Buffett’s investment in 2008

About the company

- Berkshire Hathaway Inc. is a holding company owning subsidiaries that engage in a number of diverse business activities including
  - property and casualty insurance and reinsurance
  - utilities and energy
  - Finance
  - manufacturing, services and retailing
- Included in the group of subsidiaries that underwrite property and casualty insurance and reinsurance is GEICO, the third largest auto insurer in the United States and two of the largest reinsurers in the world, General Re and the Berkshire Hathaway Reinsurance Group.

Year			
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	.7
1998	48.3	28.6	19.7
1999	.5	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(.4)
2005	6.4	4.9	1.5
2006	18.4	15.8	2.6
2007	11.0	5.5	5.5
2008	(9.6)	(37.0)	27.4
Compounded Annual Gain – 1965-2008	20.3%	8.9%	11.4
Overall Gain – 1964-2008	362,319%	4,276%	

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2007	11.0	5.5	5.5
2008	(9.6)	(37.0)	27.4
2009	19.8	26.5	(6.7)
Compounded Annual Gain – 1965-2009	20.3%	9.3%	11.0
Overall Gain – 1964-2009	434,057%	5,430%	

2008 performance

- Our decrease in net worth during 2008 was $11.5 billion, which reduced the per-share book value of both our Class A and Class B stock by 9.6%.
- Over the last 44 years (that is, since present management took over) book value has grown from $19 to $70,530,a rate of 20.3% compounded annually.

Forecast of the future

- In 75% of those years, the S&P stocks recorded a gain. I would guess that a roughly similar percentage of years will be positive in the next 44.
- But neither Charlie Munger, my partner in running Berkshire, nor I can predict the winning and losing years in advance. (In our usual opinionated view, we don’t think anyone else can either.)
- We’re certain, for example, that the economy will be in shambles throughout 2009 , but that conclusion does not tell us whether the stock market will rise or fall.

two major areas of value

- The first is our investments: stocks, bonds and cash equivalents. At yearend those totaled $122 billion. About $58.5 billion of that total is funded by our insurance float.
- second component of value is earnings that come from sources other than investments and insurance. These earnings are delivered by our 67 non-insurance companies.

focus on four goals

- (1) maintaining Berkshire's Gibraltar-like financial position, which features huge amounts of excess liquidity, near-term obligations that are modest, and dozens of sources of earnings and cash;
- (2) widening the "moats" around our operating businesses that give them durable competitive advantages;
- (3) acquiring and developing new and varied streams of earnings;
- (4) expanding and nurturing the cadre of outstanding operating managers who, over the years,have delivered Berkshire exceptional results.

New business

- Early in 2008, we activated Berkshire Hathaway Assurance Company ("BHAC") as an insurer of the tax-exempt bonds issued by states, cities and other local entities.
- BHAC insures these securities for issuers both at the time their bonds are sold to the public (primary transactions) and later, when the bonds are already owned by investors (secondary transactions).

New business

- Early in the year, Berkshire offered to assume all of the insurance issued on tax-exempts that was on the books of the three largest monolines.
- These companies were all in life-threatening trouble .
- We would have charged a 1.5% rate to take over the guarantees on about $822 billion of bonds.

New business

- The monolines summarily rejected our offer, in some cases appending an insult or two.
- we wrote about $15.6 billion of insurance in the secondary market. And here’s the punch line: About 77% of this business was on bonds that were already insured, largely by the three aforementioned monolines. In these agreements, we have to pay for defaults only if the original insurer is financially unable to do so.

New business

- We wrote this “second-to-pay” insurance for rates averaging 3.3%. That’s right; we have been paid far more for becoming the second to pay than the 1.5% we would have earlier charged to be the first to pay.
- In other words, three other monolines have to first go broke before we need to write a check.

New business

- Two of the three monolines to which we made our initial bulk offer later raised substantial capital. This, of course, directly helps us, since it makes it less likely that we will have to pay, at least in the near term.
- In addition to our book of secondary business, we have also written $3.7 billion of primary business for a premium of $96 million.

Most important

- The investment world has gone from underpricing risk to overpricing it.
- A few years ago, it would have seemed unthinkable that yields like today's could have been obtained on good-grade municipal or corporate bonds even while risk-free governments offered near-zero returns on short-term bonds and no better than a pittance on long-terms.

Most important

- When the financial history of this decade is written, it will surely speak of the Internet bubble of the late 1990s and the housing bubble of the early 2000s. But the U.S. Treasury bond bubble of late 2008 may be regarded as almost equally extraordinary.

Most important

- Clinging to cash equivalents or long-term government bonds at present yields is almost certainly a terrible policy if continued for long. Holders of these instruments, of course, have felt increasingly comfortable –in fact, almost smug – in following this policy as financial turmoil has mounted.
- They regard their judgment confirmed when they hear commentators proclaim "cash is king," even though that wonderful cash is earning close to nothing and will surely find its purchasing power eroded over time.

Most important

- Approval, though, is not the goal of investing. In fact, approval is often counter-productive because it sedates the brain and makes it less receptive to new facts or a re-examination of conclusions formed earlier.
- Beware the investment activity that produces applause; the great moves are usually greeted by yawns.

View on derivatives

- Derivatives are dangerous. They have dramatically increased the leverage and risks in our financial system.
- When Berkshire purchased General Re in 1998, we knew we could not get our minds around its book of 23,218 derivatives contracts, made with 884 counterparties (many of which we had never heard of). So we decided to close up shop. Though we were under no pressure and were operating in benign markets as we exited, it took us five years and more than $400 million in losses to largely complete the task.

View on derivatives

- why Berkshire is a party to 251 derivatives contracts ?
  - I believe each contract we own was mispriced at inception, sometimes dramatically so.
  - Our derivatives dealings require our counterparties to make payments to us when contracts are initiated. Berkshire therefore always holds the money, which leaves us assuming no meaningful counterparty risk.

View on derivatives

- Our derivatives "float," totaled $8.1 billion.
- If we break even on an underlying transaction, we will have enjoyed the use of free money for a long time.
- Our expectation, though it is far from a sure thing, is that we will do better than break even.

Derivatives example

- Some of our contracts come due in 15 years, others in 20.
  - we might sell a $1 billion 15-year put contract on the S&P 500 when that index is at, say, 1300. If the index is at 1170–down10% –on the day of maturity, we would pay $100million.
  - If it is above 1300, we owe nothing. For us to lose $1 billion, the index would have to go to zero.
  - In the meantime, the sale of the put would have delivered us a premium – perhaps $100 million to $150million –that we would be free to invest as we wish.

Derivatives example

- Our put contracts total $37.1 billion and are spread among four major indices: the S&P 500 in the U.S., the FTSE 100 in the U.K., the Euro Stoxx 50 in Europe, and the Nikkei 225 in Japan.
- Our first contract comes due on September 9, 2019 and our last onJanuary 24, 2028.
- We have received premiums of $4.9 billion, money we have invested.
- We, meanwhile, have paid nothing. Nonetheless, we have used Black-Scholes valuation methods to record a yearend liability of $10 billion, an amount that will change on every reporting date.
- The two financial items – this estimated loss of $10 billion minus the $4.9 billion in premiums we have received – means that we have so far reported a mark-to-market loss of $5.1billion from these contracts.