

TRANSCRIPT BROUGHT TO YOU BY



SANTANGEL'S REVIEW™

**2017 Santangel's Investor Forum
October 11, 2017
New York City**

Keynote Speaker: Ed Thorp

The Santangel's Investor Forum is an annual, invitation-only conference featuring under-the-radar managers who rarely speak publicly. Through fireside chats and insightful presentations, the Forum facilitates intimate conversations among high quality speakers and audience members about the art and science of investing.

For more information on the 2017 Santangel's Investor Forum or to sign up for our weekly mailing list please email info@santangels.com

Transcript of Charlie Munger at the 2017 Daily Journal Corporation Annual Meeting

CHARLIE MUNGER:

The essence of what's going on here, of course, is we have a corporation that was in a branch of the newspaper business, and our branch of the newspaper business, like most newspaper businesses, has gone to hell compared to what it was in its peak years. And almost every other newspaper business is going to hell with no pardon, they're just disappearing. What we have is this computer software business where we're serving the same customers to some extent, except now they're all over the country, even some of them outside the country, with this...we were selling software to all these courts and public agencies, whereas before we were giving information to lawyers and other people and publishing public notices.

And our software business is of a type where it's a long, tough slog, but we're slogging very well and we really love the people who are doing it for us. We've got a lot of wonderful people and in our software business, the implementers and the computer programmers and the people that deal with the public agencies, and the ethos of the place is very admirable. Everybody's trying to get ahead here by doing the work right and serving the customers right and having a lot of financial wherewithal where money is never a problem and doing what we're supposed to do. And so, it's a pleasure to people like Rick Guerin and myself to watch all these young people doing this, and of course we're very glad to be able to do it when we should be dead [laughter].

A lot of you people came into this because Berkshire was successful and Guerin was successful, and for various odd reasons of history, and most of you are accidentally in the software business, and I am too because Guerin did it when I wasn't paying much attention. I don't do this kind of venture capital stuff and he doesn't either, but he did it here, and so if there's anything wrong with what happens in our software business, you're looking at the man who caused it all over here. I'll take credit for the successes, but if there's failure you're looking at the man here who got us into this.

It is amazing to me some of the things that are happening in our software business. We just are getting a contract from South Australia. Now, if anybody told me when I was

young that a Daily Journal company would be automating the courts of South Australia, I mean, I hardly know where it is. Anyway, it's amazing what's happening, and it's a fair amount of fun to watch, probably because we're doing more winning than losing. I've never been able to enjoy losses the way some people do, I would much rather win.

And I really like to work with good people instead of the opposite, and we've got a lot of good employees in our software business. We've got a bunch of implementers in Utah who are really good at it and [who] we really trust, and then the customers like them. We've got all these computer programmers and so forth around here, and a game of service like that when it's complicated, what you have to do is minimize your glitches and crawl out of them very rapidly in a way where the customers trust you, and our people are good at that and they get better and better, and they're trying to get ahead by being good with the service, not by having some politician as a consultant. Some of our competitors do that kind of stuff, but we're trying to slog our way out by doing the work right.

When I was a lawyer, there's a saying I've always used, "The best business-getter any lawyer ever has is the work that's already on his desk." And that's the basic ethos of our software business. If we just keep doing it right I don't think we have to worry about the future, not that we won't have our downdrafts and our failures, but we are actually grinding ahead slowly in that software business.

And it's very interesting because Guerin and I know practically nothing about it, and Gerry didn't come up as a software engineer, so we're basically doing something that's quite difficult. We are judging people because we don't understand what the people do. That's what Andrew Carnegie did, of course, he didn't know anything about making steel, but he knew a lot about judging whether the people he was trusting were good making steel, and of course that's what Berkshire's done if you stop and think about it. We have a lot of businesses at Berkshire that neither Warren nor I could contribute much to, but we're pretty good at judging which people are capable of running those businesses.

But this is pretty extreme here, the little Daily Journal Company going into the computer software business. It's a long, slow kind of business, RFPs. The first time we contact a customer until we started making money, maybe five years, so it's like deciding to start prospecting for oil in Borneo or something, and they just keep doing that over and over again and the money goes out and the effort goes out, and it starts coming in five years from now. I love that kind of stuff, not when I think we're taking territory, it doesn't look good then we write it all off and we don't report wonderful numbers or anything, but if it makes sense in the long term, we just don't give a damn what it looks like over the short term, and we know we've collected a bunch of shareholders that share our ideas. After all, we're running a cult, not a normal company, and I think most of you feel you're willing to wait.

