

BUFFETT VS. WALL STREET

> Buffett, known for his dislike of Wall Street whizzes, put much of the blame on investment bankers and their partners for the tech bubble, and the pain it has caused many investors.
>
> "By shamelessly merchandising birdless bushes, promoters have in recent years moved billions of dollars from the pockets of the public to their own purses -- and to those of their friends and associates."
>
> According to Buffett, bankers' short-term profits were put before the interests of the average investor.
>
> "The fact is that a bubble market has allowed the creation of bubble companies, entities designed more with an eye to making money off investors rather than for them. Too often, an initial public offering, not profits, was the primary goal of a company's promoters."

Buffett also criticized himself however, recounting some of his less successful old-economy ventures.

> "We make many mistakes: I'm the fellow, remember, who thought he understood the future economics of trading stamps, textiles, shoes and second-tier department stores."

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Buffett: Hard Times Ahead for Papers

By MARGERY BECK

.c The Associated Press

OMAHA, Neb. (AP) - Investment guru Warren Buffett predicted hard times for the newspaper industry Sunday, a day after holding his company's annual shareholder's meeting.

The Internet is scooping newspapers - not only on news, but in cheap accessibility, said Buffett, chairman of one of Wall Street's top success stories, Berkshire Hathaway Inc.

The company owns The Buffalo News, a daily newspaper in Buffalo, N.Y.

While Buffett still reads newspapers, he more often finds himself turning to his computer for news these days, he said, and suspects others do, too.

Often he can get the New York Times' or The Boston Globe's morning newspaper stories the night before on the newspapers' Web sites - for free, he said.

"That cannot be a good thing for newspapers," Buffett said. "It's not a good idea to be charging a lot of money for something you can get for free."

Warren Buffett

More dire than subscription costs for print newspapers is the Internet's siphoning of advertising dollars, said Buffett and Charlie Munger, Buffett's investment partner and vice president of Berkshire.

"The idea that chopping down trees, running them through million-dollar presses ... is going to be competitive with some little click on a computer" is nonsense, Buffett said.

While Internet news is largely dominated by newspapers, there is no guarantee that newspapers will be able to corner that market, Munger said.

"They are sure they can dominate that," he said. "I am by no means sure."

Even as Buffett touted the efficiency of the Internet, he held firm to his stance that he cannot invest in the technology stocks that blossomed from it.

"It's a great spectator sport for me. I just don't want to bet on the game," Buffett said.

Buffett is known for investing only in companies he understands. Berkshire's holdings include such brand name companies as Coca-Cola, Gillette, Dairy Queen and Benjamin Moore paints.

The future of Internet companies eludes him, Buffett said.

"I just don't know who's going to make the money in it," he said.

Neither does most of Wall Street, if last year's plummet of tech stocks is any indication.

Buffett was roundly criticized by some Berkshire investors at last year's meeting for refusing to invest in tech stocks.

Many returned this weekend to thank him.

"Tech stocks ... they're not so good," said 14-year-old shareholder Jason Meyer of Madison, Neb.

On The Net:

Berkshire Hathaway Inc.: http://www.berkshirehathaway.com

AP-NY-04-29-01 1953EDT

Some of America's rich urge no repeal of estate tax

Version 1

NEW YORK (Reuters) - Some of the richest Americans are urging Congress not to repeal the estate tax, The New York Times reported Wednesday.

The report said about 120 wealthy Americans had signed a petition to oppose phasing out the tax, which is assessed on the net worth of someone at death. President Bush has included the repeal of the tax in his $1.6 billion tax-cut proposal.

Among those signing the petition were George Soros, a billionaire financier; Warren Buffett, an investor listed as America's fourth-richest person; the philanthropist David Rockefeller; and William Gates Sr., a Seattle lawyer and father of America's richest man, Microsoft Corp. Chairman Bill Gates.

The petitioners argue that repealing the tax will cost the Treasury billions of dollars in lost revenues and will result in either increased taxes in the long run or cuts to Medicare, Social Security, environmental protection and other government programs.

Repealing the levy, which Bush calls a death tax, "would enrich the heirs of America's millionaires and billionaires, while hurting families who struggle to make ends meet," the petition says.

The petition will appear as an advertisement in The New York Times on Sunday and in other newspapers later, the Times said.

