

WARREN BUFFETT GUIDE TO INVESTING

Warren Buffett is showing no signs of slowing down in his early nineties amid an increasingly difficult investing environment. Despite the turmoil, the “Oracle of Omaha” has been as active as ever.

Buffett’s buying spree of energy giant Occidental Petroleum continued in 2023, as he took advantage of a pullback in prices, boosting Berkshire Hathaway’s stake in the oil giant to more than 20%.

Meanwhile, the investing legend proved there is no place on earth he won’t go to find a cheap stock, finding buying opportunities recently in five Japanese trading houses. Buffett even traveled to Japan in April personally, his first time there in more than 11 years, to meet with the heads at these firms personally and evaluate his investment.

While his investment picks have changed over the decades—from sectors to countries—his core investing philosophy has remained the same. Here’s how he does it today and how he’s always done it.

For Warren Buffett, deciding what stocks to buy is “simple but not necessarily easy.”

He spends most of his day reading. He calls it his “secret.” Buffett reads hundreds of pages a week to build up “compound knowledge” over decades. He reads books, newspapers, and especially, annual reports. *“The beauty of it is that the knowledge is cumulative. ... What you’re learning about Company A will help you thinking about Company B,”* he said.

It’s a lot of work, and it takes a lot of time. Buffett enjoys that work and has the time to do it. He is a professional investor.

Most people aren’t professional investors. The advice he’s given, time and time again over the years, is that for most people, the best thing to do is make regular contributions to a low-cost stock index fund and spend your time on the other things you need, or want, to do.

“You will not get that advice from anybody else because nobody gets paid to give you that advice,” he added.

Buffett also stresses this: Don’t take advice from anyone who is paid to offer it. *“You will have all kinds of people telling you how much better they can do for you”* if you pay them, *“but they won’t do better.”*

“They come in and they talk for hours, and you pay them a large fee, and they always suggest something other than just sitting on your rear end and participating in American business without cost.”

— 2016 BERKSHIRE ANNUAL MEETING

To prove his point, in 2007, he made a massive 10-year bet for charity with a proponent of active investing that a low-cost Vanguard S&P 500 index fund would outperform a hand-picked basket of hedge funds, which charge large fees.

At the end of the wager, the S&P index fund had gained 125.8%. The hedge funds were up an average of around 36%.

A key element of the index fund strategy, however, is that you don’t put everything in at once.

“I would do it over a period of time, because the very nature of index funds is that you are saying, I think America’s business is going to do well over a — reasonably well— over a long period of time, but I don’t know enough to pick the winners and I don’t know enough to pick the winning times.”

— 2002 BERKSHIRE ANNUAL MEETING

If you *do* want to do it yourself, Buffett says you need to know three investing principles that have guided him since he was a young man.

They’re from a book first published in 1949: “The Intelligent Investor” by Benjamin Graham. Buffett read it while he was an undergraduate at the University of Nebraska.

“‘The Intelligent Investor’ changed my life. ... Graham’s book gave me a philosophy, a bedrock philosophy, on investing that made sense.”

— 2013 BERKSHIRE ANNUAL MEETING

PRINCIPLE ONE

Don’t look at a stock like it is a ticker symbol with a price that goes up and down on a chart. It’s a slice of a company’s profits far into the future, and that’s how they need to be evaluated.

“Charlie (Munger, Buffett’s longtime business partner) and I haven’t the faintest idea where the stock market is going to go next week, next month, or next year. We never talk about it. ...

“What we see when we look at the stock market is thousands and thousands and thousands of companies priced every day, and we ignore 99.9 percent of what we see... and then every now and then we see something that looks like it’s attractively priced to us, as a business. Forget about the word ‘stock.’

“When we buy a stock, we would be happy with that stock if they told us the market was going to close for a couple years. We look to the business.”

What does Buffett look for in a business? In his 1977 letter to shareholders, Buffett listed four things he wants to see, whether he’s buying the entire company for Berkshire, or just a slice of it as a stock.

1. “One that we can understand...”