I've lived all my life with people who are into deferred gratification, in fact, most of them will never have any fun, they just defer gratification all the way to the end, that's what we do. It does cause you to get rich, so we're going to have a lot of rich dead people, but we can incite

a lot of envy. A lot of you when the people walk by your grave and there will be this nice grave with this nice monument and they'll say, God, what a great grave, I wish I were under it.

But at any rate, deferred gratification really does work if what you're interested in doing is growing a business that gets better and better or getting rich yourself so that your grave can look nice to outsiders. Guerin and I have never taken any money out of this company in all these years. We don't take salaries, we don't take directors fees. We're a peculiar example. I wish our example spread more because I think if you're wealthy and own a big share of a company and you get to decide what it does and whether it liquidates or whether it keeps going, that's a nice position to be in, and maybe you shouldn't try and grab all the money in addition, and that's my theory on executive compensation.

And some of the old fashioned guys like Carnegie never took a salary to speak of. Cornelius Vanderbilt didn't take any, of course he owned the whole place practically, and he would have considered it beneath him. He lived on the dividends like the shareholders did, and so there's a lot of those old fashioned ideas here in the Daily Journal company.

I'll first take a bunch of questions about the Daily Journal, and after that we'll take questions on anything you want to talk about.

BRAD GILLESPIE:

Hi, Brad Gillespie from Chicago. At least year's meeting you talked about the milestone of getting the LA court system here at Journal Technologies, and I was wondering in the last year as it's gone by, what good milestones have happened and what bad things have happened with that?

CHARLIE MUNGER:

Gerry, you take that one. I'll answer it [in brief]: It's going fine.

GERRY:

We have three case types for Los Angeles. One case type went live last April, another case type will go live this coming July, and the third case type is about 10 to 12 months later after that. We have to work within the Los Angeles schedule. After all, they have a lot of people to train and that becomes a very important factor. Training is critical because if the end users aren't trained properly, virtually everything falls apart, and so that's the schedule. We discussed it this morning, and we meet with the court about three miles from here virtually every day, and we have a good team from the court, and I think they're very excited about what they're doing, and that's critical to us that the court feels good about the system.

CHARLIE MUNGER:

One good thing about what we're doing is it's slow and it's agony in the delays between the first customer contact and finally getting into a decent revenue stream, but once you succeed it's very sticky business, very sticky business, and the fact that it's difficult to do means it's difficult for people to change much, and so if you go slog through all this tough territory [like] we're slogging through there's a reward out there somewhere, and we're not in a small business. It has way more potential than the original print business we had giving information about the appellate cases to lawyers. It's a big market and the people have no option but to charge ahead. These courts and district attorneys, public defenders, all these people that we're serving, they're overwhelmed with options, better systems and more software. So it's a huge market, and the fact that it's so awful to grind through means that the people that want easy gratification don't come in. If it seems slow and painful to you, we kind of like it that way.

MALE SPEAKER:

Another Daily Journal question. I'd be curious on your thoughts about...we're slowly grinding through, but it seems like Tyler Technologies is going to be through a lot quicker, they're just one main, 24 states. So, I was just wondering how you think your competitive position versus Tyler is doing?

CHARLIE MUNGER:

Well, Tyler is an extremely aggressive company and they were bigger faster, and so I liked the ethos of our operation better than I like theirs. If I were buying software, I'd rather buy ours than theirs, so our system is to keep fighting the game, and I wish all the customers I had in life were like Tyler.

GASPAR:

Hi. I'm Gaspar from Marina del Rey. Thanks for your answers so far. I'm a little nervous about the rate of revenue growth going down a little bit, the expenses going up. I appreciate what you're saying about deferred gratification. Any major milestones in the next three to five years that you think you'd like to hit, or any major customers that you'd like to get that would really help things along?

CHARLIE MUNGER:

Well, I'll take the first question. It feels like we're proceeding slowly, but we bought a bunch of contracts in effect for money, and we knew that they were going to end, and so we're amortizing the cost of those contracts. But it was really anticipated at the time that we got big revenues up front for taking, so we're not declining as much as...we're getting ahead. There's a little blip in the figures.

Now, the second part of the question was?

GASPAR:

Any major jumps or acquisitions you'd like to make or customers that you'd like to acquire in the next...

CHARLIE MUNGER:

Every contract that's significant is a major jump, and the business is so big they're whole states. I mean, this is a huge business and everybody is just scrambling at the first parts of something that's going to grow bigger and bigger and last and last, and as long as we're doing the work right, so I'm all right. It's likely to work out right.

MALE SPEAKER:

The Daily Journal owns a lot of Wells Fargo. Can you comment?