Buffett told the Times that repealing the estate tax would be a "terrible mistake" and the equivalent of "choosing the 2020 Olympic team by picking the eldest sons of the gold-medal winners in the 2000 Olympics."

Gates Sr. was quoted as saying his son was "sympathetic" to the cause.

Warren Buffett

Buffett and Bill Gates have both said they will give away most of their fortunes in bequests at their death, the Times said.

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Version 2

A Sign That the Death Tax May Live to See Another Day

George Soros, Warren Buffett and Bill Gates' dad are all against George W. Bush's estate tax repeal. It could be an indication that the proposal will be sacrificed at the tax-cut altar

BY FRANK PELLEGRINI

HERBERT KNOSOWSKI/AP Bill Gates: Wants to pay his estate taxes

Printable Version

William H. Gates, father of Bill, says he would have started a club called "Millionaires for the Estate Tax," if he'd had the time.

Warren Buffett

Instead, some of the nation's stinkingest stinking rich men are banding together a little more informally — in a petition that will run as a full-page ad in Sunday's New York Times, for starters — to explain to George W. Bush and congressional Republicans why their proposed repeal of the so-called "death tax" is not a good idea.

"Repealing the estate tax," the petition reads, "would enrich the heirs of America's millionaires and billionaires while hurting families who struggle to make ends meet... would have a devastating impact on public charities... would be bad for our democracy, our economy and our society." The petitoners add that adjustments may be needed to help families passing down farms and small businesses. "Let's fix the estate tax, not repeal it."

Sounds, quite frankly, like something Tom Daschle and Dick Gephardt would say, and indeed some of the signatories have given some of their big bucks to the Democratic party. But Gates, who organized the drive (and assures us his son agrees in spirit but preferred not to get involved), insists that partisanship had nothing to do with it. Just some civic-minded billionaires who think legislated financial dynasties are bad for America.

Which may not be surprising coming from hippie ice-cream magnate Ben Cohen, or even the politically liberal George Soros. But there are two Rockefellers on the list as well — philanthropist David Rockefeller Jr., former chairman of Rockefeller & Company, and Steven C. Rockefeller, chairman of the Rockefeller Brothers Foundation. Not to mention Agnes Gund, a philanthropist whose family owns stakes in many companies. Warren Buffett, the zillionaire

[redacted]

investor who's newly revered these days for weathering the tech bubble-bust with his zillions intact, didn't sign — but only because the petition didn't go far enough.

"We have come closer to a true meritocracy than anywhere else around the world," Buffett told the Times. "You have mobility so people with talents can be put to the best use. Without the estate tax, you in effect will have an aristocracy of wealth, which means you pass down the ability to command the resources of the nation based on heredity rather than merit."

It's a distinctly American idea, that the best kind of rich man is the self-made, Horatio Alger kind — and that goes for the rich man's heirs too. "Old money" no longer has much hold on the American imagination, and "nouveau riche" is no longer an insult (especially among the nouveau not-so-riche). Nobody wants to be like the Europeans anymore, especially since we got so much richer than them. Nobody likes a rich kid. And the dot-com gold rush, however short-lived, only reinforced the idea that America is supposed to be the land of opportunity.

Certainly these guys are impressively populist for rich old white men — it's enough to make you miss the robber barons — but the Monopoly men have certainly homed in on the repeal's political weak spots.

The estate tax puts a cap on non-taxable inheritances — currently $675,000, and already scheduled to be raised to an even million by 2006. (Farms and family businesses already enjoy the $1 million exemption.) Amounts above that threshold are taxed at rates that begin at 37 percent and rise to 55 percent for anything greater than $3 million.

The estates of fewer than 48,000 Americans a year — 2 percent of annual deaths — pay the tax now. And it remains a powerful incentive for the aging rich to give some of their millions to charity before the government gets its bite. Opponents of the plan — including the petitioners, who should know — also say that the cost of a repeal will be far greater than the $236 billion price tag Bush puts on it.

And so the estate-tax repeal is looking more and more like the perfect bone for Bush to throw the Democrats when the negotiating gets started in earnest. Despite Denny Hastert's impressive p.r. sell of the cut last year — he had the bill delivered to the White House on a tractor, playing up the family-farmer angle — it remains the most obviously rich-skewed of Bush's cuts. Turning over that paper $236 billion to the Democrats for some lower-income cuts — or pulling it from the plan altogether — could speed up the negotiations significantly.