When Buffett talks about “understanding” a company, he means he understands how that company will be able to make money far into the future.

He’s often said he didn’t buy shares of what turned out to be very successful tech companies such as Google and Microsoft because he didn’t understand them. At the 2000 annual meeting, a skeptical shareholder told Buffett he couldn’t imagine him not understanding something. Buffett responded, “Oh, we understand the product. We understand what it does for people. We just don’t know the economics of it 10 years from now.”

2. “With favorable long-term prospects...”

Buffett often refers to a company’s sustainable competitive advantage, something he calls a “moat.”

“Every business that we look at we think of as an economic castle. ... And you want the capitalistic system to work in a way that millions of people are out there with capital thinking about ways to take your castle away from you, and appropriate it for their own use. And then the question is, what kind of a moat do you have around that castle that protects it?”

— 2000 BERKSHIRE ANNUAL MEETING

A “moat” consists of things a company does to keep and gain loyal customers, such as low prices, quality products, proprietary technology, and, often, a well-known brand

built through years of advertising, such as Coca-Cola. An established company in an industry that has large start-up costs that deter would be competitors can also have a moat.

3. “Operated by honest and competent people...”

“Generally, we like people who are candid. We can usually tell when somebody’s dancing around something, or where their—when the reports are essentially a little dishonest, or biased, or something. And it’s just a lot easier to operate with people that are candid.

“And we like people who are smart, you know. I don’t mean geniuses. ... And we like people who are focused on the business.”

— 1995 BERKSHIRE ANNUAL MEETING

The quality of the business itself, however, takes precedence.

“The really great business is one that doesn’t require good management. I mean, that is a terrific business. And the poor business is one that can only succeed, or even survive, with great management.”

— 1996 BERKSHIRE ANNUAL MEETING

4. “Available at a very attractive price.”

“The key to [Benjamin] Graham’s approach to investing is not thinking of stocks as stocks or part of a stock market. Stocks are part of a business. People in this room (Berkshire shareholders) own a piece of a business. If the business does well, they’re

going to do all right as long as they don't pay way too much to join into that business."

— 1997 BERKSHIRE ANNUAL MEETING

Buffett's goal is to buy when the price is below a company's "intrinsic value."

"The intrinsic value of any business, if you could foresee the future perfectly, is the present value of all cash that will be ever distributed for that business between now and judgment day.

"And we're not perfect at estimating that, obviously. (Laughs)

"But that's what an investment or a business is all about. You put money in, and you take money out.

"Aesop said, 'A bird in the hand is worth two in the bush.' Now, he said that around 600 B.C. or something like that, but that hasn't been improved on very much by the business professors now."

— 2014 BERKSHIRE ANNUAL MEETING

PRINCIPLE TWO

The stock market is there to serve you, not instruct you.

Many nonprofessional investors become concerned when stock prices fall. They think the market is telling them they made a mistake. Some may even be so shaken that they sell stocks at the lower prices.

Buffett takes the opposite view. If he buys a stock because he thinks the company will be a long-term winner, he doesn't let the market convince him otherwise.

"My enthusiasm for stocks is in direct proportion to how far they go down. I like it when things I like go down in price. ...

"Am I better off if I have to pay high prices or low prices? So, it's not bad news for us when stocks go down at all. Now, you know, it's bad news for us when something goes wrong with a company.

"But the fact that something gets cheaper, I mean, if I walked into McDonald's tomorrow and they've cut the prices of hamburgers by half, you know, I will be happy because I'm going to be buying hamburgers for a long time."

— CNBC SQUAWK BOX INTERVIEW, MARCH 1, 2010

Fear is a natural reaction when stocks fall. Most people find the pain of losing something is greater than the pleasure of gaining something.

Buffett talks about the importance of emotional discipline.

"If you have a temperament that when others are fearful you're going to get scared yourself, you know, you are not going to make a lot of money in securities over time, in all probability.

"You know, people really — if they didn't look at quotations — but, of course, the whole world is urging them to look at quotations,

and more than that, do something based on small changes in quotations...