CHARLIE MUNGER:

Well, of course Wells Fargo had a glitch. The truth of the matter is they made a business judgment that was wrong. They got so caught up in cross-selling and so forth, having tough incentive systems that they got the incentive systems so aggressive that they, some people reacted badly and did things they shouldn't, and then they used some misjudgment in reacting to the trouble they got in. I don't think anything's fundamentally wrong for the long-pull with Wells Fargo. They made a mistake and it was an easy mistake to make.

The smartest man I ever knew made a similar mistake. Henry Singleton, who was the smartest single human being I knew in my whole life. And Henry Singleton of Teledyne also had very aggressive incentive systems like Wells Fargo and his customers, many of them subsidiaries, was the government and of course it's not that hard to cheat the government. And with his very aggressive incentive systems two to three out of 20 subsidiaries cheated the government, so he's got three scandals at once.

It wasn't that Henry was trying to cheat the government, it's just that he got a little aggressive in applying the incentives and he got blindsided. That can happen to anybody. I don't regard getting the incentives a little aggressive at Wells Fargo as a mistake. I think the mistake there was when the bad news came they didn't recognize it rightly. They made a mistake, but what happens in a tough system like capital, you make a mistake like that and pretty soon you're gone.

RANDY GARDEN:

Randy Garden from Phoenix, Arizona. I'm a Daily Journal shareholder. This is for Gerry or Charlie. Congratulations for inverting and not doing things wrong in regard to Daily Journal. What about, do you have any insight into the Alameda court system and the problems that Tyler's having over there?

CHARLIE MUNGER:

Well, no, but I'm not dissatisfied with it. I don't think I want to criticize Tyler any more than I have. So I think one of our [competitors] you'll be sad to know is having some problems with pleasing a customer. You can see the salt tears running down my cheeks.

MALE SPEAKER:

I have a quick question on your software fees in terms of your revenue lines. What portion of that is recurring versus one-time fees?

CHARLIE MUNGER:

That is so complicated that I'm not even going to try to answer it. I will just answer in substance. There's a lot that's recurring if we stay in there. You can't look at our financial statements and make very good judgments about what's going to happen. It's the nature of our game, but it's confusing. It confuses us a little bit, and so we're not quoting that on purpose. It's a very complex, confusing system when you've got all these RFPs and...it's very complicated.

FEMALE SPEAKER:

Any other questions about the business?

MALE SPEAKER:

So, you purchased the building in Logan, which I believe is used exclusively in Journal Technologies, but in accounting it's under the traditional business, I'm wondering why in the segments.

CHARLIE MUNGER:

Gerry, I give you that one. He says why is Logan somehow in the traditional business? It shouldn't be.

GERRY:

The Daily Journal purchased the building and they own the building, and Journal Technologies pays rent to the parent company for that and the amount of rent is not, what we would consider, material from that perspective, and because it's owned by the Daily Journal that's how we originally classified it, no real significant reasons. Now all the expenses are on the Daily Journal's, or on the General Technologies' books.

CHARLIE MUNGER:

That's some quirk of accounting. It doesn't really matter.

MALE SPEAKER:

I just want to follow up on the question of incentives. You were explaining at Wells Fargo that you might've been a little too aggressive, but you don't have a problem with aggressive incentives. Can you expand on that a little more?

CHARLIE MUNGER:

Well, how do you know that they're aggressive until you try? They didn't react enough to the bad news fast enough, and of course that's a very dangerous thing to do. I don't think it impairs the future of Wells Fargo. As a matter of fact, they'll be better for it. The one nice thing about doing something dumb is you probably won't do it again.

MALE SPEAKER:

So this isn't a Gerry general question, but my question comes from the perspective of someone early in their career who's trying to figure out which of several paths to pursue. Two thoughts that seem helpful for this purpose are 1) figuring out what work you have the possibility of becoming the best at, and 2) ascertaining what kind of work would most help society. Do you think these ideas are the right ones to focus on and if so, how would you go about answering them?

CHARLIE MUNGER:

Well, in terms of picking what to do, I want to report to all of you that in my whole life I've never succeeded much in something I wasn't interested in. So, I don't think you're going to succeed if what you're doing all day doesn't interest you, and you've got to find something you're interested in because it's just too much to expect of human nature that you're going to be very good at something you deeply dislike doing, and so that's one big issue.

And of course you have to play in a game where you've got some unusual talents, even how you play. If you're 5 foot, 1, you don't want to play basketball against a guy that's 8 feet, 3, it's just too hard. And so, you've got to figure out a game where you have an advantage, and it has to be something that you're deeply interested in.

