The Forging of a Skeptic - From Accountant to Buffett's Voice on Wall St.

http://seekingalpha.com/article/235292-behind-the-scenes-with-buffett-s-biographer-alice-schroeder

Miguel: Hi Alice. I'd like to start by thanking you for taking the time to talk with me.

Alice: Miguel, thanks for inviting me to do the interview. This is the first time I've ever talked to anyone at length about Warren Buffett, *The Snowball*, why I wrote the book, and the lessons learned.

Miguel: Start by explaining what was special about your experience with *The Snowball*.

Alice: When we discussed doing this interview, a theme that emerged was the hidden world of people like Warren Buffett, people who are in the top tenth of one percent of society in terms of fame, money, and connections, and how little most of us know of that world and its hierarchy and norms. Instinctively, you know that Snookie doesn't go to parties with Bob Iger and Willow Bay (Disney CEO and his wife, a television host), but the more granular distinctions aren't self-evident. For example, how valuable a form of social currency strong political connections in Washington can be, not because of their actual importance, but because they bring you reliably fresh and impressive-sounding conversational material to use at dinner parties.

Even once inside a person's world, getting to know their life history and psyche takes years, and that's even truer of an important public figure because they're so self-protective. Warren is so remote that his inner world has been accessible only to a tiny handful of people over the course of his lifetime, even though so many people are acquainted with him and consider him a friend. That makes it all the more unusual that he made himself world accessible to me and wanted me to write about him.

He spent a huge amount, I've estimated 2,000 hours, of concentrated time with me, and through this direct experience I gleaned impressions of him. These could be compared to his own self-perception, to the impressions of hundreds of other people whom I interviewed, and to the documented history of his life as contained in his papers and letters and photographs from more than 70 years of collected material.

Nobody who has ever known him has had this 360 degree perspective. There are people who know more facts about him, but nobody else has a well-synthesized a view. I probably know him better than anyone, in this objective sense.

Miguel: Let's talk about your background. Give us a quick tour of your career from working as an auditor, regulator, insurance analyst, to working on the street and meeting Warren Buffett.

Alice: I came to Wall Street as my third career. I started as an auditor working at Ernst & Whinney, the predecessor to Ernst & Young, in Houston, where I became a CPA. I then went to the firm's national office in Cleveland, then to NYC. In total I was with E&Y for 11 years, auditing all sorts of companies, from defense contractors to banks. At headquarters, I had a

variety of roles in the area of professional ethics, accounting standard-setting, and regulation. When Ernst & Young merged, I was assigned to the merger transition team for about a year and half.

After I moved to New York to resume work as an auditor it didn't take long to figure out that this was not what I wanted to be doing. I loved analysis, I'm very curious, and I wanted to understand the big picture and write about it for others. At the time my former boss and mentor, Denny Beresford, was Chairman of the FASB (Financial Accounting Standards Board, the standard-setter for U.S. Generally Accepted Accounting Principles). He knew I was considering leaving Ernst & Young and suggested that I come work for the FASB. I took that job thinking that it would be intellectually challenging, analytical, and involve plenty of speaking and writing.

At the FASB,I was assigned, essentially by being next in line as the most recent arrival there, to a dreaded project, which was to oversee the issuance of some of the most important new accounting regulations for U.S. insurers in 20 or so years.

Nobody on the staff wanted to work on these. The insurance industry had been fighting ferociously for more than a decade to keep them from getting passed, and with a lot of success. Insurance accounting is so arcane that insurers can usually fend off regulators and law enforcement people without too much trouble by throwing up a cloud of impenetrable jargon. People at the FASB enjoy mastering narrow subjects, but they don't want to make a career out of any one thing, and this project was like quicksand that had nearly swallowed a couple of people.

There's a saying on Wall Street that you either have the insurance gene or you don't. It's an interesting industry for investors because it requires a lot of probabilistic thinking. If you look at the landscape of investing you'll see that many distinguished investors have an affinity for insurance, chief among them, of course, Warren Buffett. I got assigned to this project by chance, but I fell in love with the industry within a couple of weeks.

The main topic was SFAS 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*; I also went on to complete EITF 93-6, *Accounting for Multiple-Year Retrospectively Rated Contracts*; and, EITF 93-14, *Accounting for Multiple-Year Retrospectively Rated Insurance Contracts by Insurance Enterprises and Other Enterprises*.

Their titles are a mouthful, but essentially they all eliminate deceptive accounting practices in which reinsurance contracts were created specifically not to indemnify risk, but to shuffle or smooth earnings around from one accounting period to another – or artificially inflate an insurance company's reported capital reserve one way or another.

If these rules passed, some companies and segments of the reinsurance industry would be losing their most profitable products, at least on a risk-adjusted basis. Conceptually, these deals were a very effective form of leveraging capital at very low, and even no, risk. They were very similar to the type of securitizations that got Enron in trouble. Not surprisingly, Wall Street also was starting to dabble in the business.

I was determined to get it done. This project had languished long enough, and I didn't want to make a career out of writing these rules. As part of this process, I oversaw several public hearings that you could fairly call contentious. We got the whole thing finished in eighteen months. Denny Beresford, my research director Tim Lucas, and one board member in particular, Jim Leisenring, were courageous in helping me fight off a wave of industry obfuscation and denial.

Toward the end, as the outcome became clear, some in the insurance industry flipped and started recruiting me. Their ostensible goal was to enlist my expertise, but really they wanted me to help them find ways around the rules I had just written. That wasn't very appealing. Meanwhile, I recall someone at the FASB observing, "You're great at interpreting complex ideas for a hostile audience," and Karen Rubsam, who later became CFO of Zurich Re, suggested I consider becoming an analyst.

Having fallen in love with the industry, I went to Wall Street to cover insurance companies, and ended up at a small boutique investment bank that is now known as Dowling Partners. They were a maverick firm that took delight in tipping over sacred cows. They were also technically sophisticated and wanted someone with an accounting background.

V.J. Dowling, who ran the firm, was and is brilliant. He viewed the industry as a vast minefield of deceit that could be navigated by sleuthing and in-depth analysis. He was incredibly competitive. His attitude was you must be first to reveal market-moving information – or it's worthless. It was a great foundation to start with.

Eventually, Dowling relocated from Boston to Hartford, CT. That became a logistical catalyst for my move to a New York securities firm. I joined Oppenheimer in 1994 and it became one of the highlights of my career. I was fortunate to make partner and managing director quickly – and made the *Institutional Investor* All-America Research Team within two years. Oppie was a vibrant place to work that brought out the best in me. I had some brilliant colleagues, including Steve Eisman (FrontPoint partners, as described in Michael Lewis' *The Big Short*) and Meredith Whitney, back when she was a wide-eyed research assistant who worked for Steve.

Miguel: I apologize for interrupting, but you mentioned some amazing situations and people. I find it interesting how certain settings can forge traits. In this case you, Meredith Whitney, and Steve Eisman all shared office space. Were there any characteristics that your coworkers that led them to future greatness?

Alice: "Greatness" is a flattering term. What I will say is that Meredith, Steve, and I tend to be among the skeptics. Oppenheimer attracted and supported skeptics.

Miguel: What fostered this skepticism?

Alice: Oppenheimer did not do much banking. It was a 2nd, if not 3rd tier firm on league tables. The only way clients would pay attention to Oppie analysts was if we added real insight and made a lot of noise about it. One way to do this was by following small caps. Another way was by being contrarian and accurate – the person who did not buy baloney dealt out by management. Unlike many firms, Oppenheimer supported you if you did that.

Miguel: This reminds me of James Grant indicating a great way to make a name is to follow unpopular paths and recommend shorts.

Alice: In a normal market, it is tough to be the naysayer, but the past few years have been a heyday for short sellers. With so much hedged money, there's also far more demand for diverse opinions today. In general, though, the human race is biased towards the positive. You have to be optimistic to go through life.

There's also some interesting research that shows that people who speak out critically are viewed as smarter than those who give only uncritical applause, even though they are less liked. In the long run, the price of popularity is paid in respect.

Miguel: Two things I wanted to go back to; first your experience as a regulator and how this taught you how games are played; and second, you mention the importance of being skeptical. Is this an inborn trait or can analysts, investors, and others develop this trait (if so how)?

Alice: We may have a natural bent one way or another, but it is very strongly shaped by experience. As just one small example, when I worked on the E&Y transition team, it was fascinating to see first-hand the amount of friction, wasted time, and lost energy that inevitably occurs in a merger integration. And this was quite a successful merger. So you can imagine how skeptical the experience made me of projected "acquisition synergies" in deals I later covered or took part in on Wall Street.

My experience in regulation was also immensely useful in this respect. It exposed me to dozens of people lobbying for an outcome. This is a side of human behavior that we see much less often as an analyst or investor. Try as they might, people aren't putting their best foot forward when they're lobbying you; they're putting their greedy foot forward. Also – and I have never said this before in an interview — being in the presence of a blonde has an interesting effect on some people. It can get tedious to be underestimated, but has its advantages. Certainly, it raises one's skepticism.

Miguel: So on to the question about skepticism. Being underestimated resulted in developing a different perspective. How can we make sure that we have a healthy amount of skepticism? In other words, how do you recommend developing skills for detecting charm versus substance?

Alice: I think it's one of the hardest things in the world to do. I've definitely made my share of mistakes that taught me a few things, and there's always more to learn.

You have to separate charm, meaning impression management skills, from the substance of what a person actually accomplishes. The personality, friendliness, and impressiveness of the person can be positively or negatively correlated with the results they are producing. Psychopaths and con artists are notoriously good at manipulating impressions.

Paul Babiak's book, *Snakes in Suits*, is a terrific primer on how to recognize a psychopath in a business context. With practice, you don't have to do business with someone directly to evaluate whether they're trustworthy.

Working as an auditor was helpful. Auditors have their faults, and obviously were implicated in a lot of accounting failures in the past decade. Still, as an auditor, you are trained to look for discrepancies and assume they may be important. You aren't supposed to ignore little aberrations, however seemingly minor, just because someone has a reasonable-sounding explanation to rationalize them away. In financial markets, companies use this psychological vulnerability against investors all the time.