Will Bush listen? What the superrich think the American Way ought to be may fall on deaf ears in this White House. His constituency in this case isn't really the Buffets and Gateses of the world, more the middle-class rich, the single-digits multimillionaires who just want to have big houses and two Land Rovers and send their kids and grandkids to the Ivy Leagues for generations and generations.

Like, say, the Bushes.

Ben Graham

From Berkshire Hathaway 2000 Annual Report

A bit of nostalgia: It was exactly 50 years ago that I (Warren Buffett) entered Ben Graham's class at Columbia.

During the decade before, I had enjoyed "make that loved" analyzing, buying and selling stocks. But my results were no better than average.

Beginning in 1951 my performance improved. No, I hadn't changed my diet or taken up exercise. The only new ingredient was Ben's ideas. Quite simply, a few hours spent **at the feet of the master** proved **far more valuable to me** than had ten years of supposedly original thinking.

In addition to being a great teacher, Ben was a wonderful friend. My debt to him is incalculable.

Value investing gurus Graham and Dodd back in vogue

By Martha Slud

NEW YORK (Reuters) - Nearly 70 years ago, Columbia University finance professor Benjamin Graham and junior colleague David Dodd wrote "Security Analysis," a dry-sounding tome that became the value investor's bible, embraced by famed stock pickers such as Warren Buffett.

Now, as many people pick through the rubble of the technology stock earthquake, a new generation of investors is brushing up on Graham and Dodd. The duo didn't live to see the Internet sector's boom-and-bust, but it's pretty certain that if they had been around they would not have touched a highflying dot-com stock with a 10-foot pole.

"It was a simple way of looking at the stock market," said long-time value investor Walter Schloss, who began his career as a stock analyst for Graham's investment firm, Graham-Newman Corp., in 1946. "The question is, 'what price is it (a stock) worth?"'

"Security Analysis," written five years after the 1929 stock market crash, outlines how to find good, beaten-down stocks trading below their intrinsic value based on a rigorous analysis of corporate balance sheets. Graham's systematic approach to selecting stocks for the long haul has been compared to Euclid's contributions to geometry, or Charles Darwin's impact on the study of biology.

"They are our bibles -- the Old and New Testament, so to speak," value investing disciple Deborah McGinty-Poteet said of "Security Analysis" and Graham's subsequent "The Intelligent Investor," published in 1949.

McGinty-Poteet is manager of mutual funds at Brandes Investment Partners, which is running two new Graham-Dodd-oriented value mutual funds for Banc of America's Nations Funds. The investment firm's founder, Charles Brandes, worked as Graham's stock broker after the famed author retired in the early 1970s and became a believer in Graham's investing philosophy.

The Graham-Dodd stock picking method strongly influenced Buffett, who was Graham's star student at Columbia in the early 1950s, as well as other well-known value investors, such as Mario Gabelli and Roy Neuberger.

After several years of poor performance compared with the fast-rising growth sector, value funds won hands down last year. The average multi-cap value fund rose 8.8 percent in 2000, compared with an 11.1 percent decline for the average multi-cap growth fund, according to fund tracker Lipper Inc.

With returns such as these, many business school students are taking a greater interest in value investing and its founders, said Michael Ryngaert, finance department chairman at the Warrington College of Business Administration at the University of Florida.

"Definitely, students are paying a lot more attention this year," Ryngaert said. "There is an increased interest because of largely what happened with the dot-com episode."

In another sign that Graham and Dodd are back in vogue, a rare book dealer in New York is offering a first edition of "Security Analysis" for a whopping $30,000, a price that would likely come as a shock to the book's authors. In comparison, a 1996 version of the 1934 original sells for $40 on Amazon.com.

The antique book's price is steep, admits Michael Diruggiero, co-owner of the rare books seller, TheWorldsGreatBooks.com, but he said it reflects the limited supply and high demand for the classic textbook.

"The book is so important to so many people," he said. "It's the first book to take investing from a whimsical endeavor and turn it into a science and a system that people can follow."

The book should appreciate over time for the patient buyer -- making it a true value investment, Diruggiero said.

"As an investment strategy, rare books almost certainly go up in value," he said.

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