

# Straight Outta Omaha: OG Thoughts On Investing - Warren Buffett

Here is part three in this Warren Buffett series ([part one](#) & [part two](#)), covering a few of the sections I have pulled out from the last 50 years of [Berkshire Hathaway Letters to Shareholders](#)<sup>x</sup>, which I finished reading in October of 2017. Although the entire 50-year series was filled with a ton of business and investment wisdom, all the pieces that I pulled are from the past seven years. I admit a probable recency bias, whereby after reading almost 700 pages, I remember more of the recent letters than the older ones. Needless to say, you bet I will be reading through *all* those letters again in the future.

For the selections of this post, I pulled Buffett's insights and comments that most resonated with me. I have annotated with my emphasis **[BOLDED]** and thoughts [[in blue below](#)]. At the end, I close with my concluding thoughts and takeaways. See what you think...

This third piece comes from the [2013 shareholder letter](#) "Some thoughts About Investing:"

---

## Some Thoughts About Investing

*Investment is most intelligent when it is most businesslike.*— The Intelligent Investor by Benjamin Graham

It is fitting to have a Ben Graham quote open this discussion because I owe so much of what I know about investing to him. I will talk more about Ben a bit later, and I will even sooner talk about common stocks. But let me first tell you about two small non-stock investments that I made long ago. Though neither changed my net worth by much, they are instructive.

This tale begins in Nebraska. From 1973 to 1981, the Midwest experienced an explosion in farm prices, caused by a widespread belief that runaway inflation was coming and fueled by the lending policies of small rural banks. Then the bubble burst, bringing price declines of 50% or more that devastated both leveraged

farmers and their lenders. Five times as many Iowa and Nebraska banks failed in that bubble's aftermath than in our recent Great Recession.

In 1986, I purchased a 400-acre farm, located 50 miles north of Omaha, from the FDIC. It cost me \$280,000, **considerably less than what a failed bank had lent against the farm a few years earlier**. I knew nothing about operating a farm. But I have a son who loves farming and I learned from him both how many bushels of corn and soybeans the farm would produce and what the operating expenses would be. From these estimates, I calculated the normalized return from the farm to then be about 10%. I also thought it was likely that productivity would improve over time and that crop prices would move higher as well. Both expectations proved out.

I needed no unusual knowledge or intelligence to conclude that **the investment had no downside and potentially had substantial upside**. There would, of course, be **the occasional bad crop and prices would sometimes disappoint**. **But so what? There would be some unusually good years as well, and I would never be under any pressure to sell the property**. Now, 28 years later, the farm has tripled its earnings and is worth five times or more what I paid. I still know nothing about farming and recently made just my second visit to the farm.

One theme that you will see over and over again in Warren Buffett's investment career is his ability to keep emotion out of his investment selection process. When others are getting beaten and bruised during a financial crisis, Buffett is opportunistic, buying assets (stocks, farms, real estate, etc) below their intrinsic value. He patiently builds up cash and sits on his hands until the right opportunity presents itself. He practices his own advice to "be greedy when others are fearful." He waits for that "fat pitch" to hit it out of the park with minimal risk and asymmetrical upside.

A second theme that I have noticed studying both Buffett and his partner Charlie Munger is their preference to earn a lumpy 20% return (the compound annual growth rate they have achieved between 1965 through 2013) over decades vs. a smooth 8% year in and year out (as an example). They have the patience and mental fortitude to ride out the inevitable bad year(s). This is possible because they use minimal leverage and are thus never in a vulnerable position to sell when things go south for a period of time.

In 1993, I made another small investment. Larry Silverstein, Salomon's landlord when I was the company's CEO, told me about a New York retail property adjacent

to NYU that the Resolution Trust Corp. was selling. Again, a bubble had popped – this one involving commercial real estate – and the RTC had been created to dispose of the assets of failed savings institutions whose optimistic lending practices had fueled the folly. **Here, too, the analysis was simple.** As had been the case with the farm, the unleveraged current yield from the property was about 10%. But the property had been undermanaged by the RTC, and its income would increase when several vacant stores were leased. Even more important, the largest tenant – who occupied around 20% of the project’s space – was paying rent of about \$5 per foot, whereas other tenants averaged \$70. The expiration of this bargain lease in nine years was certain to provide a major boost to earnings. The property’s location was also superb: NYU wasn’t going anywhere.

