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This newsletter summarizes the Berkshire Hathaway annual meeting events and topics highlighted there.

Value Investing Issues

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I attended three events tied to the Berkshire Hathaway annual meeting this year. The CFA Nebraska Value Investors' Dinner on Thursday, Creighton University's Value Investing Panel on Friday and the main event on Saturday (I was able to stay for the entire Q&A session this year but left right before the formal meeting began).

Berkshire Hathaway Annual Meeting May 3, 2014

Brand

The subject of branding was surprisingly not asked at the meeting or in interviews surrounding the weekend. Berkshire has rebranded several subsidiaries to clearly identify them with the holding company. HomeServices is now called Berkshire Hathaway HomeServices, and I have For Sale signs in my neighborhood to prove it, with a maroon background. Berkshire Hathaway Specialty Insurance, which offers financial reinsurance type products, was started in 2006 and recently branded itself with blue as the primary color. MidAmerican Energy Holdings, an energy provider, is now Berkshire Hathaway Energy (although they have yet to redesign their logo). This is an interesting switch for Buffett, who has traditionally left companies alone to retain their identity. The real estate company will be drawn to the integrity of the Buffett brand, utility growth may be helped by Berkshire's reputation from past acquisitions, and BHSI will use the name to attract business partners. Some of the companies would not make sense to rebrand, such as BNSF (risk of accidents) and McLane (desire to fly under the radar). Others, such as Dairy Queen and Justin Brands are so well known in their market that a change would be counterproductive. Over the next couple of years it will be interesting to monitor this development to see which subsidiaries are rebranded and which are not.

Board Members

As Buffett says, the most important reason to have a board is to pick the CEO. So why does he continue to fill the board with octogenarians? He and Munger should stay, but friends of Warren should go. At the same time as the board is most needed, these great businessmen will be dropping off due to death, disability or lack of interest once Warren is gone. The great decision for the board is if Howard Buffett, Warren's son, will continue as chairman or if someone with a stronger business background is found. Hopefully Bill Gates will stay involved. The fact that "dad" had to explain his vote on the Coke board about pay says it all. Howard is on the board at Coke due to Berkshire's 10%

stake in KO, yet his dad says he represents the shareholders. I want him to represent the Berkshire shareholders.

I also note that Berkshire has added several women to the board in an attempt to be more diversified. While I think Meryl Witmer was an excellent addition last year, I do not understand why Susan Decker is on the board at all. She was fired from Yahoo!, spent a year at Harvard Business School teaching, and now appears to be a professional board member. She is the poster child for what Buffett makes fun of during the meeting.

Information

Berkshire has accumulated a variety of companies that provide Buffett with consumer trends before the government reports them. He doesn't talk about it, but I wonder if this is a conscious effort or a lucky coincidence. Examples include BNSF, Borsheims, and the myriad of holdings at Marmon. Although he dislikes macroeconomic forecasts, he is the recipient of a lot of macro data.

Removing Ignorance

My favorite quote of the day comes from Charlie Munger, saying that a key part of investing is "removing ignorance". This is simply another way of talking about lifelong learning and latticework concepts, but I really like it.

Cost of Capital

While working at an insurance company, one of the last things I was asked to do was calculate THE cost of capital for the firm. I presented several options, noting that the choice among them came from personal preference, and was chewed out for doing so. I was pleased to have Munger talk about the lack of an obvious answer and the use at Berkshire Hathaway of opportunity cost as decision maker.

Incentives

I like to talk about incentives and how they direct the actions of management, and was intrigued by Munger's comments about transparency of pay plans. While you generally would think it was good to be transparent about pay of senior managers, he finds it less than useful as it leads to envy and peer pressure to increase pay across the board. Companies tend to target pay in the top quartile, so the math is fairly obvious. Benefits consultants have little incentive to encourage lower salaries.

Quotes (taken from Omaha World-Herald May 4, 2014

Benchmark

When asked why Berkshire uses an apples to oranges comparison or the S&P500 total returns to Berkshire book value, which I have always found to be a very challenging benchmark especially as the company moves to fully owned subsidiaries, Munger had this to say: …*Warren wants to make things difficult for himself. It makes it hard for Warren to look good. It's insane.* I agree.

<u>*Outperformance*</u>
Asked about how it will be harder to outperform as Berkshire gets bigger, Munger makes a side comment. *I think we've adapted pretty well to changes in our circumstances. Since change is inevitable, how well you adapt to it is terribly important.* As you think about the strategies used by Buffett over the years, everything from arbitrage to stock picker to accumulator, their ability to adapt to what is cheap at the current time using the same basic tools is very strong vote for the value investing methodology.

<u>*Charlie as CRO*</u>
Buffett: *Charlie, he's my canary in the coal mine.*

<u>*Buffett's description of Munger, according to Munger*</u>
You once called me the abominable no-man.

Best Article

Andrew Ross Sorkin, of NY Times and CNBC and one of the journalists allowed to ask questions on "game day", wrote a nice piece after the meeting about how trust plays into the cult of Berkshire Hathaway. Munger calls it "overtrust", and is aware that it will lead to isolated problems while building the overall culture of a broad array of firms. He shares that having the right controls, trustworthy managers (and trusting them) is better than overprotective corporate lawyers and HR staffs. What he doesn't mention is that each of the subs has their own legal and HR departments. I have always been concerned that Berkshire's incentives seem to reward the "chiefs" quite heavily while leaving it up to the chiefs to incent the "Indians". This seems like something to watch, especially once Buffett-Munger are gone. The front running of Lubrizol stock, and the rumors that it was a common practice at the firm, should make regulators wary. Trust but verify remains a valuable strategy for auditors and regulators.

Current Research

I recently completed a research project on reasons why interest rates could stay low, and have recently started a project considering high interest rates. My current thinking is not what rates will do, but what they are unlikely to do. They are unlikely to stay level or go up slowly. I think they will either go down, creating deflation, or jump up to double digits. I could even argue that they will do both, increasing first as a result of deficits and money printing, and then drop below zero as demographics take over. A shock to the economy, perhaps due to energy prices as occurred in the 1970s, could generate a spike in rates of all kinds. This has led me to think about how that might impact my personal investing strategies, in particular if I should spend more time thinking about utilities. This would be a hedge against deflation since their returns are guaranteed on a nominal basis. My current holdings have inflation hedges, but if rates go down equities will generally do poorly. We should all spend more time thinking about the differences between real and nominal rates.

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