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BBB – Berkshire, Banks and Buffett

This past weekend was the Berkshire Hathaway Annual General Meeting. For value investors like us, this is one of the best weekends of the year. In-person attendance this year was greater than 40,000 individuals and the true tally is much higher given the growing base of people who watched the live stream on Yahoo Finance. This year the company partnered with CNBC to release meeting archives all the way back to 1994, representing more than 20 years of meeting videos and transcripts. We look forward to sifting through the archives, and learning more about the opportunities and challenges the company has navigated in the past. We find that studying the history of companies, industries and markets can be particularly useful in helping to position our portfolios prudently over market cycles.

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Warren Buffett provided a great reminder about the important of patience, a long-term horizon, an ability to stomach the volatility and the power of owning businesses. He stated that if you had put just $10,000 into a stock market index fund that reinvested dividends back in 1942 and held it for 75 years, it would have grown to ~$51 million today, for an average return of ~12% per annum. Recall, one of the key principles from Security Analysis by Benjamin Graham is that shares are not merely something to be traded around, but rather an ownership stake in a real business. With the average holding period for common stocks across the world continuing to decline, it does seem that this long-term ownership mindset is becoming less prevalent. It is also our view that the rewards of stock ownership are best experienced by investing in a diversified array of good businesses that can compound their earnings and dividends over a long-term time horizon.

Wells Fargo

Warren Buffett and Charlie Munger also commented on the ongoing challenges at Wells Fargo. "*At Wells Fargo, they made one mistake that maybe I've made from time to time, which is incentives work. And so they incented bad behavior instead of incenting good behavior. And that happens from time to time.*" Wells Fargo continues to deal with a number of challenges that stem from poor implementation of incentives for managers and employees. The company's focus on growing the number of accounts and services per customer eventually drove employees to create fake accounts, and the company responded rather slowly to this problem. We don't believe this issue will have a large financial impact on future results. Wells Fargo has typically been a conservative lender and retained its focus on retail banking and commercial lending, areas where we believe the relative risks and rewards can be more attractive. We believe Wells Fargo will overcome the challenges that are present today, and even without material growth, we see the potential for good returns through the right-sizing of its cost structure. The shares remain attractively valued relative to peers and the company's own history at just ~1.4x book value.

Elon Musk and Moats

A shareholder question regarding a recent quote from Elon Musk prompted Buffett to say, "*There are some pretty good moats around… Being the low-cost producer, for example, is a terribly important moat*" – citing Geico's cost advantage relative to peers. Musk responded later that night, "*Saying you like moats is just a nice way of saying you like oligopolies*." At QV, our concentrated portfolio approach often leads us to select businesses with sustainable competitive advantages and attractive industry dynamics. AP Moller Maersk, a QV Global Equity Strategy holding, is a good example of this. The container shipping company has industry-leading scale that allows it to meet customer needs in an efficient manner, which has typically translated into above-average margins relative to peers. While transitory factors can, at times, lead to volatility in margins, we believe its advantage is sustainable over the long term. We have also seen a steady rate of consolidation within the industry, shifting it closer towards an oligopoly. The top 5 companies in the container shipping industry now represent about 64% of the market, up from just 30% in 1998. Over the long term we believe an attractive valuation, improving industry dynamics and a strong competitive moat is the recipe for strong risk-adjusted returns. New insights and helpful reminders from history are key reasons we will continue to listen in and learn from great events like this.