People who are psychologically and financially invested in a stock work very hard to resolve any newly arisen cognitive dissonance in favor of their vested interests. Cialdini speaks of the *Commitment and Consistency* principal and psychologists speak of confirmation bias. The auditing profession is built on the foundation of fighting that bias; small discrepancies must

never be dismissed; they must be investigated. Whether in journalism, writing, or finance, that's an invaluable lesson.

There's another thing. Many exceptionally good business people are charismatic –- but not charming. Charisma is the ability to attract people to you and to convince them you are exceptional, even if you aren't likable. The Gordon Gekkos of the world.

Charisma can interfere with your ability to override what Cialdini calls the "click whirr" reaction, your evolutionary response to persuasive stimuli. You can trick yourself into believing you're objective about someone you don't find particularly charming when in fact you're falling for their charisma. Predatory people on Wall Street and business often base their careers on the "click whirr" reaction.

My own rule of thumb: watch what they do, not what they say. If someone's behavior deviates from what they are telling you, always go with the behavior. This means sometimes you've got to override your gut, which like all instincts is driven by evolutionary biology. I'm a strong believer in listening to intuition, but only after it's checked against reality. "Blink" is not a smart way to invest.

An example is American International Group (AIG). Like many analysts, I recommended that stock for a long time, too long, even though it in many ways was a tremendous black box, primarily justified on the basis of it employing the smartest people in the industry in which it competed. I ended up being one of the first people to downgrade AIG when I was at Morgan Stanley (MS), and my observations were extremely basic. Historically, AIG had announced the date on which they would release earnings on a certain schedule every quarter. It had never varied.

Early in 2003, at the end of a bad insurance cycle when a lot of similar companies had taken reserve charges, the day arrived and AIG didn't announce their earnings release date. That was out of pattern, and I thought it had to mean something bad was brewing. We suspected this had to do with pressures from the economy that were affecting their business, so that's what we said in the downgrade. Next thing you know, AIG reported a $2.8 billion reserve charge. If business had been better and they'd had a tailwind, they might never have taken this charge. They probably would have bled it into earnings and covered it up. And Eliot Spitzer forced Hank Greenberg out over this charge. That was the beginning of the landslide for AIG.

Miguel: You talk about Cialdini and mention the importance of looking for congruence. Are there any material besides Cialdini's Influence which you find useful in becoming a better auditor?

Alice: Yes, I will give away some of my secrets. People would do well to study investigative journalism. Read something like *Den of Thieves* or *A Civil Action* and try to reverse engineer how it was reported.

Here are three other great books on conversing with people, understanding their real motives, and just generally understanding how the human mind works.

- *The Craft of Interviewing* by John Brady.
- *The Zen of Listening* by Rebecca Shafir.
- *The Moral Animal* by Robert Wright.

A Behind The Scenes Look At Wall St & Morgan Stanley

Miguel: Can you comment (without stepping on anyone's toes) on the experience of being an analyst at Morgan Stanley? Take us behind the scenes of coming up with an idea, monitoring a company, and issuing a rating.

Alice: Oh, I'll comment freely. When I left, I did not sign a separation agreement. It would have required me to get written permission to speak or write about Morgan Stanley and would have subjected me to liability if I said anything that they, by their unspecified definition, considered criticism. I would have been paid much more for agreeing to this, but I didn't want to be muzzled.

So what is it like to be an analyst…When I started at Oppie it was very free form. Analysts used their judgment. Over time, as I moved through the different firms, especially Morgan Stanley, more and more requirements arose. There were things you had to write every time you published on a company. The financial models became standardized. Like any other business, the more you standardize something, the more you stamp out creativity.

This was more than just compliance. Through this process, big firms like Morgan Stanley were also trying to brand themselves. The firm wanted to be the brand, and discouraged its analysts from doing distinctive enough work to result in them becoming a brand themselves.

You may wonder why analysts at banks hedge themselves so much – on the one hand this, on the other hand that. Partly it can be lack of courage. But someone is always trying to lawsuit-proof your opinion. Decisive statements are lawyered into "may, can, could, might, potentially, appears" instead of "is, does, should, will," much less "look out below."

The time pressures that work against quality research are also well-known. You write up a lot of inconsequential things, especially what I call "elevator notes" (this quarter "X was up and Y was down"). Instead of writing original or probing views, you are really incentivized to spend as much time as possible marketing.

Also, if you adhere to consensus, it does protect your career. There's an old saying that no one ever got fired for buying from IBM. Nobody ever got fired for making a wrong estimate that was within sell-side consensus.

Whereas, if you break from consensus, you really can't afford to be wrong very often. That phenomenon really drives the sell side. It can be overt, such as when we were judged on how "commercial" our work was. This is a veiled threat, because, of course, our work has to be marketable in order for us to have a job. The firms essentially want two things that are incompatible.

They really do want you to do nonconsensus work that's attention-getting enough to be of interest to clients, but it also has to be right to be commercial, or you are punished. The fear of punishment nearly always beats the desire for reward, so this creates constant pressure to pull in your elbows.

Finally, of course, there's the well-known banking conflict of interest. My team had its encounters, especially over AON, at the time a disaster of a stock. Once, we were told "Pat Ryan [then CEO of Aon] is reading your reports, and he's not happy," as if our job was to make Pat Ryan happy. Aon was so beaten down that it always looked cheap.

It repeatedly head-faked investors. Management would claim victory on a turnaround, then it would blow up again. Our refusal to recommended Aon no matter how cheap it got frequently

put us in opposition to Gary Parr, the banker, who was a fierce advocate for his client. The day Gary left Morgan Stanley, we literally gathered in the hallway and celebrated.

With that said, ultimately Morgan Stanley backed me up. It backed me up on many occasions. My research director, Mike Blumstein, was very supportive. A number of bankers were supportive. On one memorable occasion, Joe Perella intervened directly with a banker after I talked to him about a proposed GE deal. He killed the deal, which probably saved us a huge lawsuit.

From what I understand, pressure still exists. For one thing, if there's a layoff, analysts who are needed and liked by bankers are protected. The 20% of the department that is getting fired will be chosen from the rest. You can do the math on that.

Miguel: You jumped in front of my next question. I didn't realize the pressure you faced on the sell side. Are there any firms that you recommend as staying true to their research and escaping the perils of groupthink?

Alice: Boutique investment banks and broker-dealers by definition are better if you are looking for stock picking advice. In effect, they're performing a different service than a large bank. They don't send their analysts on constant marketing trips to discuss their sectors and the banking work is distributed among more people. They're more heavily staffed for research in general, and usually commit all their resources to a one or two industries. They follow small caps. The risk you have with boutiques is their dependence on access to managements and industry sources. They're like journalists who follow a beat –- they live and die by their sources.

In terms of groupthink, first, it's part of human nature. There's a lot of research that shows this, such as the famous Milgram experiment. Let's translate this to a stock. If a company is obviously broken but no one else is saying that, then an analyst who thinks so will begin to question his or her judgment when the market continues to disagree. Another way to put this is to say that bystander apathy is powerful on Wall Street. Bystander apathy is the famous psychological propensity of people to ignore disasters happening right in front of them when they're in a crowd, if no one has made the first move. Analysts think, "Who am I to try to rescue investors from impending disaster. I'm no smarter than these other 18 people covering this company."

You have to have enough of an ego to believe you're smarter, and, this will sound corny, but it helps enormously if you have crusader streak. Crusaders will suffer all kinds of slings and arrows in the name of whatever they believe is justice. That's how you become a Steve Eisman.

People who gravitate to short-selling also innately have this personality. It's kind of interesting that some of them now have almost cult-like followers. In recent years, we've been living in a time when being a crusader and being negative is handsomely rewarded and respected. A decade ago, that certainly wasn't true. Someday the pendulum will swing back.

Miguel: How did this pressure play into the shortsighted nature of company guidance and quarterly estimates?

Alice: You know, I don't see that being linked to the time pressure of sell-side analyst work as much as the fundamentally short-term nature of investors' quickened expectations. If you're a hedge fund manager who's being judged, not just quarterly but monthly, weekly, and even daily, then every minute matters. The brokerage firms all have at most 1 year rating systems. And, often you are judged in shorter increments than that for your stock picking.

The rating systems are a major criticism I have of Wall Street research. When the firms began to judge analysts for things other than their banking skills and client popularity, they migrated to stock-picking. Now, there's a big difference between stock-picking –that is, continuously making predictions about exactly which companies in a particular group will do the best over the next few months — and investing, which is a profession in which it pays to realize most of the time you don't have a good answer to that question.

One of the several reasons I left the Street is that I was tired of being a short-term market prognosticator. Almost by definition, that's a silly thing to do.

Miguel: From what you tell me, what I hear is that they (short-sighted analysts) are not thinking like owners.

Alice: They don't have the luxury of thinking like owners. Neither the buy side or sell side, with the exception of a handful of value managers, the majority of whom continue to manage relatively smaller funds by Wall Street standards.

Miguel: So let's bring Warren Buffett into the picture. You're an analyst covering insurance companies. When is the first time you come across Berkshire Hathaway (BRK.A)? Do you still remember the day you released the Paine Webber report?

Alice: Oh yes. I came across Buffett when Berkshire bought the second part of GEICO, which was a major event. It never occurred to me to begin following it until several years later, when Buffett announced his bid for General Re. At that point, a number of my clients asked me to follow Berkshire Hathaway. They were going to own the stock and they wanted research coverage.

These clients knew I liked complex difficult things to analyze. That I was interested in doing things that were different even if there was no obvious commensurate reward for the extra effort. The sell-side had limited interested in following Berkshire, to say the least. The stock didn't trade. At the time, Warren essentially didn't pay bankers and frequently expressed a negative attitude toward the Street.

So, I went to my research director at PaineWebber and made a case that our retail brokers would appreciate this coverage because their clients were interested in Berkshire and Warren Buffett. Being able to call and talk about Berkshire was a service for retail clients that did not involve asking for a transaction. It was something their financial advisors appreciated being able to offer. To its credit, PaineWebber gave me a thumbs up.

Miguel: What was the next step? Did your director just say 'go for it'? What was it like discovering Berkshire Hathaway?

