



THE TAO OF CHARLIE MUNGER

A compilation of quotes from Berkshire Hathaway's Vice
Chairman on life, business, and the pursuit of wealth
by David Clark

Book Summary

Chapter-by-chapter summary of the key takeaways derived from the book.

The book is available for purchase from Amazon [HERE](#)



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Part I – Charlie’s Thoughts on Successful Investing

Circle of Competence

“Knowing what you don’t know is more useful than being brilliant.” – Charlie Munger

We should become conscious of what we don’t know and use that knowledge to stay away from investing in businesses we don’t understand.

Avoid Being an Idiot

“People are trying to be smart – all I am trying to do is not to be idiotic, but it’s harder than most people think.” – Charlie Munger

Charlie’s investment philosophy is predicated on the theory that a short-sighted stock market will sometimes under-price a company’s shares relative to the long-term economic value of the company. When that happens, he buys into the company, holds it for the long term, and lets the underlying economics of the business lift the stock price.

Sitting on Your Ass

“Sit on your ass investing. You’re paying less to brokers, you’re listening to less nonsense, and if it works, the tax system gives you an extra one, two, or three percentage points per annum.” – Charlie Munger

One is better off buying a business with exceptional business economics working in its favour and holding it for many years than engaging in a lot of buying and selling, trying to anticipate market trends. Constantly buying and selling means constantly being taxed. If one holds an investment for twenty years there is only one tax to pay, which, according to Charlie, equates to an extra 1 to 3 extra percentage points of profit per year.

The Dawning of Wisdom

“Acknowledging what you don’t know is the dawning of wisdom.” – Charlie Munger

The smarter we get, the more we realise how little we actually do know. By acknowledging what we don’t know, we are putting ourselves into a position to learn more; thus, the dawning of wisdom.

A Mispriced Gamble

“You’re looking for a mispriced gamble. That’s what investing is. And you have to know enough to know whether the gamble is mispriced. That’s value investing.” – Charlie Munger

A company is a mispriced gamble when the price of a stock is out of sync with the company’s long-term future economics.

Why does this mispricing phenomenon occur? Because of the short-sighted nature of the institutions – primarily mutual funds and hedge funds – that are dominant players in the stock market and that are concerned only with the direction in which a company’s share price is headed over the next six months. Charlie, by contrast, is concerned only about where a company’s underlying economics are headed over the next ten years. It is the discrepancy between the two that creates his mispriced gamble – his buying opportunity.

When to Bet Heavily

“You should remember that good ideas are rare – when the odds are greatly in your favour, bet heavily.” – Charlie Munger



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When some macroeconomic event causes stock prices to collapse, Charlie buys as much as possible. Remember, in Charlie's world, as stock prices fall, the odds become more in our favour, provided we invest in companies with good long-term economics working in their favour. When that happens, Charlie recommends that we bet big!

Foresight

"I've never been able to predict accurately. I don't make money predicting accurately. We just tend to get into good businesses and stay there." – Charlie Munger

The one thing that he can predict is that the stock market will have moments of wild exuberance and high stock prices, usually followed by bouts of depression and much lower stock prices. Can he predict with accuracy when these events will happen? No. but he does know they will happen – he just has to have the patients to let them happen.

Patience

"I succeed because I have a long attention span." – Charlie Munger

Most people think that means patiently sitting on some investment forever, waiting for its value to go up. In Charlie's world it also means sitting on a pile of cash waiting for some great business's stock price to get beaten down.

Waiting

"It's waiting that helps you as an investor, and a lot of people just can't stand to wait." – Charlie Munger

You have to wait for the right company – one with a durable competitive advantage – that is selling at the right price. Warren got out of the stock market in the late 1960s, and he waited five years before he found anything that he was interested in buying.

Understanding the Odds

"Move only when you have the advantage – you have to understand the odds and have the discipline to bet only when the odds are in your favour." – Charlie Munger

As stock prices rise, the odds start going against investors. And when stock prices fall, the odds start turning in investors' favour. Charlie also learned that if he stays fully invested in the market as it rises, he won't have any cash to invest when the market crashes. It doesn't matter how good the odds are; if you don't have any cash to bet with, you are never going to make a dime.

A Few Good Companies

"If you buy something because it's undervalued, then you have to think about selling it when it approaches your calculation of its intrinsic value. That's hard. But, if you can buy a few great companies, then you can sit on your ass. That's a good thing." – Charlie Munger

A company with a durable competitive advantage has business economics that will expand the underlying value of the business over time, and the more time passes, the more the company's value will expand. Thus, once the purchase is made, it is wisest to sit on the investment as long as possible, because the longer we own the company, the more it grows in value, and the more it grows in value, the richer we become.