“Think how much more rational investing in a farm is than the way many people buy stocks.

“If you buy a farm, do you get a quote next week, do you get a quote next month? If you buy an apartment house, do you get a quote next week or month?

“No, you look at the apartment house or the farm and you say, I expect it to produce so many bushels of soybeans and corn, and if it does that, it meets my expectations. ...

“Some people really do not have the — apparently, they don’t have the temperament, or emotional stability, or whatever it may be, to invest in securities. ...

“In the end, what counts is buying a good business at a decent price, and then forgetting about it for a long, long, long time. And some people can do it and some people can’t.”

— 2010 BERKSHIRE ANNUAL MEETING

The traditional view is that investors face greater risk when stock prices are making big moves, up or down. For Buffett, that volatility is good because there’s a greater chance there will be “mistakes” in the market. And when those mistakes push a stock price lower, it can be an opportunity.

“Ben Graham used the example of ‘Mr. Market.’ ...

“And Ben said, “You know, just imagine that when you buy a stock, that you — in effect, you’ve bought into a business where you have this obliging partner who comes around every day and offers you a price at which you’ll either buy or sell. And the price is identical.

“And no one ever gets that in a private business, where daily you get a buy-sell offer by a party. But in the stock market you get it. That’s a huge advantage. And it’s a bigger advantage if this partner of yours is a heavy-drinking manic depressive. (Laughter)

“The crazier he is, the more money you’re going to make.”

— 1997 BERKSHIRE ANNUAL MEETING

PRINCIPLE THREE

Maintain a margin of safety

“We try not to do anything difficult. ...“This is not like Olympic diving. In Olympic diving, they have a degree of difficulty factor. And if you can do some very difficult dive, the payoff is greater if you do it well than if you do some very simple dive.

“That’s not true in investments. You get paid just as well for the most simple dive, as long as you execute it all right. And there’s no reason to try those three-and-a-halves when you get paid just as well for just diving off the side of the pool and going in cleanly. (Laughter)

“So, we look for one-foot bars to step over rather than seven-foot or eight-foot bars to try and set some Olympic record by jumping over. And it’s very nice, because you get paid just as well for the one-foot bars.”

– 1998 BERKSHIRE ANNUAL MEETING

Beyond Graham’s three principles, Buffett has a list of things you should do as an investor, and things you shouldn’t do.

Do buy and hold (mostly)

Buffett often says his favorite holding period is “forever” and recommends buying a stock that you don’t ever want to sell. But he stresses, that doesn’t mean he never sells a stock. If a company loses its long-term competitive advantage or he thinks the money can be used for a better opportunity elsewhere, Buffett will, and has, sold stocks in Berkshire’s portfolio.

Do grab opportunities

“Big opportunities come infrequently. When it’s raining gold, reach for a bucket, not a thimble.”

– 2009 LETTER TO BERKSHIRE SHAREHOLDERS

Do go against the crowd

“We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful.”

– 1986 LETTER TO BERKSHIRE SHAREHOLDERS

Do stay in your “circle of competence”

Buffett often uses baseball legend Ted Williams to illustrate an important aspect of his investing philosophy.

As Buffett explained in an HBO documentary, “If he waited for the pitch that was really in his sweet spot, he would bat .400. If he had to swing at something on the lower corner, he would probably bat .235.

“The trick in investing is just to sit there and watch pitch after pitch go by and wait for the one right in your sweet spot. And if people are yelling, ‘Swing, you bum!’ ignore them.”

And those “fat” pitches are likely to be in what Buffett calls his “circle of competence”.

“You don’t have to be an expert on every company, or even many. You only have to be able to evaluate companies within your circle of competence. The size of that circle is not very important; knowing its boundaries, however, is vital.”

– 1996 LETTER TO BERKSHIRE SHAREHOLDERS

Do not try to time the market

“We don’t have an opinion about where the stock market’s going to go tomorrow or next week or next month. So, to sit around and not do something that’s sensible because you think there will be something even more attractive, that’s just not our approach to it.