Alice: Warren always said he revealed everything investors needed to know from his financial statements, but that was not the perspective of many analysts. I find it interesting that Buffett has criticized Wall Street for being over-dependent on private information from management. When I started taking Berkshire's public disclosures and merging them with my earnings model on General Re, I quickly learned what so many people already knew, which is that investors had been struggling for years trying to value Berkshire.

I ultimately based my valuation on three things: insurance, the group of other little businesses, and the publicly traded investment portfolio. I just started putting it together. There really was not a lot of information to do a detailed valuation and frankly there is still a lot of ambiguity. But I assumed that anything would be value-added to investors versus what they had, and that turned out to be right.

As an aside, at the time and continuing to this day, it's not uncommon for money managers who are vocal champions of Berkshire's attractiveness as an investment in public to take me aside in private and wring their hands over the problem of how you value Berkshire stock, and whether it is over- or under- or fairly valued.

People get stuck in this position because they trust Warren philosophically, and they believe the empirical track record, yet, for lack of information, they're prevented from living up to the professional standards of analysis that that they apply to their other investments and that Warren applies to his own investments. As security analysts, this makes them uncomfortable.

Warren has always had the attitude that investors should trust him enough to let him operate in privacy. People were fine with that for a long time, and were rewarded for their trust. As he's gotten older, they're less fine with it, which is reasonable.

Meeting The Oracle of Omaha

Miguel: At what point (and I don't know if this happened or not) do you say there is more to this guy (Warren) than meets the eye? Did you just write the (BRK Initiating Coverage) report and never expect things to progress (into a book deal)?

Alice: You can tell he's not ordinary by reading anything he's ever written. I knew right away he was a legend. It was also apparent at our first meeting how different he was. I took a list of 60-some-odd questions that should have filled several hours of conversation. We sat on his Gulfstream flying to Omaha and he sliced through those questions in about 45 minutes in between mouthfuls of potato chips. I had to improvise, which was terrifying at the time. It was my first encounter with what conversing with him was like.

But, to go back to exactly how I met him: Shortly after I started working on the report, clients who wanted to meet Buffett asked me to get a meeting with him. The ostensible reason was that they were going to be voting on the General Re merger and their fiduciary obligations as fund managers required them to meet with the management of any company whose stock they owned. Truthfully, I'm not sure how eager they would have been to fly to Omaha to meet anyone but Warren Buffett.

So I wrote him a letter saying that shareholders representing 13% of General Re's stock wanted to meet with him and we were all willing to fly to Omaha if he would give us an hour of his time.

I thought it was a long-shot. But Warren called me within a couple of days on the phone. That was my first encounter, and, as are many people who don't know him at first, I was shocked that he answered his own phone and dialed his own outbound calls. I thought it was a prank until after the first sentence or two when I was sure from the voice that it was him. Then my knees were shaking.

He said, "Come on out." So we went. In the end, he gave us about two hours. The conversation would seem surreal to a lot of people because we literally spent almost two hours talking about

insurance. It really is the insurance gene thing. And, I was with exceptional investors like Jody Jonsson from Capital Group and Chris Davis. Warren enjoyed it because he loves to talk about insurance.

Three weeks later, I was in my office, never expecting to hear from Warren or talk to him again. My phone rang. It was him. Hearing his voice, with no secretary placing the call, was again shocking. He got straight to the point.

He said (and I'm paraphrasing),

I never have had any contact with the Street, but Berkshire is now very complicated. Someone needs to teach investors how it works. This means I have to choose between the lesser of 2 evils. Either I give one person an advantage over their peers. Or, I have to be bothered all the time by analysts. I don't want a gaggle of analysts calling me all the time, so I am choosing to give one person an advantage. Would you do me a favor and be that person?

With hindsight, this elegant way of reasoning and drawing me in was so classically Warren. It made a strong impression on me at the time. When you ask how I knew he was different, it was from episodes like this. And, perhaps as he wanted, I felt that he chose me. I had shown the initiative to cover the stock and had brought people to Omaha, and he really likes it when people come to Omaha. It matters to him more than people realize. So I said, "Of course, I would be thrilled to," and that was the beginning.

By the way, there has sometimes been a misunderstanding that he asked me to cover the stock. There is no way he has ever asked anyone to cover the stock. It's unthinkable. He rarely asks anyone outright for anything. He wanted to talk to me because I was already going to do it.

So, after that, I would fly to Omaha and interview him once or twice a year, and talk with him by phone periodically. My first interview was that conversation on a NetJets plane in 1998, flying to Omaha with him and Susie.

Susie sat in the back of the plane and read magazines the whole time. She was obviously irritated at him. This side of Susie came out very, very rarely, but if she saw Warren showing off in front of a woman, that could trigger it. And Susie dealt with it fabulously, very gracefully, letting him know in multiple nonverbal ways that he was irritating her. Susie was an unusual person whose emotional intelligence was off the charts.

Miguel: What was it like being the world expert on Berkshire Hathaway?

Alice: I thought that it would be interesting to our retail brokers and to a limited number of institutional investors. I knew that a lot of people on Wall Street were indifferent to Warren Buffett and some even disliked him for one reason or another.
What I didn't expect was that the new role would become huge, but it did, because, until that time, Warren had been so inaccessible. The *New York Times* ran a front page business section story "The Oracle of Omaha Taps a Medium on Wall Street." For a while I had 3 people answering the phones. I can't tell you how many phone calls just never got returned; it was like a wildfire. Thankfully, it calmed down after a few weeks.

Berkshire was a very interesting stock to follow, especially as you began to really understand it and its most important elements. Shortly after I began my new role, Warren made a series of acquisitions in the late 1990's and early 2000's. There was, as there still is, a fascination with the

minutiae of these companies. But it seemed to me that the most important part of what he did resembled a factory-like process. What interested me was the factory.

Miguel: When does the Snowball come into the picture?

Alice: In 2003 I had been following Berkshire for 5 years. I had been an analyst for 10 years, and the job was getting a lot less fun during the Spitzer era. I was thinking about starting a boutique research firm. I was talking within Morgan Stanley about moving into management. I was also contemplating doing something completely different.

There were two threads that merged. One was that an author contacted me with an idea for a book about Buffett. I didn't love this author's particular idea, but it got me thinking more about the subject of what books should be written about him. There were so many books trying to describe how Buffett invests, but there was nothing, really, that combined his management and business philosophy with a fairly comprehensive account of his own biographical information. There was no "biography of ideas." I wasn't really thinking about writing a book; I called him and told him about this book suggestion and said I thought he should write it.

Warren replied that he liked the idea but that he would never write a book, and asked me who else I thought could do it. I said Carol Loomis, and he said Carol is not going to do it. He asked me again, "Who else do you think could do it?"

Then comes the second thread, but only retrospect did it make sense. Warren, ever since 9/11, had periodically mentioned that he liked the way I wrote and thought I should quit my job and write a book. I realize now that this started right after the death of Katherine Graham. Warren viewed *Personal History* as a seminal episode because it defined her in the public's mind. When Kay died it brought him to the conclusion that the subject has to get on with it if such a book is to be written. But I found this out from conversations with him later. He never mentioned *Personal History* to me at the time. So I would say, "But Warren, what should I write about?" at which point he would say, "oh, you'll think of something." I assumed he meant something about insurance or Wall Street. Unsurprisingly, nothing compelling came to mind, so I wasn't going to quit my job to write a book.

Now, when he put me on the spot in this conversation, it was clear that, absent him or Carol, nobody would write this book that I had conceived of but me, and that's what he was saying. Once I understood the offer, I knew *The Snowball* was worth doing. The magnitude of writing a book like that was overwhelming, though. It still didn't occur to me to shelve my other plans right then and there to write a book like this. I said something to Warren about how maybe I could do it in 10 years or so when I retired.

I wasn't worried about the timing because, just as with my report on Berkshire, it never occurred to me that I would have any direct help from him. That may sound odd, because a lot of people would have seen the advantage of getting his cooperation and would've asked for it.

But one of the criteria of getting along with Warren, of him seeking out a relationship with you, is that you don't have expectations. People who ask him for things, even small things, do not get to stick around long. Over and over, I've seen that only a person who genuinely has no expectations gets offered things by him. At the time I had no inkling of this, so I wasn't expecting it when Warren instantly said, "Well, I'll cooperate with you if you write the book. I'll do interviews with you; I'll give you my files, etc."

That changed everything. It meant I would have to start right away. (At the time he was 73.)

It was an incredible offer, but even so I had to think about it. It was a big risk. I had never done anything like this before, and I could fail. I was giving up my career. Financially, though this still surprises some people to hear, I would be giving up a job on Wall Street that was far more lucrative and financially stable than even the best of book contracts.

But, most frighteningly, it was a huge responsibility, and it was an irrevocable one. I was being entrusted to produce the book that would define Buffett and would always bear the responsibility for interpreting the knowledge I was given.

Yet I was really excited about to spend all this time learning from him. (I later realized that the kind of attention I received was something even some of his close business partners, family, and friends were rarely given.) I felt that the world needed this book, and it could be a great gift to do this for people. I like challenges. I would learn new skills: writing narrative, interviewing, and structuring the story. No one else ever had or ever would have this opportunity. How could you turn it down? So I called him back two days later and said, let's go. In June, 2003, I flew out there and we started.

Miguel: So you decide to write the book, what's next? Did you quit your job? How did you juggle multiple responsibilities?

Alice: Originally I thought I could do this on a part-time basis and at least stay with Morgan Stanley and write occasionally as a strategist if I gave up my stock responsibilities. That was naive. I ended up becoming what's called an Advisory Director, which is somewhat like going limited at Goldman (GS). I had some minor responsibilities at Morgan Stanley while writing the book, but spent close to full time writing.

Miguel: At that point, what was the message of the book? How were you going to tell Warren's story?

Alice: Initially, it was still this notion of the biography of ideas. Warren kept referencing Iacocca's biography and Kay Graham's. He loved Iacocca's book and, in fact, started shoveling biographical material at me immediately. There were a lot of stories he had been saving for "the" book. Some of the material was very personal and revealing, including the mental illness in his family and his shoplifting as a child. Sources who had never spoken to anyone came forward because this was "the" book. Warren said he wanted to reconcile his public and private selves. It was the right thing to do, revealing the source (and wellspring) that forged Buffett.

