

1 Historical Outperformance

Berkshire's historical outperformance has recently been documented by Goldman Sachs, hired by General Re for an opinion on the fairness of a merger with Berkshire. The total annual return on the Berkshire Hathaway Class A Common Stock (listed on the New York Stock Exchange symbol BRK.A) was 69.18, 52.11, 37.50, 34.85, 44.62, and 35.51 percent over the 1, 3, 5, 10, 15 and 20-year periods, respectively, ending June 17, 1998. These returns are after taxes, management costs and transaction fees.

As a comparison, the total annual return of the S&P Index was 23.78, 27.04, 19.81, 15.13, 13.34, and 12.92 percent over the 1, 3, 5, 10, 15 and 20-year periods, respectively, ending June 17, 1998.

In an investing environment where the S&P Index outperforms 90 percent of all mutual funds, Berkshire's historical outperformance can be restated as follows:

The annual percentage increase in the price per share of the Berkshire Class A Common Stock *exceeded* the annual percentage increase in the S&P Index by 1.5, 0.1, 11.1, 13.5, 13.8, and 17.1 percent over the 1, 3, 5, 10, 15 and 20-year periods, respectively, ending December 31, 1997.

Most money managers are envious of such unparalleled outperformance, and most competitors respond by saying that the performance has been lucky.

Warren Buffett's Berkshire Hathaway

2 No Losses for Shareholders

Long-term shareholders of Berkshire have never lost money. In fact, Berkshire has never posted a negative return. Can any long-term individual investor make such a claim? Can an institutional investor claim to have never lost money over the long term? A close look at the first page of Berkshire Annual report (Figure 2.1) reveals that besides never losing money, Berkshire's performance has been double digit in all years except

<i>Annual Percentage Change</i>		
<i>Year</i>	<i>Per Share Book Value of Berkshire</i>	<i>S&P 500 with Dividends Included</i>
1965	23.8	10.0
1966	20.3	(11.7)
1967	11.0	30.9
1968	19.0	11.0
1969	16.2	(8.4)
1970	12.0	3.9
1971	16.4	14.6
1972	21.7	18.9
1973	4.7	(14.8)

(Continues)

Figure 2.1 Berkshire's Corporate Performance vs. the S&P 500

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<i>Year</i>	<i>Per Share Book Value of Berkshire</i>	<i>S&P 500 with Dividends Included</i>
1974	5.5	(26.4)
1975	21.9	37.2
1976	59.3	23.6
1977	31.9	(7.4)
1978	24.0	6.4
1979	35.7	18.2
1980	19.3	32.3
1981	31.4	(5.0)
1982	40.0	21.4
1983	32.3	22.4
1984	13.6	6.1
1985	48.2	31.6
1986	26.1	18.6
1987	19.5	5.1
1988	20.1	16.6
1989	44.4	31.7
1990	7.4	(3.1)
1991	39.6	30.5
1992	20.3	7.6
1993	14.3	10.1
1994	13.9	1.3
1995	43.1	37.6
1996	31.8	23.0
1997	34.1	33.4
1998	48.3	28.6
1999	.5	21.0

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31. Starting in 1979, accounting rules required insurance companies to

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Figure 2.1 (Continued)

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value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported.

The S&P 500 numbers are pre-tax whereas the Berkshire numbers are after-tax. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

Figure 2.1 (Continued)

four! Please note that since 1965, even a passive investment in the S&P Index (a better investment than 90 percent of all mutual funds) would have lost money in seven different years. Make that eight years if you include the S&P Index loss of 10.1 percent in year 2000.

There are two rules when investing money:

Rule #1 = Never lose money.

Rule #2 = Don't ever forget Rule #1.

Mr. Buffett has never reported an annual loss and my guess is he never will.

May I suggest you visit the company's website (www.BerkshireHathaway.com) and study the first page of Berkshire's annual report. It tells the whole story.