Now you get into the ethical side of life, well, of course you want to be ethical. On the other hand, you can't, you're just dreaming of how you think the world should be run and that it's too dirty for you to get near it. You can get so consumed by some kind of ideological notion, particularly in a left-wing university. It's like you think you're handling ethics, and what you're doing is not working and you're watching a wave go by, and maybe you're smoking a little pot to boot. This is not the Munger system.

My hero is Maimonides, and all that philosophy, and all that writing he did after working 10 or 12 hours a day as a practicing physician all his life. He believed in the engaged life, and so I recommend that you engage life. You spend all your time thinking about

some politician who wants it this way or that way. You're sure you know what's right, you're on the wrong track. You want to do something every day where you're coping with the reality. You want to be more like Maimonides and less like Bernie Sanders.

MALE SPEAKER:

I have a question on American Express. What does increasing the litany of payments weaken as [unintelligible] as a value proposition in the long-run as in like this American Express value proposition more in terms of payment, or is it more in terms of service and rewards?

CHARLIE MUNGER:

Well, I'm going to give you an answer that will be very helpful to you because you're somewhat confused about what the exact future of American Express will be. I'm confused too. I think that if you think you understand exactly what's going to happen to payment systems 10 years out, you're probably under some state of delusion. It's very hard to know.

So if you're confused, all I can say is welcome to the club. They're doing the best they can, they've got some huge advantages that they're...it's a reasonable bet, but nobody knows. I don't know if IBM is going to sell that much of Watson. I always say I'm agnostic on the subject. You're talking about a payment system 10 years out. I'm agnostic on that too. I think if you keep trying and do the right thing and you play the game hard, your chances are better, but I don't think those things are knowable. Think of how fast they change.

MALE SPEAKER:

Hi, Mr. Munger. Do you think domestic natural gas exploration and production is a good business despite the capital intensity? Thank you.

CHARLIE MUNGER:

Well, that's a different subject. I have a different feeling about the energy business than practically anybody else in America. I wish we weren't producing all this natural gas. I would be delighted to have the [unintelligible] that's coming out of our shale deposits of natural gas just lie there untapped for decades in the future and pay extra. You want your Arabs to use up their oil, but nobody else in America seems to feel my way, but I'm into deferred gratification.

The oil and gas is not going away, and I think it's just as important as the topsoil in Iowa. If any of you said, oh, goodie, I found a way to make money, we'll ship all our topsoil from Iowa to Greenland, I wouldn't think that was a very good idea, and so I don't think that hastening to use up all of our oil and gas is a good idea, but I'm practically the only one in the country that feels that way. There's not enough deferred gratification in it to please me, but I don't see any advantage. I regard our oil and gas reserves just as chemical feedstocks that are essential in civilization. Leave aside their energy content, I'd be delighted to use them up more

slowly. By the way, I'm sure I'm right and the other 99 percent of the people are wrong.

But no, I don't know. The oil and gas business is very peculiar. The people who succeed in most other businesses are doing way more physical volume than they did in the past. But a place like Exxon, the physical volume goes down by two thirds, it's just that the price of oil goes up faster than the physical volume goes down. That is a very peculiar way to make money and it may well continue, but it's confusing, we're not used to it.

MALE SPEAKER:

Mr. Munger, as an 18-year-old interested in many disciplines, I was wondering how you can thrive as a polymath in a world that celebrates specialization.

CHARLIE MUNGER:

Well, that's a good question. I don't think operating over many disciplines as I do is a good idea for most people. I think it's fun, that's why I've done it, and I'm better at it than most people would be, and I don't think I'm good at being the very best at handling differential equations. So it's been a wonderful path for me, but I think the correct path for everybody else is to specialize and get very good at something that society rewards and then get very efficient at doing it, but even if you do that, I think you should spend 10 or 20 percent of your time in trying to know all the big ideas in all the other disciplines. Otherwise, I use the same phrase over and over again...otherwise, you're like a one-legged man in an ass-kicking contest. It's just not going to work very well. You have to know the big ideas in all the disciplines to be safe if you have a life lived outside a cave. But no, I think you don't want to neglect your business as a dentist to think great thoughts about Proust.

MALE SPEAKER:

Mr. Munger, question about Lollapalooza effects. What are you observing now in your study of current events that's causing you concern, and how can you use that interdisciplinary approach to spot them in events? Thank you.