“Anytime we get a chance to do something that makes sense, we do it. And if it

makes even more sense the next day, and if we've got money, we may do more...

"Picking bottoms is basically not our game. Pricing is our game. And that's not so difficult. Picking bottoms, I think, is probably impossible."

— 2009 BERKSHIRE ANNUAL MEETING

Do not get envious of people making money from risky behavior

"People win lotteries every day, but there's no reason to have that affect you at all. You shouldn't be jealous about it."

"If they want to do mathematically unsound things, and one of them occasionally gets lucky, and they put the one person on television, and the million that contributed to the winnings—with the big slice taken out for the state—don't get on, it's nothing to worry about."

"All you have to do is figure out what makes sense... Let the rest of the world go its own way. You don't want to get into a stupid game just because it's available."

— 2016 BERKSHIRE ANNUAL MEETING

Do not bet against a stock's price by shorting it

"It's tempting. You see way more stocks that are dramatically overvalued in your career than you will see stocks that are dramatically undervalued..."

"It is a very, very tough business because of the fact that you face unlimited losses, and

because of the fact that people that have overvalued stocks—very overvalued stocks—are frequently on some scale between promoter and crook..."

"But it is very painful and, in my experience, it was a whole lot easier to make money on the long side."

— 2001 BERKSHIRE ANNUAL MEETING

Do not buy stocks on margin

"It is crazy, in my view, to borrow money on securities... It's insane to risk what you have and need for something you don't really need."

"Borrowing money is a way of trying to get rich a little faster, but there are plenty of good ways to get rich slowly. And you can have a lot of fun while you're getting rich as well."

— CNBC "SQUAWK BOX" INTERVIEW, FEBRUARY 26, 2018

Do not invest in nonproductive assets like gold and cryptocurrencies

"If you owned all the gold in the world you could have a cube that would be 67 or 68 feet on a side, and you could get a ladder and you could climb up on top of it, and you could say, I'm sitting on top of the world, and think you're king of the world."

"You could fondle it, you could polish it, you could do all these things with it. Stare at it. But it isn't going to do anything..."

“Anytime you buy an asset that can’t do anything, produce anything, you’re simply betting on whether somebody else will pay more for, again, an asset that can’t do anything...”

“I would bet on good-producing businesses to outperform something that doesn’t do anything over any period of time.”

— 2011 BERKSHIRE ANNUAL MEETING

“If you and I buy various cryptocurrencies, they’re not going to multiply—they’re not going to be a bunch of rabbits sitting there in front of us. They’re just going to sit there.

“And I got to hope next time you get more excited after I’ve bought it from you, and then maybe I’ll get more excited and buy it from you.

“And actually, we could sit in the house by ourselves and we could keep running up the price between the two of us. But at the end of the time, there’s one bitcoin sitting there. And now we’ve got to find somebody else.”

— CNBC “SQUAWK BOX” INTERVIEW, MAY 7, 2018

Finally, two important things to remember in investing and life from Warren:

1. Doubling your net worth won’t make you way happier, especially considering the risk you would have to take.

“I wasn’t unhappy when I had \$10,000 when I got out of school. I was having a lot of fun. I was looking for things to buy. And the fact that after I spent \$10,000 I ran out

of money meant that I just kept looking for things that were better than the ones I already had.

“But if you think that if you have \$100,000 that means that you’re an unhappy person and a million dollars is going to make you happy, it is not going to happen. Then you’ll look around and you’ll see people with two million. And it just doesn’t work that way.

“You will not be way happier if you double your net worth. You’ll get kind of a euphoric surge or something like that, but to risk starting all over again and losing everything... it’s just madness.”

— CNBC “SQUAWK BOX” INTERVIEW, FEBRUARY 26, 2018

2. Remember the power of unconditional love

“Unconditional love is the most powerful force in the universe. I got unconditional love from my parents... and I’ve been blessed in that I love what I’m doing so much that I have no desire to get away. I’m playing in my playground.”

— WARREN BUFFETT SPEAKING TO HARVARD STUDENTS, OCTOBER 2007

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