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3 Low Cost, Almost No Cost

Fidelity Magellan charged \$600 million in manager fees to manage \$100 billion in assets in 1999. Low cost provider Vanguard Index 500 charged \$200 million to manage \$100 billion in assets in the same year. Berkshire Hathaway charged only \$6 million for corporate administration to manage over \$100 billion in assets in 1999.

When you compare short and long-term returns of the three investment vehicles, it becomes clear you don't always get what you pay for. When the assets of Magellan or even Vanguard Index 500 go up, so does management cost. This is not the case with Berkshire: When assets go up, costs go down.

Even if one day Berkshire becomes the largest domestic company measured by market capitalization, the chairman will still run headquarters with 12 employees, still pay himself a \$100,000 salary, still live in his modest home, and still operate out of Omaha, in a simple 3700 square foot office. As with every investment, costs matter.

4 Proven Public Record

In a financial community known more for brilliant marketing than investment returns, it's great to have over 45 years of investment manager experience to look back and compare. It's an extraordinary track record.

Warren Buffett's Berkshire Hathaway

Certainly historical returns are no guarantee of future returns, but a careful review of the past is better than a prospectus of what an unproven manager is promising to return. Most money managers can put together market-beating returns for three to five years. But who other than Warren Buffett can say they have consistently beaten the S&P over 45 years? Who else can say they have never had a negative return over 45 years? Who else can say they have beaten the S&P 41 out of 45 years?

5 Owner's Manual

All major purchases in your life come with an owner's manual—except financial investments. Berkshire Hathaway is the only stock to publish a manual for its owners. Chairman Buffett recommends that prospective “owners” read this publication before a purchase. If you agree with the manual, then buy the stock.

The manual will also help those who are considering trading Berkshire Hathaway stock. This stock is for those who intend to buy and hold. Traders and timers should pass on Berkshire stock. (See Berkshire's Owner's Manual, Appendix VIII.)

6 Unique Annual Meeting

Scheduled every spring in late April or early May, the Berkshire annual meeting is a unique event in the world of in-

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vestments. Chairman Buffett calls this the “Woodstock of Capitalism”. No other publicly traded company comes close to attracting such a large percentage of its shareholders to its annual meeting, a must for any serious investor. More than 15,000 investors descend onto Omaha to listen and learn from the greatest investor of all time.

After handling legal affairs in the first ten minutes, the chairman closes the meeting and opens up the floor. Shareholders can ask unedited questions from investing to the state of world affairs. Chairman Warren Buffett and vice-chairman Charlie Munger give shareholders six hours of their time and Mr. Buffett doesn't miss an opportunity for his shareholders to buy everything from Berkshire-related active wear to candy to ice cream to vacuums to jewelry. You can get a quote on your auto insurance from GEICO. Most products and services owned by Berkshire are displayed.

7 No Dividend

Berkshire is a pure long-term capital gain stock. Instead of giving part of the earnings back to the shareholders, which are taxed twice, the company reinvests all earnings and the company plans to continue to reinvest as long as the rate of return is greater by plowing the money back into growing the company. The chairman has promised to distribute earnings in the form of dividends if he cannot get a greater return through reinvestment.

Unlike other investment vehicles, the chairman has a personal reason to minimize dividends and build the capital base of the company: He and his family own 40 percent of it.

Berkshire will also buy back its own stock, which is more tax efficient, if that becomes the most attractive use of capital.

Warren Buffett's Berkshire Hathaway

8 No Taxes

Unlike other popular forms of investing, particularly mutual funds, Berkshire Hathaway pays taxes for its shareholders. Berkshire has some of the diversification benefits of mutual funds without the tax risk. In 1998 the company paid nearly \$2.7 billion in taxes on behalf of its owners. And the 30+ years' book value annual returns of 25 percent are after taxes. Note that the 30+ years of annual market price returns are 31 percent annually *after* taxes.

The company carries tax liabilities of unrealized capital gains. This may seem like an expense that will never be realized because the company never plans to sell its long-term holdings. So, the taxes on these gains will never be paid. Remember the chairman's favorite holding period is forever.