He was very clear from the very beginning that he did not want any editorial involvement. That it was my book. He did not want to have any control and he wanted me to write whatever was best in my judgment. He explicitly said, as I wrote in the first few pages of *The Snowball*, "Use the less flattering version'' if his version differed from anyone else's.

Warren wanted a successful book that would be credible enough to sell well. In a sense, he also didn't trust himself to write it. I have an interesting interview recorded of him insisting that I will do a better job of the book than he would. He also knew if he got involved, a publisher might market the book as if he were the co-author or as if it were ghost-written, and he wanted the boundary very clear that it was not his book.

Miguel: As you are writing the book, does anyone stop you along the way? Was there any fear involved in the process?

Alice: There was constant fear from the first moment to the last. All different kinds of fear. Writing is all about fear.

Miguel: What do you mean by that?

Alice: Every word that you put on paper is an expression of your window on the world, of your abilities. It's going to be judged and often judged harshly. In this case, it was a book that would be potentially historic. I was worried from the first day to the last as to whether I could live up to the responsibility I had been given. I was afraid of all kinds of other things. I was afraid of failure. I had to learn to write narrative and I was afraid of failing at that. I had to learn to interview like a journalist, which is a very difficult skill.

There is another set of fears that go along with writing. You as an author have to confront yourself on the page. This doesn't happen when you're writing technical material, but when you venture away from that to draw judgments about people, all kinds of existential and psychological considerations emerge.

The dynamic between the author and the subject is fraught with complication in every writing relationship. When the person on the other side of the table is Warren Buffett, there's another kind of fear. I learned and observed very early in the project things that had happened to journalists who reported on him in a manner that bothered him. It's an understatement to say that Warren is sensitive to criticism.

When we started, I had no idea what he was really like, whereas he know himself and his life story. A couple of people called me as soon as the book was announced and said things along the lines of "I know him really well and I didn't think it could be done," and "I couldn't do it, but maybe you can pull it off."

Once I was far enough into the project to understood what they meant, it was too late to back out. I wasn't particularly happy about being in this position. The path of least resistance would have been to write a Valentine book, but I just couldn't do it. Instead I convinced myself that he would be supportive of a truthful book. I told him, and my agent told him, any number of times, that there were parts of the book he wasn't going to like, and he seemed fine with that and kept cooperating. It's pretty clear that, to get the book done, we were both engaged in some magical thinking.

Miguel: I had no idea how many things you went through both career-wise and then in writing this book. I don't think most people appreciate how different you are from a traditional Wall Streeter (or even author).

Alice: I've had some unusual experiences in my life that helped my judgment here. One example is from my career, during the E&Y merger. I was one of the two people responsible for "independence" — that is, rules that prevent auditors from having conflicts of interest with clients, such as investing in client stocks and having relatives employed by clients.

The Ernst rules went beyond the minimum AICPA requirements, and we chose to continue that. I was involved in making decisions and giving people the news that they had to make awful

choices. Their options were to quit their job or to sell a major investment in an illiquid limited partnership at a big loss, for example. Or to quit their job as a partner in Atlanta unless their sister, the CFO of some publicly-held client in Seattle, was willing to resign.

These experiences taught me vivid lessons. Conflicts-of-interest-in-appearance and conflicts-of-interest-in-fact are two very different things. Inherently, conflicts-of-interest policies can only address appearances. And virtually 100% of the time, well-intended, ethical people are blind to conflicts when they're faced with giving up some personal thing that they highly value.

This happens to be one of Charlie Munger's oldest points, though the implications I draw are slightly different than his.

Rules are necessary because people are inherently human, not inherently evil. We can easily be way too black-and-white in our judgments of people who commit things that are labeled improprieties in hindsight. Nobody is all good or all bad. Well, almost nobody is all bad.

My experiences made me firmer about applying principles, while at the same time, softer toward the people involved. For example, a relationship with Warren Buffett is extremely valuable. I don't judge people for protecting it, I just feel freer for having been disentangled.

Backtracking a bit, another advantage of starting as an auditor before Wall Street was that I had to spend a lot of time thinking, "Is this a good business or not? Is this company going to succeed or not? Is this a good industry or not?" I audited some truly awful companies. I couldn't understand why anyone would want to be in these businesses. So, it came very naturally when I encountered Warren's focus on the qualities of a good business.

Miguel: It's funny and I hope one day you can meet my boss. But you can tell him anything in the world (about an investment) but he always circles back to two questions

1.
    1. Is it a good company, and
    2. Is it cheap?

Alice: Sure.

Miguel: I think that I am a little bit like you in that I love thinking about things. But I also find it very easy to get lost in details while forgetting to ask, "Is this something I even want to own in the first place?"

Alice: One trap is not probing deep enough to really answer whether a particular investment opportunity is a good business. It's easy to make a facile judgment about that based on a summary description of a business. The sheer breadth of different business and investment opportunities in a modern capital market creates an overflow of information that leads many investors to have short attention spans in thinking about companies comparatively.

Curiosity is an inherent kind of arbitrage that no amount of computer technology can overcome. Warren makes it sound so simple to know what is and is not a truly good business – and great business do resonate very clearly when you understand why they are great and especially when they've been identified as successful investments by an investor like Warren Buffett and proven so with hindsight – but like many things in investing, Buffett makes it sound easier than it is.

When it comes to appreciating something that is special about a business that others do not, I've learned that the devil really is in the details.

Will The Real Warren Buffett Please Stand Up

Miguel: Alice, tell me about the process of getting to know Warren Buffett.
Alice: I would ask him questions, and he was able to pull elaborate modules out of his memory bank. He has thought about so many things over the years that there are polished nuggets prepared to respond to almost any question. At times, it was hard to get him to give spontaneous answers –- or to give on-point answers to questions he hadn't been asked before.
As you get to know someone over time by spending days on end with them sitting in their office watching them, you begin to see the real person. I got to know him and understand his mind in business and investing by writing *The Snowball*. I saw him interacting with his family, his friends, managers, his office staff, and of course, myself. I saw him in all kinds of moods.

It was eye-opening to watch Warren dealing with celebrities. He's expert at it, yet occasionally some weird thing happens. There was one funny episode, for example, when he invited Sophia Loren to the shareholder meeting as a celebrity guest. He was surprised, and a little insulted, when she wanted to be paid to attend. I mean, in his mind, who wouldn't want to attend his shareholder meeting? So throughout all of these interactions I saw the different aspects of his personality emerge.

Miguel: Could you shed some light on Buffett's daily life? What is his daily routine? Maybe you could comment on his interactions with the management teams.

Alice: Sure. He comes in the morning and his routine is to switch on CNBC with the sound muted and start reading while glancing at the crawl from time to time. The wooden shutters on the windows are always closed. You get no sense that a world exists outside, which is what he wants, no distractions. As far as I can tell, he doesn't need sunlight.
He is already pretty well versed on the news by the time he gets in, through the Internet and television. But he still prefers newspapers. He reads the *WSJ, NYT, Financial Times, Washington Post*, the *Omaha World-Herald*. He reads some offbeat things like the *NY Observer*. He reads all sorts of trade press relating to the different businesses that Berkshire runs. Ame*rican Banker, Oil & Gas Journal, A.M. Best, Furniture Today*. There are stacks of reports from the different BRK subsidiary companies on his desk. Throughout his day he grazes through the reading pile.

Meanwhile he talks on the phone. He doesn't make a lot of outgoing calls; people call him. That's his day … most of the time.

People do come to visit him and he'll sit and spend an hour with someone or have lunch or dinner. A lot of days he doesn't have anything on his schedule. His interaction with managers is minimal. Some of them call him regularly, but he's not kidding when he says that others, he speaks to maybe a couple of times a year, or they communicate in writing.

He responds if they call him. He almost never calls them. If they call him he'll be very agreeable and talk but he keeps the conversation quite short. When they do call, he acts as a sounding board. The one thing he controls is capital decisions. But anything else, it's pretty much up to them.

He is a very good listener who gives excellent advice, and he's also pretty firm about not giving unasked advice. The managers vary in their desire (for asking for advice). The ones that do ask use words like "invaluable" to describe his advice.

Within headquarters he has low interaction with his staff other than with Debbie and the other secretaries. He talks to Marc Hamburg (the CFO) regularly, although not necessarily daily. He talks with his the bond trader. These conversations are very brief. You'll notice this is a running theme… while he does have long conversations, it's only with a few friends and only on occasions of *his* choosing.

In the office, he knows everyone's name and occasionally walks down the hall and says hello to people. He is the furthest thing from a walk-around manager, though. He stays in his office (he is at one end of the hall) and everyone else sticks to their end.

Miguel: Obviously he is a voracious reader and gets through things pretty quickly. How much time is spent on new ideas besides following the subsidiaries and general business press?

Alice: You mean investment ideas?

Miguel: Sure, whether it's a new investment idea or not. He talks about enjoying books…I'm curious where he finds the time to do those kinds of activities (in addition to investing).

Alice: Yes, he's mostly updating himself. Books and entertainment would be at home.

Miguel: Is there anything that surprised you about his daily routine or communications?

Alice: While I was an analyst, he would always say, "Call me anytime," but I rarely did. I had this false notion that he was busy all day and it would be an imposition to call him. Later I learned some of his closest friends feel the same way, and meanwhile Warren is sitting there in Omaha wishing more people would call him.

Only certain people, though, that should be stressed. Essentially, only people who he is certain have no expectations of talking to him get to talk to him.

You know his saying about potential acquisitions, "If the phone don't ring, you'll know it's me." That's not coming out of a vacuum. If you want to connect with Warren Buffett, do it in writing.

Something to keep in mind is that Warren is extremely precise and literal in what he writes and says. You can tell this from reading his writings closely, but it was even more interesting to watch him create them in real time. It's unwise to read more into his words than is there. It's equally unwise to assume that everything you might want to know has been said.

One thing I found surprising initially, but with hindsight not, is that Warren relies on those people who do call him as his window on the world. He needs eyes and ears. You know, if you're Warren Buffett, you can't walk into a Dairy Queen to check things out. People are always putting on a show for him. He appreciates candid information and seeks it out.

