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Berkshire Hathaway, Part I

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Essay: Berkshire Hathaway and Value Investors
Part I

The time period of 1969-1975 was one of the most treacherous ever experienced by value investors. The year 1969 is commonly recorded in histories of investments as the end of the "go-go" era. It was also the year that marked the commencement of a period of high inflation and higher interest rates. In that year, the Federal Funds rate reached the then unprecedented level of 8.21% as an average for the year. The monthly figures are yet more gruesome as depicted in Table 1.

Table 1: Federal Fund Rate Monthly 1969

January 1969	6.30%
February 1969	6.61%
March 1969	6.79%
April 1969	7.41%
May 1969	8.67%
June 1969	8.90%
July 1969	8.61%
August 1969	9.19%
September 1969	9.15%
October 1969	9.00%
November 1969	8.85%
December 1969	8.97%

Source: United States Federal Reserve

The S&P 500 generated a loss of 8.4% during the year 1969. Interest rates retreated between 1970 and 1972 and the S&P 500 managed to generate a reasonable rate of return during that time period. Of course, the 1973-1974 time period produced a loss of 37%, followed by a gain of similar magnitude in 1975 as interest rates retreated during the period following the 1973-1974 oil shocks.

Berkshire Hathaway managed to produce gains in book values throughout the period. The relative results are reflected in Table 2.

Table 2: Annual per Share Book Value Growth of Berkshire Hathaway Relative to S&P 500

	Berkshire Hathaway	S&P 500
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)%
1974	5.5%	(26.4)%
1975	21.9%	37.2%
Cumulative	148.2%	11.6%
Annualized	13.9%	1.6%

Source: Berkshire Hathaway Annual Report

Those results are a triumph for the basic principles of value investing, but the investment community of the era was not much impressed. Relative to the S&P 500, the Berkshire Hathaway share price reflects investor sentiment, as can be seen in Table 3.

Table 3: Berkshire Hathaway Share Price Performance Relative to S&P 500 1969-1975

	Berkshire Hathaway	S&P 500
1969	13.5%	(8.4)%
1970	(7.1)%	3.9%
1971	76.9%	14.6%
1972	14.5%	18.9%
1973	(10.1)%	(14.8)%
1974	(43.7)%	(26.4)%
1975	(5.0)%	37.2%
Cumulative	2.7%	11.6%
Annualized	0.4%	1.6%

Source: Berkshire Hathaway Annual Report

At year end 1972, Berkshire Hathaway shares traded for an approximate 11.3% premium-to-book value. At year end 1975, Berkshire Hathaway traded for an unbelievable 60% discount-to-book value.

There have been many books written that explore the question of how Berkshire Hathaway achieved its remarkable record of growth in value, but there are none that explore the question of why the investment community failed to recognize that record for many years. In fact, Berkshire Hathaway stock could have been purchased for a discount-to-book value of 39% as late as year-end 1978. The year-end premiums and discounts to book value are recorded in Table 4.

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Table 4: Year-End Premium/Discount to Book Value for Berkshire Hathaway Stock 1965-1982

1965	20.8%	Discount
1966	41.3%	Discount
1967	37.5%	Discount
1968	2.6%	Discount
1969	4.5%	Discount
1970	22.0%	Discount
1971	19.0%	Premium
1972	11.3%	Premium
1973	4.1%	Discount
1974	48.7%	Discount
1975	60.0%	Discount
1976	41.1%	Discount
1977	31.0%	Discount
1978	38.7%	Discount
1979	4.8%	Discount
1980	6.0%	Premium
1981	6.5%	Premium
1982	5.0%	Premium

Table 4 represents the record of how, and to what degree, the investment community undervalued Berkshire Hathaway shares. That discount is also a significant factor in the accumulation of the wealth of Warren Buffett. It will be recalled from various Buffett biographies that he originally owned 29% of Berkshire Hathaway. It was during the 1970s that Buffett gradually increased his stake to a high of 46%.

Of course, it might be asserted that investors in general, and value investors in particular, now genuinely understand that investing is a pursuit that requires patience to endure perhaps lengthy periods of inactivity. In 1999, the then recently acquired General Reinsurance produced an unexpected underwriting loss at Berkshire Hathaway. In that year, Berkshire Hathaway shares declined by 19.9%. Interestingly, that was the year of the Internet Bubble. In the first two months of the year 2000, Berkshire Hathaway stock declined from a year-end price of $56,100 to a March 10, 2000 price of $41,300.

It might be asserted with considerable justification that Berkshire Hathaway was unknown during the 1970s. The same cannot be said for the years 1999 or 2000. The investment world has greatly benefited from the publication of several excellent books on Warren Buffett and Berkshire Hathaway. People seem to have a genuine desire to comprehend how this gentleman discovers his investment ideas. It should not be forgotten that, before an investment idea of any sort can be discovered, it must first be created. It is almost always created by acts of extreme and unjustifiable cynicism and pessimism. The investment world might benefit mightily from a book about the valuation extremes accorded to even the best enterprises.