9 Chairman's Age

In the business of investing, age matters. Unlike professional sports, having a little gray hair in the money management business helps. How? Investors are all tested over time. The more time, the greater the test. Money managers also are given a chance to test and prove their theories and improve their skills. It is remarkable that the average age of new mutual fund managers is 28. Why not put your money with a seasoned proven manager 40 years the senior of the average mutual fund manager?

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At an age when most senior corporate managers have been forced to retire, Berkshire's chairman continues to tap dance to work everyday. And if there's any indication of long life, it's having meaningful work that you enjoy.

When the chairman passes his estate to his wife and when she passes it to the world's largest foundation, will the managers of all the subsidiaries stop performing? Will Coke stop selling one billion servings each day? Will Gillette stop selling razor blades to two billion men every day?

Unfortunately, Chairman Buffett's age is often used as a reason to stay away from ownership in Berkshire. In fact, I think his age, wisdom, chosen management team and experience are reasons to own Berkshire.

10 Acts Like a Mutual Fund

Berkshire combines the qualities of stock ownership with the qualities of a mutual fund. Like a mutual fund, Berkshire is a diversified group of publicly traded companies researched, purchased and managed by the chairman. Like a mutual fund, an investor gets a low-cost basket of stocks along with the world's greatest investor with one purchase.

Unlike a mutual fund, a purchase of Berkshire also gets you many benefits not available from a mutual fund.

- (1) The chairman sits on the board of directors of three of the top holdings.
- (2) Berkshire holds a portfolio of wholly owned private businesses. These businesses are as diverse as the publicly traded security portfolio.

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- (3) Berkshire has over \$27 billion to invest from its private insurance operations that is no cost.
- (4) The cost of owning Berkshire does not compare to a low cost index fund or the average mutual fund.
- (5) Berkshire does not advertise.
- (6) Berkshire does not have a star rating.
- (7) Berkshire's performance has consistently beaten the S&P index.
- (8) Berkshire is in the position to help successful entrepreneurs cash out of their enterprises by agreeing to be acquired.

Make no mistake, Berkshire is more than a mutual fund. Often it is mistaken and compared to this group. The wholly owned operating businesses are more important than the equities. For decades, Berkshire's first choice use of capital has been to buy entire businesses.

Berkshire has 90,000 employees, would rank in the top fifty in the S&P 500 Index on operative earnings (excluding investment gains) and equities are only 25 percent of its market valuation. Berkshire acts like a mutual fund but is far more than that.

11 Unique Charity Program

Berkshire is the only publicly traded company that permits its shareholders to designate the charitable contributions. Each year the owners of the company determine in proportion to their ownership interest how much and where the charitable dollars will flow. In most, if not all other companies, the chairman/CEO determines which charities will benefit. Each year, 98 percent of

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all eligible shareholders participate in this charity program, contributing over \$17 million to nearly 4,000 charities in 1999.

In 1999, shareholders of Class A shares were able to designate \$18 per share to up to three different charities. The shareholders name the recipient, Berkshire writes the check.

This shareholder designated contribution program teaches the art and science of giving. This prepares shareholders to eventually plan their estates and think of a higher purpose than mere ownership of a money machine. Once you get in the practice of giving it becomes easier, particularly when your company makes it so simple.

Second, it permits shareholders to give back to a variety of causes: civic, cultural, economic, recreational, educational, environmental, as well as to children, churches and health care.

Most important, it rewards *long term ownership*. This program is for owners, not buyers, speculators, traders, or short term holders. To qualify you must be a registered Class A shareholder of record August 31. To qualify, shares cannot be in street name (with your broker ready to be traded in a flash). Class A shares must be registered with the Registrar in the owner's individual name, trust, corporation, partnership or estate. This program once again demonstrates the brilliance of its chairman.

12 Chairman's Letter and Plain Annual Report

This annual letter is copyrighted. It can be read online at www.berkshirehathaway.com. No other chairman's letter is sought after by most of the investment community. Buffett's writing style is witty, self-deprecating, thought-provoking and wise.

His letters have also been reassembled by Larry Cunningham in *The Essays of Warren Buffett: Lessons for Corporate America*.