Through this vast network of connections that he's built, he's created a sort of database of information about business and the economy that's probably irreplaceable.

Miguel: Is he the type to call a "buddy" at a large corporation?

Alice: I don't want to say he never makes outgoing calls. But, more often than not, people call him.

Miguel: So jumping back to the book how did it progress (as you got to know him more intimately). Was there a change in focus over the first couple of years? What were the changes in how you wanted to organize his life?

One of the very interesting things about Buffett is the dichotomy between his character and experiences. By that I mean he was 30 years old and a millionaire and very confident in a business sense—and at the same time he seems to be the shy nice guy (who can barely ask a girl on a date). So maybe you can comment on the young Buffett and how the book progresses from there.

Alice: As he gave me more biographical information, I discovered more sources to interview, many suggested by him. So, as I got to know him better, I tended to reorganize and restructure the book to mesh with his personality and my advancing knowledge of him. You have to understand that I did most of the writing in the last 2 years. I was doing mostly research the first 2 years.

There was a critical path that very much influenced the process, of course. He was obviously the scarcest resource. So I interviewed him as much as I could and as quickly as I could for a year and half.

The second-scarcest resource was access to his files — so I went to that right away simultaneously while interviewing him.

The third was people in his life who were very elderly. In a sense I used the actuarial tables for guidance on when to interview people. I started with people over age 95, 90…and I worked my way down – but I still missed some people.

It was too bad because there were people who were already deceased or in dementia, and I didn't get to talk to them and missed getting to know them. One of the joys of this book was getting to know so many amazing people, and especially, spending time with wise elderly people. But I managed to get most of the key sources, and I felt it was appropriate to focus on them first, because, today, many of them are no longer around or aren't in a position, physically, to provide the kind of insight into Warren Buffet that they so generously did when I was writing the book.

I was still doing bits of research until right before the book was published, which is standard in journalism. As the emphasis switches from initial digging to fine-tuning, it goes from 80-20 research versus writing to 20-80. It's not unlike researching a stock, really.

Miguel: Please comment on the highlights of Buffet's life through the view of his closest friends, family, etc. That is, the people you interviewed. Are there any milestones that people don't know about or overlook in his character development?

Alice: This was some of the "new news" in *The Snowball*. For example, his relationship with his parents and the role of mental illness in his family shaped his character and his whole career.

He's cautious and non-confrontational. He's wary of extremes in all forms. He's insistently reluctant to criticize anyone and hypersensitive to criticism himself. He needs to be liked and needs approval, but paradoxically is not a people-pleaser. He's demanding of himself and has very high standards. He's very oriented toward security … hyper-aware of risk.

He's got a keenly honed sense of justice, but isn't one to fight for it in an overt way; he can be timid when called upon for moral courage. He's uncommonly clever at finding pragmatic, indirect solutions to problems, usually multiple problems taken care of by one solution. You can take those traits and look at his career and find strands of them *everywhere*.
His relationships with women provide the most important window on his character. Susie had a very strong impact on his business career because she enabled him socially to overcome his shyness and get around in the business world. He has credited Dale Carnegie, but to fully understand the magnitude of her influence you have to carefully read the formative events in his life that involved her, something I went through in some detail in *The Snowball*. Warren's relationship with Susie is as clear a window into who he is, his traits and temperament, as any other.

His hard work in the social area to overcome his natural awkwardness is what enabled him to get past the front door with Katherine Graham. If you look back on his career and think of all the things that happened to him that wouldn't have had Kay Graham not entered his life, it's immense.

You can never know what the other path would have been, because he is obviously brilliant, and other good things would have happened. But his Washington connections, media connections, all of these different things led to many of his investments, and his pleasures in life, and they originated from Katherine Graham. Given his strategic way of thinking, it's not surprising that he arranged to get exposure to her.

Even the GEICO investment was influenced by Katherine Graham. She introduced him to Jack Byrne. He made his decision to invest in GEICO partly because he thought Jack Byrne was the right person to be the CEO.

Miguel: Earlier I asked you from the point of view of an analyst but now I would like to as you as an author, did you get an "Aha!" feeling that Warren wasn't a typical human being? When did that hit you and how did it hit you?

Alice: That was obvious when I met him as an analyst in the first 5 minutes into the conversation. When he opens his mouth it just comes through. His way of articulating ideas is very original. He is a great synthesizer and especially strong at pattern recognition. He's also able to follow what I would call it decision trees and figure out probabilities in his head at an astonishing pace.

So when you are in a conversation with him, he has worked out many of the directions in which the conversation can go, the likelihood of each, and how he wants to manage his end of it. He's reading you emotionally too. You recognize that right away in a conversation with him. You realize he's many moves ahead of you on the chess board. It is eerie, but also fascinating.

You also can see how unusual he is because he's a great teacher. If you ask him questions he loves to convey the things he's learned.

Miguel: What makes him such a wonderful teacher?

Alice: Well, first, it is that he enjoys teaching and, second, that he has worked hard at learning communication skills and specifically learning to communicate as a teacher. So he knows how to order material, how to tell stories, he knows how people process information. It's also, I think, a valuable insight that teaching is one of his preferred modes of talking to people much of the time.

You could almost call it his default mode. And that the value, influence, and trust he built by being such a memorable teacher of investing, business, and life in his public communications was, from a relatively early period, a very important ingredient for his tangible business success. This began as early as high school, but was crucial to running the Buffett partnerships and later Berkshire Hathaway. I think this point is actually still quite underappreciated among even his most obsessive followers.

Miguel: Give us advice to becoming better communicators.

Alice: Well…this is not anything profound. But you see that he uses very short parables, stories, and analogies. He chooses key words that resonate with people —that will stick in their heads, like Aesop's fables, and fairytale imagery. He's good at conjuring up pictures in people's minds that trigger archetypal thinking. It enables him to very quickly make a point … without having to expend a lot of verbiage.

He's also conscientious about weaving humor into his material. He's naturally witty, but he's aware that humor is enjoyable and disarming if you're trying to teach something.

Miguel: What is your favorite part of the book?

Alice: Okay, well I won't say favorite because that is similar to picking your favorite child. There are parts of the book that I love for all kinds of different reasons. There is one intellectually challenging and interesting part to me that I think is intriguing and has been paid less attention.

I was able to put together how he created BRK out of Blue Chip and Diversified. I was also able to put together how he created his partnership. That was nearly all new information.

I found it fascinating to see brick by brick how he did this. It deserved study because it ran to the question of what is a great business. These are the businesses that he created for himself.

Miguel: This section is portrayed along with a diagram of Berkshire and the subsidiaries…

Alice: Yes, although the story begins at the point in which he closes the partnership, and it ends with the Buffalo News, which runs through multiple chapters. The creation of the partnership is primarily in the chapter called Hidden Splendor. But there are bits of it before that chapter.

Miguel: I see. I want to return to your interviews with Buffett's inner circle. As you are interviewing these people what are the similarities in what they reveal about Warren?

Alice: Yes, in fact, it was so repetitive that I could tell that some of these people had been interviewed so many times before and spent enough time talking to each other that it had a sometimes rehearsed quality. Wit, loyalty, & honesty were the 3 qualities that were cited over and over.

He's extremely witty. He can knock out a one-liner every few seconds. One of the nicer aspects of being around him is the easy humor of the conversations. I tried to include as many quotes as I could in *The Snowball* so that readers could get a sense of what a terrific conversationalist he is. When Michael Lewis reviewed *The Snowball* in *The New Republic* magazine, his conclusion from reading these quotes was that "Buffett is incapable of being dull," which is so true.

In terms of loyalty, Buffett cherishes relationships and has gone to a lot of effort to maintain contact with old friends. Far more so than the average person does. He told me once that his mother got more than 65 birthday cards on her 65th birthday. This was a real point of pride. There's an element of the collector that comes to the forefront in his loyalty about people. It's not dissimilar to the way he views the companies Berkshire owns as paintings in a museum.

He's almost painfully honest at times. Yet some people I interviewed belabored his honesty beyond the point that made sense. They would belabor it to such a degree that you began to realize they held some specific concerns in this area. Eventually it became clearer that this had to do with the incidents in his life where he has been ruthless. I included some representative examples in *The Snowball*, but space allowed only a fraction to make it into the book.

Look, he's allowed to be human. He's a decent, honest, admirable person of integrity who's accomplished magnificent achievements. That should be enough. Surely people realize that he didn't get where he is by running a philanthropic institution. But some who are loyal to Warren equate loyalty with portraying him as infallible. Those two things are not the same. It's not necessary at all to pretend that someone is infallible in order to be loyal and admire them. I found in the case of Warren Buffett that there were people who genuinely believed that if they admitted any imperfections in him, it would make them disloyal.

Miguel: They were turning him into a saint, so to speak?

Alice: They were, and, the more you saw it, the sillier it became. I will never forget a few people insisting to me that Warren is really not that interested in money.

Buffett The Investor & Businessman

Miguel: How is Warren different than other value investors?

Alice: He's more interested in money, for one thing (laughs).
In terms of how that affects his investing behavior, number one, in his classic investments he expends a lot of energy checking out details and ferreting out nuggets of information, way beyond the balance sheet. He would go back and look at the company's history in depth for decades. He used to pay people to attend shareholder meetings and ask questions for him. He checked out the personal lives of people who ran companies he invested in. He wanted to know about their financial status, their personal habits, what motivated them. He behaves like an investigative journalist. All this stuff about flipping through *Moody's Manual's* picking stocks … it was a screen for him, but he didn't stop there.

Number two, his knowledge of business history, politics, and macroeconomics is both encyclopedic and detailed, which informs everything he does. If candy sales are up in a particular zip code in California, he knows what it means because he knows the demographics of that zip code and what's going on in the California economy. When cotton prices fluctuate, he knows how that affects all sorts of businesses. And so on.

The third aspect is the way he looks at business models. The best way I can describe this is that it's as if you and I see an animal, and he sees its DNA. He isn't interested in whether the animal is furry; all he sees is whether it can run and how well it will reproduce, which are the two key elements that determine whether its species will thrive.

