# THE TAO OF WARREN BUFFETT

## Warren Buffett's words of wisdom explained by Mary Buffett & 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**

Cowley, Alistair
alistair.cowley@growthwithvalue.com
www.growthwithvalue.com

# Table of Contents

## Getting and Staying Rich

- *"The great personal fortunes of this country weren't built on a portfolio of fifty different companies. They were built by someone who identified one wonderful business."* – Warren Buffett
  - If you do a survey of the superrich families in America, you will find almost without exception that their fortunes were built on one exceptional business.

    The key to Warren's success is that he has been able to identify exactly what the economic characteristics of a wonderful business are – a business that has a durable competitive advantage that owns a piece of the consumer's mind.

- *"You should invest like a Catholic marries – for life."* – Warren Buffett
  - Warren knows that is you view an investment decision from the perspective that you will never be able to undo it, you'll be certain to do your homework before taking the plunge.
- *"I don't try to jump over seven-foot bars; I look around for one-foot bars that I can step over."* – Warren Buffett
  - Warren is waiting for the perfect pitch and is staying with the sure thing: companies with products that don't have to change, businesses that he knows will still be around in twenty years, selling now at a price that would make business sense even if he were buying the whole company.
- *"The chains of habit are too light to be felt until they are too heavy to be broken."* – Warren Buffett
  - This is Warren quoting the English philosopher Bertrand Russell because his words so aptly describe the insidious nature of bad business habits that don't become apparent until it is too late. Such as cost cutting after your business is in trouble, which should've been done long before you even got to the doorstep of danger. The business that becomes bloated with unnecessarily expenses in times of plenty is the business that will sink when things turn for the worse.
- *"You should look at stocks as small pieces of a business."* – Warren Buffett
- *"My idea of a group decision is to look in the mirror."* – Warren Buffett
  - To make big money in the investment world you have to learn to think independently; to think independently you need to be comfortable standing alone.
- *"You should invest in a business that even a fool can run, because someday a fool will.""* – Warren Buffett
  - You want to invest in companies with great underlying economics because it is hard to damage these kinds of businesses.
- *"With each investment you make, you should have the courage and the conviction to place at least 10% of your net worth in that stock."* – Warren Buffett
  - A sure-fire way to achieve Warren's level of conviction is to invest significant amounts of money. This causes you to focus and make certain that you have done your homework before you make your investment.

## Business

- *"Anything that can't go on forever will end."* – Warren Buffett
  - A stock price that is quickly rising will stop rising when the economic reality of the business finally sets in. it might seem as if it can go on forever, but if the business fails

to perform up to the expectations that is driving the rising price, the company's shares will peak and then drop like a brick.

- "When management with a reputation for brilliance tackles a business with a reputation for poor fundamental economics, it is the reputation of the business that remains intact." – Warren Buffett
    - A great business is usually awash in cash, carries little or no debt, and is in a great position to either buy its way out of trouble or ride out any downturn in the economy. Mediocre businesses are always struggling for cash and are loaded with debt, and if they get into problems, they usually have to rob Peter to pay Paul, which leads to even more problems. No matter how brilliantly a mediocre business is run, its poor inherent economics will keep it forever anchored to poor results.
- *"Accounting is the language of business."* – Warren Buffett
    - To read a company's financial statement you need to know how to read the numbers. To do that you need to learn accounting. If you can't read the scorecard, you can't keep score, which means that you can't tell the winners from the losers.
- *"Turnarounds seldom turn."* – Warren Buffett
    - Poor businesses remain poor businesses regardless of the price you pay for them.
- *"If a business does well, the stock eventually follows."* – Warren Buffett
    - A market phenomenon that Warren relies on is that if the underlying business does well over a long period of time, the stock price will increase to reflect the underlying increase in the value of the company. Likewise, if the underlying business does not do well over a long period of time, the stock price will decrease to better reflect the underlying value of the company.
- *"There is a difference between the business that grows and requires lots of capital to do so and the business that grows and doesn't require capital."* – Warren Buffett
    - If you have to spend billions redesigning your product mix every five years, those are billions that can't be spent expanding operations or buying new businesses or buying back stock. But a business that can grow without new infusion of capital can afford to spend its excess cash doing those things.
- *"You can always juice sales by going down-market, but it's hard to go back upmarket."* – Warren Buffett
    - Certain products own a piece of your mind – they are the brand name products that you think of when you have a particular need. However, if a manufacturer, in the name of increasing profits, decreases the quality of its products, it can run a huge risk of losing its ownership of the consumer's mind. We all have seen this happen – a quality product we love to use, but then the manufacturer cheapens it, and we stop using it. Once this happens, it is hard for the manufacturer to go back, because the bad experience with the product now owns a piece of the consumer's mind.
- *"I look for businesses in which I think I can predict what they're going to look like in ten to fifteen years' time. Take Wrigley's chewing gum. I don't think the internet is going to change how people chew gum."* – Warren Buffett
    - Consistent products equal consistent earnings. If the product doesn't have to change, you can reap all the benefits of not having to spend money on research and development, nor do you have to fall victim to the ups and downs of fashion.

