

This was my eighth trip to the Berkshire meeting, and it continues to be the number one stop on our annual value investing travel calendar. In addition to the meeting itself, and the invaluable words of wisdom imparted by Warren Buffett and Charlie Munger, it is the biggest gathering of great value investing minds one can hope to find. Events organized by Berkshire include shareholder activities at Borsheim's jewelry store and Nebraska Furniture Mart, both of which are owned by Berkshire. There are many other events available to us over the weekend that aren't sponsored by Berkshire that one or more of us have taken advantage of over the years.

Well known value investor and publisher of *Value Investor Insight* Whitney Tilson hosts a gathering every year that I have attended in the past. Tim is a perennial guest at a reception hosted by *Of Permanent Value: The Story of Warren Buffett* author Andy Kilpatrick. And every year I attend a Sunday morning meeting hosted by Markel Corp. and their Chief Investment Officer, Tom Gayner, a well respected value investor in his own right.

After many years of eating steak at Gorat's, Buffett's favorite steakhouse, a few years ago we started branching out. On Friday night, we were joined by others of the Medley clan, Jean, Kate and William, and we ate at Dario's Brasserie, a delightful place with a good selection of food and drink in the charming Dundee neighborhood. On Saturday, Eddie and I returned to Jaipur, a tasty Indian restaurant.

As always, the trip was worthwhile – a personal and professional pleasure. I encourage all of our clients who are so inclined to go just once, while Warren and Charlie are still alive and, well, to see what all the fuss is about.

- Julius Ridgway

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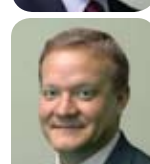
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Investment News

Medley & Brown, LLC

EXTRA EDITION 2 0 1 0



Notes from Berkshire Hathaway

Berkshire Hathaway held its annual shareholders' meeting on Saturday, May 1, in Omaha. Berkshire's recent acquisition of Burlington Northern Santa Fe Corp. ("BNSF"), in which Berkshire stock was exchanged for shares of BNSF, resulted in Berkshire's inclusion in the Standard & Poor's 500 index and a much larger and more diverse shareholder base for Berkshire. While this annual event has been widely

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followed and attended for many years, these recent developments resulted in a record crowd estimated at 37,000. This was also the second

year of a revised and much improved question-and-answer format, where questions from the audience alternated with questions selected by three journalists who culled thousands of submissions prior to the meeting. Other than that change, the format was the one we have come to expect, where Berkshire Chairman Warren Buffett and Vice Chairman Charlie Munger generously field questions for the better part of six hours. While no recording devices of any kind are allowed in the meeting, we took diligent notes in an effort to report to you the highlights of the Q&A session. For space reasons, we have edited much of the material.

Question: What are your thoughts on the financial reform bill in Congress?

Munger: Most Congressmen have not read the bill, and everyone is in doubt about what's going to happen. The government system that regulates the banks was so permissive and the culture so bad that it led to the stress that almost made the whole system go "blooey". The system needs to be less permissive. Banks don't want to lose investment flexibility. However, so much derivative exposure may not be good for the country. If I were the benevolent despot of the country I would make [former Fed chairman] Paul Volcker look like a sissy.

Question: Would the bill require Berkshire Hathaway to post collateral on existing derivative contracts on Berkshire's books?

Buffett: We have been advised that the initial requirements for Berkshire would be zero. If Berkshire were found to be "a danger to the system" by the newly created commission or the Treasury, then Berkshire could be required to post collateral on old contracts. Berkshire has 250 contracts versus millions at the investment banks. **Munger:** It would be both unfair and stupid [to require Berkshire to post collateral on existing contracts]. I don't think the government is that crazy.

Question: Talk about Greece and the future of the Euro.

Buffett: Berkshire has a lot of exposure on both the asset and liability sides in Europe, but no dramatic net exposure to any one currency.

Munger: Generally speaking, and with few exceptions, we are agnostic about the relative values of currencies.

Buffett: People have to distinguish between countries that borrow in their

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own currencies and those that borrow in other currencies. If you borrow in your own currency all you need is a printing press – you don't default. When you are forced to borrow in other currencies that is when you see failure. Greece is interesting because it is a sovereign state, but they can't print their own currency because they are tied to the Euro. The Euro was an interesting experiment but we may be seeing a test case play out.

Question: What is the biggest challenge facing U. S. investors relative to other countries, and what are the implications for investors given the global investment landscape?

Munger: We don't have a global allocation system [at Berkshire Hathaway]. We look for things that seem sensible. We are, however, more comfortable with some countries than others.

Buffett: We did not buy Burlington Northern Santa Fe to move it to China. I love that it is in the U. S. and am very optimistic about it. To your question about challenges to investors, the biggest threat is some sort of massive nuclear, chemical or biological attack. And while the probability of such an event over one year is very low, the probability over the next 50 years is high.

Julius, Tim, Doug and Eddie at 5:45 a.m. in line for good seats.



Question: How did the four Chief Investment Officer candidates [to eventually replace Buffett in that capacity] perform over the 2008-09 period? Did they use leverage?

Buffett: There has been some movement in the list. They did not distinguish themselves in '08. They did pretty darn well in '09. For the most part they did not use leverage. The potential CIO list will move around more than the CEO successor. If I died tonight, there would be a new CEO within 24 hours.

Munger: One of the candidates made 200% in 2009 with no leverage.

Question: Explain the shift to investing in capital intensive businesses and the impact on the intrinsic value of Berkshire.