I remember when his daughter opened her knitting shop. Many parents would say, I'm so proud of Susie, she's so creative, this is something of her own, and maybe she can make a living at it. Warren's version is, I'm so proud of Susie, I think a knitting shop can produce half a million a year in sales, they're paying whatever a square foot for the storefront, and labor is cheap in Omaha.

It was similar when Peter was producing his multimedia show, *The Seventh Fire*. Many parents would say, wow, my son has pulled off a critically acclaimed show. Warren obviously thought that, but what he articulated was, they're charging $40 a ticket, I think the Omaha market is too small for that price point, whereas in St. Louis they may cover the overhead, and I think he paid too much for the tent because the audience doesn't really care what kind of tent it's sitting in and it hurts margins, etc. etc.

Miguel: Speaking of tents. I have never been to the BRK shareholder meeting. Has it become cult-like at this point?

Alice: I started going in the late 90's. I envy people who were going earlier. But I've been going long enough to see how it has grown over the years and turned into more of a circus. Warren has got a huge streak of P.T. Barnum in him and likes to put on a show that every year, tops itself. He encourages the cult. It's like the nerdy kid whose lunch money was stolen grew up, and now even the popular kids treat him like a god. Put yourself in his shoes and you'll get a sense of it.

From the perspective of the shareholders, I think there used to be more serious investing content. Warren uses set pieces to describe certain ideas that he repeats tirelessly. This is efficient; he'll never be caught out for being inconsistent; it drills home his points through repetition. It's also simply the way his mind works. He thinks of a story to explain a concept (See's Candies = moat) and when the subject comes up, he turns on the mental tape recorder and it plays. Repetition doesn't bore him the way it bores other people.

At the shareholder meeting, I do think the repetition stokes the cult because it discourages people who used to come for the unfolding, unique quality of the dialogue from attending.

Miguel: Okay, so back to Warren tell us about his ruthless side?

Alice: Sure…sure… How he bought National Indemnity; how he bought stock back from his partners; how he bought and got his price for Nebraska Furniture Mart; how he has dealt with labor unions. Salomon is another instance, and probably the best publicly-known example.

To use a nonpublic example, I've seen him "encourage" people to do what he wants by subtly raising the possibility of what he might leave them in his will. But without promising anything. This is torture for some people; they are always working for a commitment that never comes.

Another aspect to it is the degree to which other people are the bad cop when it's necessary to be ruthless. I once commented to him on the way he uses other people as surrogates to protect himself from being the bad guy, and his response was, "Prepare to be enlisted," not really jokingly. Now that I think of it, in a sense, I did get enlisted.

Giving the managers sole responsibility for everything that happens at their businesses is always described as a unique and friendly aspect of Berkshire. While that is true on one level, it is also a way of protecting Warren. Warren takes being risk-averse to a level that is barely comprehensible. He has boundaries made of steel. If he can't control something *completely* he

doesn't want to control it *at all*. It's how he behaved with the partnership, and he's extended this to Berkshire Hathaway.

Therefore, this way of delegating "to the point of abdication" (in his words) is actually filed with the SEC; the 10-K for Berkshire Hathaway emphasizes that it is unusually decentralized and that Warren delegates to an extreme degree. I've seen Warren claim that he cannot overrule a decision of Debbie Bosanek: not that he is delegating to her, but that he actually isn't empowered to overrule her.

If there were ever a serious shareholder class action lawsuit, the lawyers would pull out the 10-K and claim that Warren should not be deposed because he is not really responsible for what happens at Berkshire. There's an absurdity to it, because the CEO of a company is responsible for the actions of his direct reports whether he wants to be or not. Their title is manager, not CEO.

Lastly, Warren can sometimes have a hard time seeing the human side of things. So for example, when his sister was close to filing for bankruptcy after the crash of 1987, he rationalized not helping her on the grounds that if he helped her, he was helping her creditors, who were market speculators. His kids have been on the receiving end of similar episodes, large and small, for years. But I'd rather not tell other peoples' stories and expose them to the potential consequences.

Miguel: I see what you're saying. I remember a story regarding his children (or friends of his children) and him saying "If I do it for you, I have to do it for everyone."
Alice: That's a favorite phrase of his. It's actually a great concept. He's wise to be wary of setting precedents. You have to think through the whole chain of consequences before you agree to what might seem like a small favor. That's especially true of someone in his position.

Still, it can become a catch-all excuse. It's not true that if he gave money to one friend's charity, he would have to give to everybody's. You can make distinctions between your kids based on their individual needs. He's capable of making choices.

Miguel: What you are saying about setting precedents? It reminds me of Cialdini's tactics of persuasion and especially reciprocation and foot in the door technique.

Alice: Yes…When I read Cialdini I thought, "Gosh. It's as if Warren wrote this book based on his experience."

Miguel: He understands the psychology of people.

Alice: *Reciprocity* and *Social Proof*. Those are his top two techniques. I think it was also Cialdini who mentioned that if people do you a favor they like you more. Warren has an ability to get people to invest psychologically in him.

One reason he prefers people visit him in Omaha is that somebody spending the time and money to make that journey is going to leave persuaded. They aren't going to go away thinking they wasted their money. Because the way you resolve cognitive dissonance is in whatever way makes you feel most comfortable.

Now obviously it's not a waste to go see Buffett speak. What I'm saying is that this kind of structural persuasion and elicited psychological investment tilts the odds in his favor.

Miguel: So it's almost like an emotional sunk cost. You don't think of it as a sunk cost so you keep reinvesting emotional resources to sustain a view or experience.

Alice: Yes.

Miguel: What else can you tell me about his ruthlessness? It's interesting that he can be so strong willed and yet has that characteristic where he is very cautious and doesn't want to be disliked. Where does this strength come from? From my interpretation of your book, it seems to stem from a young age. That is to say he has a backbone when it comes to business and money even from an early age.

Alice: No one can ever know for certain but I believe it was innate in him. He told me a story about when he was 6 years old, and a customer wanted him to break a pack of gum that the was selling into individual pieces. His reaction was, "I've got my principles," and he refused to do it. I don't think anyone taught him that. I think he was born with that.

Miguel: Tell me about his memory. I ask about this because psychological research has uncovered a capacity for forming false memories and yet Warren Buffett seems to retain massive amounts of information (with minimal distortions). In your opinion, how does Buffett's memory work?

Alice: Well I wrote about the bathtub memory in the book. If something is unpleasant, it goes down the drain. He also retains a sort of DVD of events in his head.

If there is new information the old version gets overwritten. It's gone. He remembers stories and certain facts, and the rest is discarded as if for efficiency or comfort.

So let's say he is at a party. There will be 2 things he remembers. He will remember that Carol Loomis wore a yellow dress and that somebody else told him a certain joke. That is all he will remember. It's as if the rest disappears. Sometimes he'll remember more if prompted, but there's not much fuzziness. Either he remembers something or he doesn't. Then, if it turns out the joke was a different one than he thought, it's as if he never heard of the first joke.

That is not to say he believes his own memory is infallible. He's keenly aware of how stories are transmuted through the telling. He was very clear (and upfront) with me about this in the beginning. One reason he said, "Use the less flattering version," is that he thought other people might remember things better than him.

Miguel: What about his memory in terms of investments?

Alice: Oh that's freaky. You're sitting there talking about something like "Isn't it amazing that after Jack Welch left GE, the company started having all these problems because of buried accounting issues?" and he will say, "Yes, that's like …" and pull a company from 30 years prior and start spouting numbers. Then he will pick another more recent company, and another.

He has accumulated a filing cabinet of knowledge about companies, and it's very big. Part of his teaching style is to have certain examples at the ready.

Miguel: How has he developed this mental database ?

Alice: Well I think there are things you can do to improve recall. But there is something to be said about being born with a prodigious memory. It seems to me that there are 3 qualities of great investors that are rarely discussed:

1.

- They have a strong memory;
- They are extremely numerate;
- They have what Warren calls a "money mind," an instinctive commercial sense.

Warren is all of these.

By numeracy I mean an excellent recall for numbers, fast mental arithmetic skills, and preferably, an intuitive grasp of the time value of money, intuitive enough that you don't necessarily need a calculator to do basic calculations. The money mind is far more important than the others.

Miguel: Tell me a little more about this.

Alice: Warren's skills as an investor have often been compared with a musician, and I think that's exactly right. The "money mind" is an instinct, almost a sixth sense, of sniffing where there is an opportunity to make money and knowing how to exploit it. Somebody who is starting businesses when they are six years old is different than the average kid. When you apply focus (which he often talks about) to those three qualities then your skills as an investor are turbo-charged.

Miguel: How can we develop more of a money mind? Is this the part that is more innate or is it more a consequence of him being an entrepreneur at a young age?

Alice: I have had many conversations with him about this. He thinks it's innate. There are people who just naturally gravitate towards activities that make money. That's not a value judgment. Something else might be more socially useful. However, I also believe the average person can be trained to become much more "money aware." You can train yourself to do an amazing amount … to go from being average to becoming good. But you will have to work at it in a way that someone like Warren will not.

Miguel: You say it's important to be numerate. Is this what attracted you to accounting?

Alice: No. Personally I have a lopsided skill set when it comes to mathematics. Patterns of numbers are not like musical bars to me. I was decent at geometry, higher math but had to work at them. Where I excelled was statistics. I did extremely well at statistics. It's interesting but Charlie Munger says that's the course that isn't mandatory but should be.

Insurance is a business of statistics and probability. I have wondered whether the mathematics of statistics uses a different part of your brain than discrete math.

Miguel: Are there any other traits that act as a magnifying glass for Warren Buffett? Comment on how his traits help him see the world in a different way?

Alice: Yes. There is temperament. His emotional oscilloscope moves in quite a narrow range. That's useful when you're playing against with Mr. Market. He's stressed it as an essential quality.

I also believe his understanding of human nature is immensely valuable. He is superb at figuring out what the great businesses are, but great people must run them. And he has been successful at seeking out really terrific management. He has made a few whopper mistakes, but they are definitely outliers in the trend of being great at picking top people.

Miguel: What are Warren's weaknesses as an investor?

