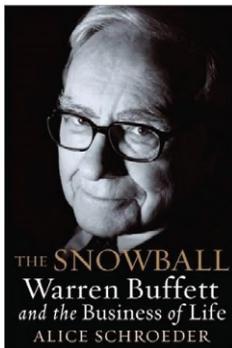


Into the mind of Buffett

Michael Potter reviews
*The Snowball:
Warren Buffett and the
Business of Life*
by Alice Schroeder
(Bantam, 2008, 976 pages)



Warren Buffett frequently seems to be in the right place at the right time. He invests in companies just before their stocks rise rapidly; and he has exited the stock market before several collapses, such as the tech crash of 2000. As a result, Buffett is one of the richest people in the world.

For decades, people have wondered if Buffett's foresight was due to skill or luck. Now a biography of Buffett by Alice Schroeder has been released, right in the middle of the current financial crisis. It seems as if Buffett's timing has been spot on yet again—the book will be examined by many for insights into how to survive the downturn.

There have been many books written about Buffett before, but this massive book (of almost 1000 pages, including references) is the first authorised biography. It is called *Snowball* because Buffett benefited from compounding of returns, similar to how a snowball becomes larger and larger as it rolls down a hill.

While there are many interesting stories in this book, unfortunately it is so long that few will last the distance. The book needed a much better, or more forceful, editor. Like Stephen Hawking's *A Brief History of Time*, I suspect that many who buy *Snowball* won't read it to completion.

Nevertheless, there are notable stories to be found. Buffett's mother was verbally abusive, striking terror into Buffett and his siblings. Her family had a history of mental illness. *Snowball* doesn't gloss over these difficult issues in Buffett's life. Buffett told Schroeder that

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if people gave different accounts of an event, then Schroeder should choose the less flattering one.

He started his entrepreneurial activity very early, gaining a substantial income by running paper routes and later by putting pinball machines in barber shops. He started paying income tax at the age of 14, went to Columbia Business School and then pursued an investing career. While Buffett set a target of being a millionaire by the age of 35, he easily beat this by reaching a million by the age of 32 (and this was in 1962). Nevertheless, he lived (and still lives) a very frugal life. He still owns and lives in the fairly modest house he bought in Omaha for \$US31,500 in 1958. He dressed so modestly that some investors were turned off from investing with him because he didn't 'look' successful.

There are many useful lessons in *Snowball*, particularly from Buffett's early life, when he unsurprisingly learnt his best lessons.

Buffett was a keen follower of the investment philosophy of the legendary Ben Graham who advocated investing in companies that were undervalued—the price of their shares was below the value of the underlying assets. Buffett spent days poring over balance sheets of companies to find this hidden value. He bought into these companies, believing that the stock price would (eventually) increase to reflect the value of the company's assets. Importantly, if the stock price fell, Buffett didn't panic and sell—he would often buy more of the company. If a value stock never reached

Buffett's estimate of fair value, he would gain a controlling share of the company and then distribute the underlying assets to shareholders (at a considerable profit, of course).

Buffett essentially invested when the market was low (and everyone else was leaving the market) and exited the market when the market was high (and everyone else was investing).

Value investing served Buffett extremely well. He invested in American Express, a company that was fundamentally sound but was in major strife in 1963. Buffett's investment may have saved it from bankruptcy. He did make some poor investments, but these were hugely overwhelmed by his successes. His original investment in a failing textile manufacturer, Berkshire Hathaway, may not have been a good idea, but Buffett transformed the company into his investment company, now worth hundreds of billions.

Other lessons learned by Buffett included not to be afraid of failure, but to always learn from any mistakes. When he believed in something, particularly an investment, he went for it with his whole heart. And he was very patient, holding investments for the longer term. While Buffett strongly advocated value investing, he rejected investing based on market sentiment or technical analysis.

But the most important lesson from *Snowball* is that you can make squillions from the stockmarket by investing in value. This is why he avoided many market crashes, such as the internet bubble of 1999. Buffett used his continuing success as a compelling argument against believers in the efficient market hypothesis (such as Paul Samuelson), who argued that no one could beat the market forever. The failure of this hypothesis has been used by many as an argument for substantial regulation, which is a complete non sequitur (imperfect markets are not necessarily improved by an imperfect government).

Unfortunately, the interesting parts of *Snowball* are somewhat hidden in a



mass of details that should have been cut back. Buffett's larger transactions are quite fascinating; but Schroeder gives us the mostly homogeneous details of most of his smaller transactions. Similarly, she runs through the details of his early investors, even when these details are very similar. In addition, Schroeder is not a wordsmith—she writes in a matter-of-fact way, generally lacking a stylish turn-of-phrase or careful analysis. This is perhaps due to her background being in stock analysis, rather than journalism or writing.

There are also a number of apparent contradictions in *Snowball* including on page 220: 'Hardly *anybody* knew Warren Buffett' and then only two paragraphs later 'In fact, by 1959, he was getting somewhat of a name around town.' On page 14 we find Buffett mostly turned down giving speeches, but on page 23 it is argued that he gave lots of speeches. Again, this looks like poor editing.

The larger contradictions or oddities are not in Schroeder's book, but in Buffett's life itself. *Snowball* does discuss in some detail how Buffett separated from his first wife Susie but did not divorce her and ended up living with another woman, almost with the blessing of Susie. While Schroeder deals with this pe-

culiarity, she should have also dealt with other ones given the length of the book.

Buffett's performance at school changed dramatically over time, but Schroeder doesn't explain this adequately.

Buffett could talk about stocks for hours on end, but found it hard to talk about anything else. He memorised vast collections of numbers and an entire textbook on investing; he also did not like his individual foods to touch: 'If a stalk of broccoli brushed his steak, he recoiled in horror.' To me this unusual behaviour could be the classic symptoms of Asperger's syndrome, a point also recognised by the review of *Snowball* in the *Times* of London. However, *Snowball* doesn't satisfactorily analyse this behaviour.

Buffett's views on economic policy also appear odd. He became a Democrat in the 1960s because of the civil rights movement, but also signed on to many of the Democrat's economic policies, including increasing taxes on the wealthy and (substantially) increasing regulation of financial markets—which would seem counter to his own interests. This is not adequately explained in *Snowball*.

Buffett may have this view because he may think that market regulation could stop the wild fluctuations in stock

prices that hurt his own wealth. However, Buffett actually made significant profits from buying in downturns, when value stocks are cheap. To value investors, this is a time to enter the market. The cynical could argue that Buffett would make money from the inconsistency of regulations (for example, if a financial product is banned, sell products that are different in form but the same in substance).

His support for higher taxes is particularly incomprehensible, because he also supports people being able to spend their money as they wish, he avoids tax several times during the book and higher taxes would reduce the stock returns that put him where he is. In addition, higher taxes would reduce the amount he can give away himself, which would be clearly better directed than government spending.

Snowball is a reasonably enjoyable voyage into the mind of one of the world's great capitalists. However, it is unfortunate that there are so many detours on the way that it is a real struggle to plough through to the end. This is a pity, because practically everyone could do with the considerable insights his life provides.

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