# Warren's Mentors

- *"Read Ben Graham and Phil Fisher, read annual reports, but don't do equations with Greek letters in them."* – Warren Buffett
  - Ben graham taught that you should only buy a stock when it is selling at a low price in relation to its long-term value. The low price will give you a margin of safety against calamity. Phil Fisher said that you need to buy a high-quality company, then hold it for a long, long time and let the retained earnings build up in value. Warren took Ben's "buy at a low price to get a margin of safety" and married it to Phil's "buy the highest-quality company and hold it forever" and ended up with "buy high-quality companies at low prices in relation to their value and then hold them for a long, long time." This is one of those equations where the sum is greater than its parts.
- *"I am a better investor because I am a businessman, and a better businessman because I am a better investor."* – Warren Buffett
  - A smart business knows a good business from a bad one – and a smart investor knows when a business is being sold cheap or is overpriced. So, to be great at investing you need to be like the businessman and know a good business from a bad one, and when you go to buy a business, you need to be like the smart investor and know whether it is selling cheap or it is overpriced.
- *"You pay a very high price in the stock market for a cheery consensus."* – Warren Buffett
  - If everyone agrees with you that a particular stock is the next Microsoft, you are going to have to pay a steep price – which leaves little upside and lots of downside. What you want is to find a stock that no one is looking at or that is out of favour with the big investment funds and is selling at a low price relative to its long-term economic value.

# Education

- *"You want to learn from experience, but you want to learn from other people's experience when you can."* – Warren Buffett
  - Experience is the best teacher, but it can be expensive if you are learning from your own mistakes. It is better to learn from the mistakes of others. This is why Warren has made it part of his educational diet to study and dissect the business and investing mistakes of others.

# The Workplace

- *"The really good business manager doesn't wake up in the morning and say, 'this is the day that I am going to cut costs,' any more than he wakes up and decides to practice breathing."* – Warren Buffett
  - If you read that a company is instigating a cost-cutting program, then you know that management has been slack at keeping costs low from the start.
- *"We enjoy the process far more than the proceeds, though I have learned to live with those also."* – Warren Buffett
  - People who are passionate about their jobs will come to rule their trade or profession because they love the process more than they love the money. The funny thing about passion is that money usually follows it.
- *"There comes a time when you ought to start doing what you want. Take a job that you love. You will jump out of bed in the morning. I think that you are out of your mind if you keep taking*

*jobs that you don't like because you think it will look good on your résumé. Isn't that a little like saving up sex for your old age?"* – Warren Buffett

- *"A friend of mine spent twenty years looking for the perfect women*; unfortunately, when he found her, he discovered that she was looking for the perfect man.*"* – Warren Buffett
    - In life and in business you have to sell the other person on who you are and what you have for them to buy. Warren had to sell himself to his original investors, and he still has to sell himself to the privately held family businesses that Berkshire wants to buy – people who have spent their lives building a business aren't interested in selling "their baby" to just anybody.

## Analysts, Advisers, Brokers – Follies to Avoid

- *"A public-opinion poll is no substitute for thought."* – Warren Buffett
    - There is a great deal of comfort when you invest with the crowd. Everyone agrees with you. However, when you invest with the crowd, you have to worry about when the crowd will leave the party.
- *"The business schools reward difficult, complex behaviour more than simple behaviour, but simple behaviour is more effective."* – Warren Buffett
    - William of Ockham (ca. 1285 – 1349), put forth the idea that the simplest explanation is usually the best explanation.