Buffett: We are putting money into good businesses but they aren't as good as the businesses we could buy when we were dealing with less money. See's Candy requires \$40 million in capital and earns a great return. But wonderful businesses don't soak up a lot of capital. That's one of the reasons they're wonderful. So you can't reinvest in See's and expect to earn the same returns. The world is not set up for us to reinvest \$10 billion at a time. But does that mean we should pay out excess capital instead? Not as long as we think we can allocate the capital intelligently. I don't know what future returns will be, but it would be a mistake to expect exceptional returns from such a large capital base.

Question: When you made your investment in Harley Davidson and others in February, 2009, why did you use debt versus equity? Harley

stock has gone up three-fold versus [your debt instrument yielding] 15%.

Buffett: You are asking the question today but at the time, 15% looked pretty damned attractive. I knew enough to lend them money but not enough to buy their equity.

Munger: We are a fiduciary for a lot of people, so we are constrained.

Buffett: We have \$60 billion in liabilities in our insurance companies, so we will never have everything in stocks.

Question: Why are you not investing in India at the rate it is growing?

Buffett: Berkshire does have and is developing more connections there. But India has distinct requirements that have disallowed non-Indian companies from being in the insurance business there. I am going to India to see what Iscar [Berkshire subsidiary based in Israel] is doing there. They are absolutely looking to expand. India is expanding rapidly, and Iscar belongs there. We don't rule out India for marketable securities or direct investment.

Munger: The one trouble in India is that the government has paralysis and endless due process. China is going to grow faster than India because the government in China creates less paralysis. I admire the democracy in India but not the paralysis.

Question: Share your thoughts on the risk of inflation in the U.S.

Buffett: I have always worried about inflation. Charlie talks about how the dollar has depreciated 90% since 1930 but it has not been the end of the world for the U. S. The risk of significant inflation across the world is higher. Governments have embraced things that could lead to inflation. Weaning off the medicine may turn out to be worse than the initial illness. There is no way that countries with high deficits relative to GDP won't see the diminution of currency value over time.

Munger: If I can be optimistic when I am almost dead, you guys can deal with a little inflation. [He is 86 years old.]

Question: Comment on models used by Berkshire's insurance operations after the widespread failure of models during the financial crisis.

Buffett: Berkshire's willingness to take big losses that others are not is a permanent and significant competitive advantage. We can lose \$3 billion in a single event and not feel any different the next day.

Munger: Berkshire deliberately seeks to insure risks that might provide large losses. We just want

to be rich enough that any one big loss won't hurt us.

Question: What do you think about short sellers being investigated for being publicly bearish and short selling companies?

Buffett: There is nothing wrong with people who are positive or negative speaking out as long as they are responsible in what they say. When you attack the conventional wisdom, you get a lot of negative feedback.

Munger: To an extent you are blaming the wrong people. Accountants get very little criticism in this country, and that's a mistake.

Buffett: When you attack the conventional wisdom, you get a lot of negative feedback.

Question: Discuss some of the synergies among Berkshire companies and whether you

encourage them to do business with one another. For example, why do some Dairy Queen stores not serve Coke products or accept American Express?

Buffett: There are 6,000 Dairy Queen stores around the world, and 99% of them are franchised. Many franchisees serve Coke, but it is entirely their business whether they sell Coke or Pepsi. Synergies at Berkshire come at the operational level. We don't tell our companies to do business with each other, but we are happy if they do.

Question: Mr. Buffett, what is the most important thing you have learned from Charlie? [This question, asked by a Chinese girl, was misunderstood by Buffett and Munger, who thought she asked what they had learned from China.]

Buffett: China is an amazing economy. In 1790 there were 290 million people in China versus only 4 million in the U. S., but for some reason for 170 years very little progress was made. The potential of the Chinese is now being realized, and it is a sight to behold.

Munger: There are some very unusual people at BYD [a Chinese investee company]. I knew from Chinese-Americans I had dealt with that the Chinese people had enormous potential for success, but I underrated how fast it could happen.

Question: Last year you were down on newspapers. What are your views today?

Buffett: Newspapers are no longer the only

game in town, and that's a big difference to advertisers. The world has changed so much in terms of the essential nature of newspapers. They have lost their immediacy – people no longer rely on papers for things like stock quotes and sports results. Newspapers are still essential to me but are clearly not for the rest of society. It blows your mind how fast people are dropping them. I can't make an affirmative case for owning them. In 1970, nothing was more bullet-proof.

Munger: Newspapers once had an impregnable strength. They were known as the Fourth Estate and kept government honest. We are losing an institution that is important to this country, and I have no idea what to do about it. Politicians are going to behave more badly as a result. We are going to miss the newspapers.

Question: Mr. Buffett, are you still as optimistic about investing in the U. S. as when you wrote the Op-Ed piece in *The New York Times* ["Buy American. I am." October 16, 2008]?

Buffett: There have only been a handful of times in 30 – 40 years that I have stated my opinion about the market as a whole. I would rather own U. S. equities than bonds or cash. But [with stocks] you need the right

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temperament. If when others are fearful you get scared too, you won't make much money in stocks.

Munger: Equities are the best of a bad lot of opportunities. I am optimistic about the future [citing China and India's potential].

Question: What question would you ask yourselves regarding Berkshire?

Buffett: Can you continue to effectively deploy the capital you generate for a very long time? There will come a point when we cannot. I think we can go further than I would have thought 30 years ago, but there will come a time when we can't intelligently allocate all the capital we generate. At that point we will do what's best for Berkshire shareholders.

Munger: We will find people on the investing side that are almost as good as Warren. Some of these people may even have qualities that Warren lacks. So, it won't be all negative when he's not around.