Investing doesn’t have to be some big complicated algorithm. Some basic math skills and common sense can go a long way. Remember the “KISS” method: Keep It Super Simple. I don’t think Buffett uses a computer, but for those of us lacking such [Rain Man](#) type math skills, an Excel spreadsheet can make the most average person feel superhuman.

I joined a small group, including Larry and my friend Fred Rose, that purchased the parcel. **Fred was an experienced, high-grade real estate investor who, with his family, would manage the property. And manage it they did.** As old leases expired, earnings tripled. Annual distributions now exceed 35% of our original equity investment. Moreover, our original mortgage was refinanced in 1996 and again in 1999, moves that allowed several special distributions totaling more than 150% of what we had invested. **I’ve yet to view the property.** Income from both the farm and the NYU real estate will probably increase in the decades to come. Though the gains won’t be dramatic, the two investments will be solid and satisfactory holdings for my lifetime and, subsequently, for my children and grandchildren.

The third observation of Buffett’s approach to investing is his willingness to invest sight unseen. He finds very talented and trustworthy people, crunches the numbers, and invests with a “forever” holding period in mind. His biggest strength, in my eyes, is finding talent, recognizing a good opportunity (by crunching the numbers), and committing capital for long periods of time.

I tell these tales to illustrate certain fundamentals of investing:

- You don’t need to be an expert in order to achieve satisfactory investment

returns. But if you aren't, you must recognize your limitations and follow a course certain to work reasonably well. **Keep things simple and don't swing for the fences. When promised quick profits, respond with a quick "no."**

- **Focus on the future productivity of the asset you are considering.** If you don't feel comfortable making a rough estimate of the asset's future earnings, just forget it and move on. No one has the ability to evaluate every investment possibility. But omniscience isn't necessary; you only need to understand the actions you undertake.
- **If you instead focus on the prospective price change of a contemplated purchase, you are speculating.** There is nothing improper about that. I know, however, that I am unable to speculate successfully, and I am skeptical of those who claim sustained success at doing so. Half of all coin-flippers will win their first toss; none of those winners has an expectation of profit if he continues to play the game. And the fact that a given asset has appreciated in the recent past is never a reason to buy it.
- With my two small investments, **I thought only of what the properties would produce and cared not at all about their daily valuations.** Games are won by players who focus on the playing field - not by those whose eyes are glued to the scoreboard. If you can enjoy Saturdays and Sundays without looking at stock prices, give it a try on weekdays.
- **Forming macro opinions or listening to the macro or market predictions of others is a waste of time.** Indeed, it is dangerous because it may blur your vision of the facts that are truly important. (When I hear TV commentators glibly opine on what the market will do next, I am reminded of Mickey Mantle's scathing comment: "You don't know how easy this game is until you get into that broadcasting booth.")
- My two purchases were made in 1986 and 1993. **What the economy, interest rates, or the stock market might do in the years immediately following - 1987 and 1994 - was of no importance to me in making those investments.** I can't remember what the headlines or pundits were saying at the time. Whatever the chatter, corn would keep growing in Nebraska and students would flock to NYU.

We should all keep in mind the wisdom that Buffett has so generously given us

in the above six fundamentals. He has essentially distilled the formula to successful investing in six simple and concise points. I'm taking extra note of what I bolded in this section.

There is one major difference between my two small investments and an investment in stocks. Stocks provide you minute-to-minute valuations for your holdings whereas I have yet to see a quotation for either my farm or the New York real estate.

It should be an enormous advantage for investors in stocks to have those wildly fluctuating valuations placed on their holdings – and for some investors, it is. After all, if a moody fellow with a farm bordering my property yelled out a price every day to me at which he would either buy my farm or sell me his – and those prices varied widely over short periods of time depending on his mental state – how in the world could I be other than benefited by his erratic behavior? If his daily shout-out was ridiculously low, and I had some spare cash, I would buy his farm. If the number he yelled was absurdly high, I could either sell to him or just go on farming.

Owners of stocks, however, too often let the capricious and often irrational behavior of their fellow owners cause them to behave irrationally as well. Because there is so much chatter about markets, the economy, interest rates, price behavior of stocks, etc., some investors believe it is important to listen to pundits – and, worse yet, important to consider acting upon their comments.