## Why Not to Diversify

- *"Diversification is a protection against ignorance. It makes very little sense for those who know what they're doing."* – Warren Buffett
    - If you don't understand what you are doing, you should broadly diversify your investments. Warren knows what he is doing, so he prefers to concentrate his investments on a few well-chosen eggs, and then he watches them like a hawk.
- *"You only have to do a very few things right in your life so long as you don't do too many things wrong."* – Warren Buffett

## Discipline, Prudence and Patience

- *"Let yourself be undisciplined on the small things, you will probably be undisciplined on the large things as well."* – Warren Buffett
    - Warren so believes in a disciplined approach that he has turned down a $2 golf bet because the odds were against him.
- *"There is nothing like writing to force you to think and get your thoughts straight."* – Warren Buffett
    - If you can't write about it, you haven't really thought about it. Writing about something makes you think about it, and thinking about where to invest your money is a good thing, which is why writing about it is even a better thing.
- *"I've never swung at a ball while it's still in the pitcher's glove."* – Warren Buffett
    - Ted Williams wrote a book entitled 'The Science of Hitting.' Ted argues that to become a great hitter you have to keep yourself from swinging at the bad pitches – what you are looking for is the perfect pitch. Warren took it as an analogy to investing: To be a great investor he only had to wait for the right opportunity. He also realised that unlike Ted, who was only allowed three strikes, he could stand at the plate all day waiting for the perfect investment opportunity to appear.

- *"Imagine that you had a car and that it was the only car you'd have for your entire lifetime. Of course, you'd care for it well, changing the oil more frequently than necessary, driving carefully etc. Now, consider that you only have one mind one body. Prepare them for life, care for them. You can enhance your mind over time. A person's main asset is themselves, so preserve and enhance yourself."* – Warren Buffett

## Beware the Folly of Greed

- *"When proper temperament joins up with the proper intellectual framework, then you get rational behaviour."* – Warren Buffett
  - *Warren has always said that the best temperament for good investing is to be greedy when others are scared and scared when others are greedy*. That, coupled with an investment philosophy that focuses on business with superior long-term economics working in their favour, is his secret to successful investing. Buy into great businesses when everyone else is scared, and stay away from them when everyone is being greedy.
- *"A stock doesn't know that you own it."* – Warren Buffett
  - People often humanise inanimate objects. When this happens with a stock, emotional thought replaces rational thought. This is a bad thing when it comes to investments.
- *"We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful."* – Warren Buffett

## When to Sell, When to Leave

- *"The most important thing to do when you find yourself in a whole is to stop digging."* – Warren Buffett
  - If you find yourself in a bad investment, the worst thing in the world to do is to continue to through money at it. Though it's painful to pull out, in the end it is far more profitable to leave the party and cut your losses before things go to zero.
- *"Most people get interested in stocks when everyone else is. The time to get interested is when no one else is. You can't buy what is popular and do well."* – Warren Buffett
- *"Risk comes from not knowing what you are doing."* – Warren Buffett
  - As Warren says, "I never buy anything unless I can fill out on a piece of paper my reasons why. I may be wrong, but I would know the answer to 'I'm paying $32 billion today for the Coca-Cola Company because…' if you can't answer that question, you shouldn't buy it. If you can answer that question, and you do a few times, you'll make a lot of money." Questions compel us to think, but answers tell us whether to act.

## Mistakes to Beware Of

- *"We never look back. We just figure there is so much to look forward to that there is no since thinking what we might have done. It just doesn't make any difference. You can only live life forward."* – Warren Buffett
- *"I want to be able to explain my mistakes*. This means I only do the things I completely understand.*"* – Warren Buffett
- *"If you don't make mistakes, you can't make decisions."* – Warren Buffett
  - If you make a decision and it turns out to be wrong, Warren says that it is best not to dwell on it, that you should move on to the next one.