Alice: It's as if large amounts of money paired with limited risk can overwhelm his peripheral vision. So if there's is a disproportionate opportunity to make money in what is a superficially a protected way such as through a preferred stock where your downside is limited, he doesn't blink at things that would normally give him pause.

He did this with US Air and Salomon Brothers. You could also argue Goldman Sachs convertible preferred and USG were hardly typical investments.

Second, sometimes he will decide on some theory upon which he wants to invest in something even if it's not an obvious barn burner in terms of financial aspects.

BNSF is an example. You have people championing this for all sorts of reasons, but certainly it did not meet his normal investing metrics. That doesn't mean it was a mistake, but it may be a good investment for different reasons than people think.

Sometimes he falls in love with people and invests accordingly or, worse, falls in love with people *because* they've sold him their companies. He fell in love with John Gutfreund at Salomon, and with Ron Ferguson at General Re. Among others.

Lastly, he clearly has a blind spot when it comes to anything that flies and has wings.

Miguel: Meaning?

Alice: Meaning he has invested 3 times in aviation: Pacific SW Airways, USAir (LCC), and NetJets. These have ranged from near-misses to disasters. He hasn't had good luck with aviation. He's called himself an Air-a-Holic. It's a weird little quirk to see this in somebody that you think of as super-rational.

Miguel: What other blind spots does he have that we can learn from?

Alice: I'm sure I could think of other things, but it would be disproportionate to spend more time focusing on blind spots. His accomplishments outweigh his blind spots by so much.
Miguel: Sure.

Miguel: Do you think there is particular reason for his focus on consumer and financial companies?

Alice: Yes. With financial companies you have leverage that can be controlled, "regulatory oligopoly," and trust. Insurance float is only one example of leverage. The spread on "float" in banking can be controlled too, if you lend intelligently. Banking is a nice little business for the

few who are willing to do it in a vanilla manner. “Regulatory oligopoly” is the entrenched competitive position that’s, in effect, provided by your regulator and its rules. It can give you quite a few, or few hundred, extra basis points of return.

I think Buffett’s consumer plays have been overrated as a theme. He likes good companies with enduring business models. Many happen to have been consumer companies. He got intrigued by the idea that a brand could be a very enduring asset. Then he was surprised at how quickly the value of brands eroded in the 1990’s. Brands with true “moats” are exceedingly rare. Of course he wants one when he can get it, but these companies usually also are expensive.

Miguel: Maybe I can ask you a tangential question. Many value investors follow this lead of avoiding all macroeconomics, whether it’s risk, etc. Tell us about the way he looks at the economy as a whole? How does he factor that into his database and decisions?
Alice: Buffett is keenly aware of the economic cycle and relevant data. He uses economic data to put context around what is happening in specific businesses. Meaning that it lets him visualize macro-risks at the company-specific level. Second, macro data signals to Buffett where Mr. Market is going awry, for example, what parts of the stock market might be fertile digging grounds.

For example, he knew to some degree that we were in a bubble in the past few years (leading up to 2008) because you could do some statistics that would show corporate profits being at unsustainable levels and housing growth exceeding demographics to a ridiculous degree. He didn’t get into the mortgage business, although you’d better believe, people were showing up on his doorstep urging him to do it with all sorts of apparently lucrative deals. The economy is context.

Miguel: How else does he process macroeconomic information? How does this relate to his fascination with history?
Alice: History was one of Warren’s best subjects even when he was very young (in school). He has a liking for it. But at the same time pattern recognition is one of his primary skills and perhaps his greatest skill. So in terms of data points, unlike many people who learn by seeking information on an as-needed basis, Warren is always looking for fuel for pattern recognition before he needs it.

He’s always looking for context. Having an interest in a broad sweep of history provides vast context for making many decisions because it enables analogies. And that I think has been very helpful for him in avoiding fallacies such as “This time it’s different.”

It allows him to make analogies between industries, for example between the internet/dotcom stocks and early auto stocks, as in the speech he gave at Sun Valley that is described in *The Snowball*.

Miguel: Tell me more about his pattern recognition skills? How is this one of his greatest skills?
Alice: Take this example. If you look at the dotcom stocks, the meta-message of that era was world-changing innovation. He went back and more patterns of history when there was a similar meta-message, great bursts of technological innovation in canals, airplanes, steamboats, automobiles, television, and radio. Then he looked for sub-patterns and asked what the outcome was in terms of financial results.

With the dotcoms, people were looking to see what was different and unique about them. Warren is always thinking what’s the same between this specific situation and every other situation.

That is the nature of pattern recognition, asking "What can I infer about this situation based on similarities to what I already know and trust that I understand?" There is less emphasis on trying to reason out things on the basis that they are special because they are unique, which in a financial context is perhaps the definition of a speculation. (Warren is not averse to speculation, by the way, as long as it's what he calls "intelligent speculation," meaning he's got long odds in his favor.) But pattern recognition is his default way of thinking. It creates an impulse always to connect new knowledge to old and to primarily be interested in new knowledge that genuinely builds on the old.

Miguel: Comment on Warren Buffett's emotions. I'm particularly interested in his ability to be so rational and unemotional.

Alice: This is a great segue. Pattern recognition skills are worthless if you invent patterns that aren't there. My one really difficult experience as an analyst was at PaineWebber during the dotcom bubble. It was like bullishness was a drug poured into the NYC water supply. Everyone believed. The idea that investment banking pressure was solely responsible for the Internet bubble has been overplayed. We were a wire house, and we drank the Kool-Aid just like everybody else.

People think Wall Street was cynical; there was less cynicism than history has recorded. Largely, the predictions about the Internet's transformative power were true. There just wasn't a lot of money in it for investors. Which is another favorite theme of Warren's. The futility of standing on tiptoe at the parade.

I recommended insurance stocks when they looked moderately priced, and then followed them all the way down to dirt cheap. Nobody wanted to buy anything real. My stock calls were mostly awful, and they would have been awful no matter what I picked unless I had said to sell the whole group. It's that difference between stock-picking and investing.

Somehow, Warren was able to ignore the whole thing. People sometimes speculate that he is emotionless, and I'm frequently asked if he is autistic. He's certainly not emotionless, but his emotional pendulum swings in a very narrow arc except on those rare occasions when something personal has deeply upset him. While he does use rules to make decisions, it's key that he's detached and not temperamentally excitable to begin with.

On business matters, his steady pulse is helped by his exceptional skill at reading *other people's* emotions. He reads people in a conscious manner that could be the result of self-training to recognize "emotional tells"; even so, he's remarkably fluent at it. If this skill could be bottled he could sell it for an awful lot of money.

Temperament is innate, but I would argue that anyone can focus on modulating their temperament within whatever band they have to work with. Anyone can work at being better at reading other people's emotions.

Curve Ball – Surprising Facts About Warren Buffett

Miguel: How has Warren Buffett's intellect surprised you over the years?

Alice: For example, he recognizes square roots and sometimes cube roots of very large numbers; which is slightly unnerving, especially when he starts telling you the square and cube roots of license plate numbers. It's something he does as a mild form of entertainment while driving.

More unnerving is that he remembers conversations that he has with you better than you do. I don't know if you've ever been in that situation –- where you realize the other person has asked you the same question some time ago. When Buffett does that, it's often a test.

He will ask very probing and penetrating questions and then 2 months later he will ask again and you know he remembers the exact words you said. It can feel a little like getting deposed, and it's a bit spooky to have a human tape recorder sitting in front of you. He doesn't have a photographic memory, but sometimes it feels close enough. And of course, he's reading you emotionally at the same time, and you know it.

Please understand, this only happens occasionally. Most conversations with him are really enjoyable because they're full of witty repartee and a download of information from his unusual brain.

Other interesting situations: I have seen him make his famous 5-minute decisions on the phone. Five minutes is the outside amount of time it takes him to make a decision. If the person can be succinct and convey the salient points in 60 seconds he'll say, "Yes" or "No" in 60 seconds.

The time is determined by how long it takes the person to convey the salient points, not how long it takes him to think about it. It's virtually instant once he has grasped the 2 or 3 variables or points that are important to him.

Typically, and this is not well understood, his way of thinking is that there are disqualifying features to an investment. So he rifles through and as soon as you hit one of those it's done. Doesn't like the CEO, forget it. Too much tail risk, forget it. Low-margin business, forget it. Many people would try to see whether a balance of other factors made up for these things. He doesn't analyze from A to Z; it's a time-waster.

Lastly, the speed of thought is so startling. Remember the 60 questions I started with the first time I interviewed him, which he covered in 45 minutes or so. He later took me to Nebraska Furniture Mart carpet warehouse and started quoting how many yards they sell of each type of carpet each week and at x price and it costs y amount a yard and we mark it up at z. He was sprinting through the carpet warehouse pointing at roles of carpet and telling me which ones sell at what price. I jogged alongside him with my jaw dragging behind me on the floor in disbelief.

I used to spend 4.5 days a week in Omaha, and I would be so wrecked by the time I got home it was unbelievable. I thought it was me; then, when I started interviewing other people who are his friends and colleagues, they would tell me that they also needed time to recuperate after seeing him. Or that they could only take him in doses of 2 hours at a time. They all like him, but it's so intense to have someone racing ahead of you mentally and you are trying to keep up. This is clearly one reason for his bond with Bill Gates. They don't have to wait for each other to catch up.

Miguel: Tell me more anecdotes, particularly about his processing skills.

Alice: I don't want to dispel any notion of his intuition. But he has internalized so much information over the years and uses so many mental

models (to quote a Mungerism) that they have coalesced into an almost visceral reaction to an investing situation. And this is what you strive for. It's not mystical, even if you can't verbalize your analysis. Much of his decision-making has sunk to almost the unconscious realm, it is so refined.

Part of his skill and speed comes from a complete unwillingness to overpay for anything, which I think, is innate or formed in him by the time he very young. When he spots something it's like a siren goes off telling him its overpriced (either quantitatively or qualitatively).

We would kick around insurance pricing at different times. He would say, "How much would you pay to write terrorism risk on this building from now 2002 until 2012 for X events?" I would give some number and then he would say yea or nay.