**Those people who can sit quietly for decades when they own a farm or apartment house too often become frenetic when they are exposed to a stream of stock quotations and accompanying commentators delivering an implied message of “Don’t just sit there, do something.” For these investors, liquidity is transformed from the unqualified benefit it should be to a curse.**

This common human behavior is why I have started to look at illiquidity as a desired feature rather than a negative one. The opposing innate character flaw to flee in the face of instability that seems built into the human genetic code is the Achilles heel to most retail investors – including yours truly. To counter this is, in large part, why I have started to invest increasing sums into [Life Settlements](#), [Private Companies](#) (the company I work for), [Rich Uncles](#) (Commercial Real Estate), and [PeerStreet](#) (Hard Money Lending). The lack of liquidity from these investments allows me to maintain a long-term view. It also

keeps me sane due to the lack of daily, or worse, minute by minute price quotes.

Don't get me wrong – I still like stocks as a long-term investment option and I'm intentionally (but slowly) training myself to “set it and forget it,” [which I explained recently with the plan for my 401K.](#)

A “flash crash” or some other extreme market fluctuation can't hurt an investor any more than an erratic and mouthy neighbor can hurt my farm investment. **Indeed, tumbling markets can be helpful to the true investor if he has cash available when prices get far out of line with values. A climate of fear is your friend when investing; a euphoric world is your enemy.**

This is why it is so important to keep some dry powder (an opportunity fund). Don't get sucked into the euphoria of a bull market and feel pressured to be fully invested at all times. If the Oracle of Omaha himself practices this, why wouldn't we follow his lead? He is, after all, the most successful investor of our time. We may not see someone with his kind of track record ever again.

Your best returns are going to come from investments made during some of the scariest times. Train your brain to look forward to market crashes. Prepare for the inevitable recession by building up a war chest of cash. And don't over-leverage yourself with debt, because if you do, you only make yourself that much more vulnerable and you will surely miss out on opportunities of a lifetime.

Don't panic!

During the extraordinary financial panic that occurred late in 2008, I never gave a thought to selling my farm or New York real estate, even though a severe recession was clearly brewing. And, if I had owned 100% of a solid business with good long-term prospects, it would have been foolish for me to even consider dumping it. So why would I have sold my stocks that were small participations in wonderful businesses? True, any one of them might eventually disappoint, but as a group they were certain to do well. **Could anyone really believe the earth was going to swallow up the incredible productive assets and unlimited human ingenuity existing in America?**

I would not bet against the ingenuity of America.

\*\*\*\*\*

When Charlie and I buy stocks – which we think of as small portions of businesses – our analysis is very similar to that which we use in buying entire businesses. We first have to decide whether we can sensibly estimate an earnings range for five years out, or more. If the answer is yes, we will buy the stock (or business) if it sells at a reasonable price in relation to the bottom boundary of our estimate. If, however, we lack the ability to estimate future earnings – which is usually the case – we simply move on to other prospects. In the 54 years we have worked together, we have never foregone an attractive purchase because of the macro or political environment, or the views of other people. In fact, these subjects never come up when we make decisions.

**It's vital, however, that we recognize the perimeter of our “circle of competence” and stay well inside of it.** Even then, we will make some mistakes, both with stocks and businesses. But they will not be the disasters that occur, for example, when a long-rising market induces purchases that are based on anticipated price behavior and a desire to be where the action is.

Simply put, you should never invest in things you don't understand. There are so many opportunities out there, it's best to stay within your circle of competence. Peter Lynch famously said, “If you can't explain it to a 10-year old in under two minutes you shouldn't own it.”

**Most investors, of course, have not made the study of business prospects a priority in their lives. If wise, they will conclude that they do not know enough about specific businesses to predict their future earning power. I have good news for these non-professionals: The typical investor doesn't need this skill.** In aggregate, American business has done wonderfully over time and will continue to do so (though, most assuredly, in unpredictable fits and starts). In the 20th Century, the Dow Jones Industrials index advanced from 66 to 11,497, paying a rising stream of dividends to boot. The 21st Century will witness further gains, almost certain to be substantial. The goal of the non-professional should not be to pick winners – neither he nor his “helpers” can do that – but should rather be to own a cross-section of businesses that in aggregate are bound to do well. A low-cost S&P 500 index fund will achieve this goal.