Finding a business with a durable competitive advantage means determining whether it has staying power. If we are going to buy and hold a company for twenty years, we don't want the product it is

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selling to become obsolete in year five. A great number of Berkshire's investments have been in companies that have manufactured the same product or provided the same service for fifty or more years. In fact, most of the wonderful businesses that Charlie and Warren own – such as Coca-Cola Company, Wells Fargo Bank, American Express, Swiss Re, Wrigley's Gum, Kraft Foods, and even Anheuser Busch before it was bought out – have been selling the same product or service for more than a hundred years!

Opportunity

"You do get an occasional opportunity to get into a wonderful business that's being run by a wonderful manager. And, of course, that's hog heaven day." – Charlie Munger

If you aren't buying like crazy when you have the opportunity to buy a business that has a huge potential, it is a big mistake. The key here is to buy aggressively when we have the opportunity. The problem is that to do so, one is usually buying into a tanking stock market and for most people that is a very difficult thing to do.

Greedy Bankers

"Mortgage lending became a dirty way to make money. You take people that can't handle credit and try to make very high returns by abusing and encouraging their stupidity – that's not the way I want to make money in banking. You should try make money by selling people things that are good for the customer." – Charlie Munger

In the old days, banks kept home mortgages on their own books, so they were very careful whom they loaned money to. But then the business model changed, and banks started selling the mortgages they wrote to other companies. It no longer mattered whom they loaned money to, because they were going to sell off the mortgages as soon as they wrote it. The game then became the more home mortgages the bank wrote, the more money the bank made. And if a homeowner defaulted, who cared? The bank was out of the equation. That's how banking went from being a boring business with boring salaries, to being an exciting business with outrageous salaries.

No Single Formula

"There isn't a single formula. You need to know a lot about business and human nature and the numbers... It is unreasonable to expect that there is a magic system that will do it for you." – Charlie Munger

People are looking for a simple method they can learn from reading one book that will make them rich. It doesn't happen that way – unless they get really lucky. One is actually better off reading a hundred business biographies than a hundred books on investing. Why? Because if we learn the history of a hundred different business models, we learn when the businesses had tough times and how they got through them; we also learn what made them great, or not so great. Which allows us to get a feel for whether or not a business has some kind of durable competitive advantage working in its favour, which is key in figuring out if it would make a great long-term investment.

Just reading books on business isn't enough; one should also add in a couple of semesters of accounting (which is the language of business), a couple of semesters of economics, and a good course on central banking so one understands the power of the Federal Reserve Bank to come to the market's rescue (most MBA courses are sorely lacking in this). Then one will be in a good position to start looking for a winning investment. But then the search for a good investment takes even more reading – so count on reading two or three hundred annual reports a year and the Wall Street Journal every day.

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Now do you understand why most people are looking for a simple, easy system for them to use. The funny part of this equation is that they are the ones who often do stupid things in the stock market that people in the know—like Charlie—end up profiting from. As Warren says, if you get into a card game and you can't figure out who is the patsy, then you're the patsy.

On Technology

"The great lesson in microeconomics is to discriminate between when technology is going to help you and when it's going to kill you." – Charlie Munger

New technology can either damage an existing business or increase its profitability.

The first question we should ask is: Will the new technology be a threat to the existing business model? Cars replaced buggies and horses. The telephone replaced the telegraph. Computers and printers replaced the typewriter.

The next question is: Will the new technology enhance the business? Here the question gets a bit more complicated. Whether or not a company will benefit from a change in technology is dependent on the type of business it is.

If you're a commodity-type business which sells a product or service that a number of other companies also supply, any technology breakthrough that will lower costs and improve margins will probably also be picked up by your competitors – which means you will lose any competitive advantage the technology provides.

When a company has a durable competitive advantage in a particular market niche, there are no competitors. With such businesses the 10% cost savings that the new technology provides is not eroded by price-cutting by competitors seeking to take market share.

Part II – Charlie On Business, Banking, And the Economy

The Wealth Effect

"The wealth effect is the extent to which consumer spending is goosed upward due to increases in stock prices. Of course, it exists, but to what extent? I made a speech a while back which I said that the wealth effect is greater than economists believe. I still say this." – Charlie Munger

Asset Inflation

"I remember the \$0.05 hamburger and a \$0.40-per-hour minimum wage, so I've seen a tremendous amount of inflation in my lifetime. Did it ruin the investment climate? I think not." – Charlie Munger

Inflation really helps the banking and insurance industries. Since that \$50,000 house is now a \$500,000 house, people have to borrow \$450,000 more from the bank. And there will be a hell of a lot more bank fees for a loan that size than for a \$50,000 loan. The property insurance company is also going to earn a whole lot more on insuring a \$500,000 property than it ever earned insuring our \$50,000 property.

In the example above, both the bank and the insurance company saw inflation cause a 1,000% rise in business, but neither institution had to add any more employees or increase the size of its operating plant. Now you know why Charlie and Warren are so big on insurance companies and banks: not only are they the perfect hedge against inflation, they actually benefit from it. For banks and insurance companies, inflation truly is the gift that keeps on giving.