## Your Circle of Competence

- *"Investment must be rational; if you don't understand it, don't do it."* – Warren Buffett
  - Warren makes it a point to understand each and every business in which he invests. He likes a sure thing – a business that he understands and that is selling at an attractive price. He leaves the dice game to the other guys.
- *"If you understand an idea, you can express it so others can understand it."* – Warren Buffett
  - This standard requires that you do your research before you buy the stock. Warren's rule is simple: Can't explain it – stay away from it.
- *"Our method is very simple. We just try to buy businesses with good-to-superb underlying economics run by honest and able people and buy them at sensible prices. That's all I'm trying to do."* – Warren Buffett
  - *Understanding the business is one of the keys to Warren's success*. If he didn't understand the business, he would not be able to determine if the long-term economics of the business were good, the management was capable and honest, and it was selling at a price that was attractive.
- *"It won't be the economy that will do in investors; it will be the investors themselves."* – Warren Buffett

## The Price You Pay

- *"For some reason people take their cues from price action rather than from values. Price is what you pay. Value is what you get."* – Warren Buffett
  - *Warren believes that the pays you pay determines the amount of value you get* – pay too much and you get little value; the less you pay, the more value you get.
- *"The key is that the stock market just basically sets prices, so it exists to serve you, not instruct you."* – Warren Buffett
  - *A business is worth what it is worth over the long term, regardless of what the short-sighted stock market says, and you, not the stock market, are in control of what and when you buy*.
- *"A pin lies in wait for every bubble, and when the two eventually meet, a new wave of investors learn some very old lessons."* – Warren Buffett
  - *A speculative frenzy occurs when the general public goes wild for stocks*. People see them running up in price and want to jump on and make some easy money. It happens big-time about once every thirty years, usually with the advent of new technology.

## Long-Term Economic Value Is the Secret to Exploiting Short-Term Stock Market Folly

- *"Look at stock market fluctuations as your friend rather than your enemy – profit from folly rather than practice in it."* – Warren Buffett
  - Bad short-term prospects mean that stock prices can fall dramatically – all the while ignoring the long-term potential of the enterprise. This presents buying opportunities in companies that have good long-term economic prospects but are experiencing a few short-term problems. Stay away from a company when fools rush in and drive up the price, and buy when fools rush out and drive down the price.
- *"Uncertainty actually is the friend of the buyer of long-term values."* – Warren Buffett
  - *Uncertainty in the stock market creates fear*, and fear creates panic selling, which forces prices downward regardless of a business's long-term economic prospects.

- *"No matter how great the talent or effort, some things take time: You can't produce a baby in one month by getting nine women pregnant."* – Warren Buffett
    - *It takes time for business values to build up* – it doesn't happen overnight. But if you buy a great business, eventually the values add up to a handsome sum.
- *"If past history was all there was to the game, the richest people would be librarians."* – Warren Buffett
    - Understanding business history is important to understanding what can happen, but it won't tell you what will happen and when it will happen. That takes some foresight on the part of the investor. Warren has tried to predict the future by staying with business that make products that don't change over time. Predictable products equates to predictable profits.
- *"Only buy something that you'd be perfectly happy to hold if the market shut down for ten years."* – Warren Buffett
    - *When you start thinking long term, you start thinking quality and the long*-term economic nature of the business. This leads you to ask whether the company's product has a durable competitive advantage. This means high margins on a product that doesn't have to change. This means that the plant and equipment never go obsolete, which means you never have to retool and have low research and development costs. Low costs means high margins, and higher margins mean more money.
- *"the investor of today does not profit from yesterday's growth."* – Warren Buffett
    - It is the growth of tomorrow that the investor of today will profit from. If I bought a business today, the profit I would be taking out of it is all in the future. I don't make any money off the past.
- *"We do not have, never have had, and never will have an opinion about where the stock market, interest rates, or business activity will be a year from now."* – Warren Buffett
    - Everyone is concerned with stock market gyrations and where interest rates are going to be next year, which means they end up doing silly things like selling a business that has great underlying long-term economics because the Fed might raise interest rates a quarter point. And when these impressionable investors sell great businesses for some silly reason, Warren is there waiting to buy them, and once he has his hands on them, he isn't letting go. So, if you want to become superrich, just ignore all the rant and rave about where the stock market is or is not going, and forget about the Fed and interest rates, and just focus on determining the long-term economic value of the companies that have a durable competitive advantage and then determine where they are selling in relation to that value. When they are undervalued, buy them, and when they are overvalued, stay away from them. And if you are diligent and stay with the program long enough, you will eventually acquire a portfolio of fantastic companies that will make you superrich over the long run, just as Warren has done.