Because I like probabilities and have enough experience with insurance, I usually did okay with this game. But his ability was remarkable. You could describe a situation with many contingencies, many derivatives, many puts and calls and swaps, and he would instinctively know whether it was priced well or not.

Those equity index puts that created issues with the rating agencies. I think the reason he had difficulty with those is that he knew immediately how to price them and that the odds were very high that they would make money for Berkshire, if looked at on their own as contracts.

The other elements that were subjective — the way they would create short-term volatility in the balance sheet; the way hedgers might respond; the regulating agencies — these didn't come into the equation because the trained, automatic part of his mind fastened on how much money could be made and the probability.

If you think about it carefully you realize how costly the equity index puts were in the financial crisis. Berkshire got the float from them to invest, but its negotiations with the rating agencies meant that, at a time when markets were in turmoil, during the very crisis that Warren had been waiting for all those years to put the tens of billions of dollars to cash to work, he couldn't do it. He was able to participate in the market crash only in a tepid way. That opportunity cost has to be offset against the expected profit from those equity index puts. They weren't worth it.

Miguel: So what kinds of questions are not being asked about Warren Buffett? And on the flip side, what is overplayed with regards to his investment style (such as focusing on brands)?

Alice: We touched on this earlier. He is great at distilling important concepts into memorable sayings. But these sayings are not a substitute for doing work and analysis and he doesn't use them that way in practice. For example, be greedy when others are fearful and fearful when others are greedy, which is a Gus Levy (former CEO of Goldman Sachs) quote that he uses a lot.

I've seen people rationalize buying a beaten-down stock because other people are fearful. That's not how Warren thinks. For the most part, he has a universe of stocks that he has analyzed. And when something hits his bid then he will buy it.

I think another thing people have gotten confused about is the sustainable competitive advantage and the moat. Durable competitive advantage and moats are not the same thing as brands. People sometimes use these terms interchangeably. I have also seen people ascribe competitive advantages to brands that don't have them. For example, retailers — retailers have brands. We all know what Macy's (M) is, but retailing is fundamentally a bad business.

In essence, the merits of a brand are not the brand itself; they are the qualities of the product that create the consumer loyalty. What attracted him, ultimately, to Coca-Cola (KO) is that Coca-Cola's formula make you more, not less, thirsty, and supposedly has been tested to prove that it doesn't wear out the palate, no matter how much is consumed. This implies infinite sales potential. The cute commercials and cheery red logo create an association in people's minds with those qualities. They aren't what makes it Coca-Cola.

While there are moats that include brands, a brand is not a moat. The moat is whatever qualities are innate to the business that make it difficult to compete with.

Lastly, investing is not a religion. It's not like you have to follow a creed. Warren will buy things that are simply cheap. He's pragmatic. There's no rule that he has to be absolutely consistent. If he sees something that he thinks is undervalued he'll occasionally buy it, even if it's a Korean dairy company. Then he'll sell it. Everything doesn't have to fit into a perfect framework.

Miguel: What are other things to avoid?

Alice: One of Warren's great strengths is that, despite his pragmatism, he is quite rigid when it comes to anything that could lead to emotional decision-making. This is the circle of competence. He never bought Intel, and if there is anyone who could have understood Intel it was him. I mean, he knows Andy Grove quite well and was around at the founding of the company and even knew Bob Noyce. There were times when it must have been obvious to him that Intel was a rocket.

This is another way of saying that he has managed to avoid style drift for the most part. There's nothing wrong with learning new things or adapting to changing circumstances. What's wrong with style drift is that emotions are forming the current that's drifts you along. Style drift is just endemic whenever the market is briskly valued and it's hard to find ways to put money to work. You could argue it's the most common reason highly regarded investors get blown up.

Lastly, I would say that people got confused that leverage is okay in financial institutions as if they are exempt from the laws of leverage because of the nature of their business. That's a mistake that people won't be making again anytime soon.

People were investing in companies leveraged 30x where they would never dream of considering a stock like that in a value portfolio in any other industry. What is very interesting is that Warren did not do this (by this I mean investing in these types of financial institutions).

When he did finally invest, in Goldman, he bought preferred stock with mandatory interest payments and various forms of downside protection. It was primarily a bet on Goldman's continued existence rather than its shorter or longer-term earnings trends. The $115 warrants were gravy.

Miguel: You mention that Warren occasionally buys something because it's cheap, that makes perfect sense to me. Sometimes you just have to buy something that's okay but at an attractive price.

Alice: What you're talking about is an instinctual attraction. Warren has an instinctual attraction for things that are worth more than they're selling for. He's tried over the years to articulate different criteria by which other people can find these opportunities. But the fact is that in he has a nose for things that are more valuable than their price and vice versa.

To some extent, when he describes investing or writes he is refining and explaining the rules by which his instinct told him to operate. If you put a dollar in front of him and say, "I will sell this to you for 50 cents" he's not going to say I don't do cigar butts anymore, and I don't see a moat there (laughter).

Miguel: Is this instinct is innate?

Alice: Some is temperamental but I also think people can figure it out. Clearly some of it is mathematical, and it's a question of being alert to it and having focus. There are times when nothing works. I use to say this about insurance stocks that once every decade you should buy all of them and once every decade you should sell all of them and the rest of the time you should do nothing.

That's probably true of a lot of industries, which means that doing nothing is the right answer most of the time. Much of the time you're either looking for what's cheap or waiting for that magic moment.

Miguel: One of my friend's likes to say, "People's decisions compound money."

Alice: And that's the other mistake, because the price you pay determines your return. For example, people will take an earnings yield, expressed in cash flow versus price paid, on a stock that they would never consider in a normal interest rate environment. Large caps are supposedly cheaper now than any time in decades based on dividend yields.

Yet investors who pay 18x earnings if rates are 1% on the theory that getting a very low earnings yield is acceptable versus treasuries might wake up disappointed. You may have to wait an awfully long time to earn your way out of a hole because of the price paid.

Look at it this way. The economy will be struggling to eke out 2% growth for who knows how long. The average business cannot, on average, get 4 – 6% real growth in an environment like that, without some drastic change in relative currency values or some other unpleasant thing that resets the base. Yet all of the assumptions I see are based on 6 – 8% growth and everything else status quo.

It's safe to assume that at some point, multiples are going to decline from here to reflect the economy's real growth rate.

Berkshire has put 60% of its cash flow into equities so far this year. It's an increase from zero, which could easily be interpreted as a portfolio repositioning, but it is not. Warren is still building cash. He doesn't like bonds right now, but he likes cash. The feeling of needing to be fully invested obstructs a lot of money managers.

Miguel: I think a lot of this irrationality has to do with capital market theories and so called portfolio optimization. Or simply put – a lack of common sense.

Alice: When people are spending a lot of their time marketing themselves and their businesses and they're not a startup, it's problematic. The greatest investors resent the time they spend marketing even though they have to do it. When marketing becomes the highlight of your day (that is to give a speech or be on television) that is a sign to be careful (of that manager).

Miguel: It's like winning a Nobel Prize…there is a curse attached (laughter).

Alice: Sure…there is mean reversion and it's true in any business. People reach a certain level and then they are not as hungry and they start to plateau. It's more fun to be on television and be awarded honorary degrees and give speeches.

Miguel: How has Warren evolved in the past years. Also tell us about his moves during the financial crisis.

Alice: After the Internet bubble, there was a point where he was seriously worried that he wouldn't get another chance to make any big scores because of his age. Instead, he has had, since 2002, a run of unique opportunity that was interrupted briefly by the housing bubble.

I've heard some people say, "He's in his heyday." The market has certainly worked in his favor. But the gigantic anchor of capital that Berkshire has to invest means that no environment can be as good for him as the past. If people are following his investments, they should consider how limited his universe of possible ideas is compared to their own.

He is being forced to accept lower returns than smaller investors simply by virtue of his market cap limitation. He's given fair warning of this often enough, so it shouldn't surprise us now. He's often spoken nostalgically of how much better he could do running a smaller portfolio.

Therefore, let's invert the situation. If you *are* running a smaller portfolio, the stocks he owns are interesting to consider, but not necessarily the first place I would look for investment ideas.

On a slightly different aspect of his life, I posted by the way on my blog called Cirque du Berk 2012 which is a proposal to move the BRK meeting to Vegas in 2012. It's only partly, barely, tongue in cheek. Warren's desire to be in the spotlight has gotten a bit stronger in recent years. He used to really shun publicity. The shareholder meeting has grown in proportion to his appearances on CNBC. It's okay, he's entitled to have some fun. But why not move the meeting?

Miguel: So Omaha is Too large?

Alice: Yes, Omaha isn't a big enough town anymore to handle this event. It's classic price-gouging; even low tier hotels are jacking up rates and requiring 3 night minimums. Some people are spending $2,500 to go to Omaha to stay at a Holiday Inn. The airline fares are a disgrace and rental cars are just as bad. The past couple of years have seen a dramatic change and it's made the shareholder meeting unaffordable.

I know that Warren isn't happy about this. People are staying home because it costs too much to attend. You can spend 4-5 nights in Paris or Bali, all in, for what it costs to go to Omaha. We're talking April in Paris vs. April in Omaha. With no disrespect to Omaha, I would rather go to Paris.

By the way, the people of Omaha aren't the ones doing this — it's the hotel chains based elsewhere. I think he should move the meeting.

Miguel: Tell us about your interests? How can people follow your latest endeavors? Where are things going for you?

Alice: I'm working on a Buffet investing book. This, I'm pretty excited about because there is so much interesting material that I think will help people apply in practice the ideas that they work

with on a very high level now. I also write a column approximately once a month for Bloomberg on whatever business topic is of interest at the time. I've written about Greece, BP, Wall Street. I'm doing public speaking. I'm doing some feature writing. I'm investing. I'm doing some nonprofit work.

Miguel: What motivates you?

Alice: Curiosity. When something crosses my field of vision I will spend time to figure it out and if it's complicated and interesting enough I'll keep figuring it out – which is why Warren Buffett was fun to study. It was delightful to write about this amazing American business story. Warren was the perfect subject.

I'm motivated by my curiosity to uncover, analyze, and present important stories with interesting characters.

Miguel: Alice thank you for taking the time to answer my questions. It has been a privilege working with you. I wish you the best of health.

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