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Part III – Charlie’s Philosophy Applied to Business and Investing

See’s Candies

“When we bought See’s Candy, we didn’t know the power of a good brand. Over time, we discovered that we could raise prices 10% a year and no one cared. Learning that changed Berkshire. It was really important.” – Charlie Munger

Part IV – Charlie’s Advice on Life, Education, And the Pursuit of Happiness

One Step at a Time

“Spend each day trying to be a little wiser than you were when you woke up. Discharge your duties faithfully and well. Slug it out one inch at a time, day by day. At the end of the day – if you live long enough – most people get what they deserve.” – Charlie Munger

Career Advice

“Three rules for a career: (1) Don’t sell anything you wouldn’t buy yourself; (2) Don’t work for anyone you don’t respect and admire, and (3) Work only with people you enjoy.” – Charlie Munger

Know-it-all’s

“I try to get rid of people who always confidently answer questions about which they don’t have any real knowledge.” – Charlie Munger

Admitting Stupidity

“I like people admitting they were complete stupid horses’ asses. I know I’ll perform better if I rub my nose in my mistakes. This is a wonderful trick to learn.” – Charlie Munger

Charlie believes we can learn from our failures only if we accept responsibility for them and examine exactly why we failed. Blaming someone else and shirking responsibility is a missed learning opportunity.

Specialisation

“Extreme specialisation is the way to succeed. Most people are way better of specialising than trying to understand the world.” – Charlie Munger

If all we do is what everyone else does, we will spend our lives competing head on with everyone else. But if we specialise in something and excel at it, the specialisation will set us apart from the crowd.

Not Working

“It’s been my experience in life, if you just keep thinking and reading, you don’t have to work.” – Charlie Munger

Out with the Old

“Any year that passes in which you don’t destroy one of your best loved ideas is a wasted year.” – Charlie Munger

What Charlie is saying is that in any year we haven’t tossed out one of our best-loved ideas, it probably means we are reading and thinking enough to evolve a little bit further in our intellectual development. In a mere seventy years the United States went from no electricity to the entire country being electrified. That completely destroyed candle making, gas lighting, and the kerosene lamp

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business. Televisions replaced the home radio business. In 1974 the digital camera didn’t exist. Today Kodak doesn’t exist – and for a hundred years previously Kodak had been an amazingly successful business. In the world of business and investing it is best to keep up with new developments and review our best-loved ideas every year, just to make sure that in thinking we are right, we don’t get it wrong.

A Moral Imperative

“Being rational is a moral imperative. You should never be stupider than you need to be.” – Charlie Munger

Being rational, to Kant and Charlie, means ignoring our emotions, and following logic and reason in making our decisions.

Secrets of Success

“I have never succeeded very much in anything in which I was not very interested. If you can’t somehow find yourself very interested in something, I don’t think you’ll succeed very much, even if you’re fairly smart.” – Charlie Munger

To be successful in something, we need to be passionately interested in it. And that passion, more than raw intelligence, tends to determine whether or not we will be successful at what we do. As Steve Jobs said, “Work is going to fill a large part of your life, and the only way to be truly satisfied is to do what you believe is great work. And the only way to do great work is to love what you do.” – Charlie Munger

Being Frugal

“One of the great defences – if you’re worried about inflation – is not to have a lot of silly needs in your life – if you don’t need a lot of material goods.” – Charlie Munger

If you don’t need something, you don’t have to buy it – so who cares if it goes up in price?

Ideology

“Another thing I think should be avoided is extremely intense ideology because it cabbages up one’s mind.” – Charlie Munger

Secret to Wisdom

“Look at this generation, with all of its electronic devices and multitasking. I will confidently predict less success than Warren, who just focused on reading. If you want wisdom, you’ll get it sitting on your ass. That’s the way it comes.” – Charlie Munger

Learning Machines

“I constantly see people rise in life who are not the smartest, sometimes not even the most diligent, but they are learning machines. They go to bed every night a little wiser than they were when they got up, and boy, does that help, particularly when you have a long run ahead of you.” – Charlie Munger

It is very important to be constantly learning, constantly improving ourselves. Think of it as compounding our intellect; the longer we work at it, the richer we become.

Perspective

“It’s bad to have an opinion you’re proud of if you can’t state the arguments for the other side better than your opponents. This is a great mental discipline.” – Charlie Munger



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This mental exercise comes from Charlie’s early training in law, where it is an advantage to be able to argue both sides of a case. Knowing the other side’s arguments, its possible points of attack, allows one to prepare counterattacks long before a case gets into the courtroom. The most interesting thing about this mental exercise is that after learning the other side’s arguments we just might discover that they are right, and we were wrong. Which is probably why so few people take Charlie’s advice on this.