The reality is that none of us have the time or interest to develop expertise in everything, and that might mean that studying businesses might not be your thing. Warren Buffett, the greatest investor of all time, just let us all off the

hook. We can sleep easy at night investing in a low-cost S&P 500 index fund and do very well with our investment funds. It's a passive form of investing that will enable us to outperform 85% of the professional money managers out there.

That's the "what" of investing for the non-professional. The "when" is also important. The main danger is that the timid or beginning investor will enter the market at a time of extreme exuberance and then become disillusioned when paper losses occur. (Remember the late Barton Biggs' observation: "A bull market is like sex. It feels best just before it ends.") **The antidote to that kind of mistiming is for an investor to accumulate shares over a long period and never to sell when the news is bad and stocks are well off their highs.** Following those rules, the "know-nothing" investor who both diversifies and keeps his costs minimal is virtually certain to get satisfactory results. Indeed, the unsophisticated investor who is realistic about his shortcomings is likely to obtain better longterm results than the knowledgeable professional who is blind to even a single weakness.

We are all being reminded here that it is not **timing the market** this is important, but rather **time in the market**. Buffett is telling us all to **maintain a long-term view, dollar cost average, and let compounding do its magic over decades**. Keep your costs low by investing in a low-cost index fund and you will do very well, even when compared to professional money managers.

If "investors" frenetically bought and sold farmland to each other, neither the yields nor prices of their crops would be increased. The only consequence of such behavior would be decreases in the overall earnings realized by the farm-owning population because of the substantial costs it would incur as it sought advice and switched properties.

Nevertheless, both individuals and institutions will constantly be urged to be active by those who profit from giving advice or effecting transactions. The resulting frictional costs can be huge and, for investors in aggregate, devoid of benefit. So ignore the chatter, keep your costs minimal, and invest in stocks as you would in a farm.

**My money, I should add, is where my mouth is: What I advise here is essentially identical to certain instructions I've laid out in my will.** One bequest provides that cash will be delivered to a trustee for my wife's benefit. (I have to use cash for individual bequests, because all of my Berkshire shares will be fully distributed to certain philanthropic organizations over the ten years following

the closing of my estate.) My advice to the trustee could not be more simple: Put 10% of the cash in short-term government bonds and 90% in a very low-cost S&P 500 index fund. (I suggest Vanguard's.) I believe the trust's long-term results from this policy will be superior to those attained by most investors – whether pension funds, institutions or individuals – who employ high-fee managers.

\*\*\*\*\*

## Concluding Thoughts

I love that Buffett puts his money where his mouth is. I try to do the same thing every single day on this blog. If you don't have the investing brilliance that Buffett does, it's probably a good idea to put most of your investment capital into low-cost index funds as he recommends and is doing for his own wife, should she survive him.

Since this post is already getting pretty long, I would like to end with some takeaways in bullet format.

- Time in the market is more important than timing the market.
- Invest based on the future productivity of an asset vs. the anticipated appreciation. This is the difference between investing and speculating.
- Ignore the noise of the media when making investment selections.
- Don't invest in anything you don't understand. If promised quick profits walk away. Practice the KISS principle.
- Always be building a war chest of cash to take advantage of opportunities that come about from crisis – call it your opportunity fund.
- Invest with a holding period of forever in mind.
- If you don't have the expertise to evaluate an investment, it's best to invest passively through a low-cost index fund – like Vanguard's VTI – and you will still achieve results better than most professionals (those people Warren commonly refers to as “helpers”).

Finally, be greedy when others are fearful, and fearful when others are greedy.

– Gen Y Finance Guy

---



## Gen Y Finance Guy

**Hey, I'm Dom** - the man behind the cartoon. You'll notice that I sign off as "Gen Y Finance Guy" on all my posts, due to the fact that I write this blog anonymously (at least for now). I like to think of myself as the *Chief Freedom Officer* here of my little corner of the internet. In the real world, I'm a 30-something former C-Suite executive turned entrepreneur turned capital allocator. I am trying to humanize finance by sharing my own journey to Financial Freedom. I believe in total *honesty* and *transparency*. That is why before I ever started blogging, I decided that I would share all of my own [financial stats](#). I do this not to brag, but instead to inspire motivate, and also to hold myself accountable. My goal is to be a beacon of hope, motivation, and inspiration for *you*, the reader, by living life by example and sharing it **all** here on the blog. My sincere hope is that you will be able to learn from me - both from my successes and my failures! [Read More](#)