CHARLIE MUNGER:

Well, I coined that term the "Lollapalooza effect" because when I realized I didn't know any psychology and that was a mistake on my part, I bought the three main textbooks for introductory psychology and I read through them, and of course being Charlie Munger, I decided the psychologists were doing it all wrong and I could do it better. And one of the ideas that I came up with, which wasn't in any of the books, was that the Lollapalooza effects came when three or four of these tendencies were operating at once in the same situation.

I could see that it wasn't linear. You've got Lollapalooza effects, but the psychology people couldn't do experiments where four or five things were happening at once because it got too complicated for them and they couldn't publish, so they were ignoring the most important thing in their own profession.

And of course the other thing that was important was to synthesize psychology with all else, and the trouble with the psychology profession is they don't know anything about "all else" and you can't synthesize one thing you know with something you don't if you don't know the other thing, so that's why I came up with that Lollapalooza stuff. And by the way, I've been lonely ever since. I'm not making any ground there. And by the way, I'm totally right.

PAUL SMITH:

Charlie, I'm Paul Smith from Los Altos, California. My question relates to a comment you made some years ago about Warren Buffett. I think you said that he has become a significantly better investor since he turned 65, which I found a remarkable comment. I was wondering if you could share information about that that maybe we haven't heard before. I know you've commented he's a learning machine, and we all know the aversion to retail that came out of the Diversified episode, and so on. It would just be interesting, is there something that's changed about his risk assessment or his horizons, or any color there would be fantastic to hear? Thank you.

CHARLIE MUNGER:

Well, if you're in a game and you're passionate about learning more all the time and getting better and honing your own skills a little more, etcetera, etcetera, of course you do better over time and some people are better at that than others. It's amazing what Warren has done. Berkshire would be a very modest company now if Warren never learned anything. He never would've given anything back, I mean, any territory he took he was going to hold it.

But what really happened was, we were out in the new fields and buying whole businesses, and we bought into things like ISCAR that Warren never would have bought when he was younger. Ben Graham would have never bought ISCAR. He paid five times book or something for ISCAR. It wasn't in the Graham play[book], and Warren who learned under Graham, just, he learned better over time, and I've learned better.

The nice thing about the game we're in is that you can keep learning, and we're still doing it. Imagine we're in the press for CNBC for all of a sudden buying airline stocks. What have we said about the airline business? We thought it was a joke it was such a terrible business, and now if you put all of those stocks together we own one minor airline. We did the same thing in railroads. We said railroads are no damn good, you know, too many of them, truck competition, and we were right. It was a terrible business for about 80 years, but finally they got down to four big railroads and it was a better business, and something similar is happening in the airline business.

On the other hand, this very morning I sat down in my library with my daughter-in-law and she booked a round trip ticket to Europe, including taxes, it was like 4 or 5 hundred dollars. I was like, "we're buying into the airline business?" It may work out to be a good idea for the same reason that our railroad business turned out to be a good idea, but there's some chance that it might not.

In the old days, I frequently talked to Warren about the old days, and for years and

years and years, what we did was shoot fish in a barrel, but it was so easy that we didn't want to shoot at the fish while they were moving, so we waited until they slowed down and then we shot at them with a shotgun. It was just that easy, and it's gotten harder and harder and harder, and now we get little edges...before, we had total cinches, and it isn't any less interesting. We do not make the same returns we made when we could run around and pick this low-hanging fruit off trees that offered a lot of it.

So now we go into things. We bought the Exxon position. You want to know why Warren bought Exxon? As a cash substitute. He would never have done that in the old days. We had a lot of cash and we thought Exxon was better than cash over the short term. That's a different kind of thinking from the way Warren came up. He's changed, and I think he's changed when he buys airlines, and he's changed when he buys Apple.

Think of the hooting we've done over the years about high tech, we just don't understand it, it's not in our central competency, the worst business in the world is airlines, and what do we do? We appear in the press with Apple and a bunch of airlines. I don't think we've gone crazy. I think the answer is we're adapting reasonably to a business that's gotten very much more difficult, and I don't think we have a cinch in either of those positions. I think we have the odds a little bit in our favor, and if that's the best advantage we can get, we'll just have to live on the advantage we can get.

I used to say you have marry the best person that will have you, and I'm afraid that's a rule of life, and you have to get by in life with the best advantage you can get, and things have gotten so difficult in the investment world that we have to be satisfied with the type of advantage that we didn't use to get. On the other hand, the thing that caused it to be so difficult was when we got so enormously rich and that's not a bad tradeoff.

MALE SPEAKER:

Mr. Munger, at last year's meeting you said Donald Trump was not morally qualified to be President, and now that he is President, do you still agree with that, or do you think he's qualified in any capacity?

CHARLIE MUNGER:

Well, I've gotten more mellow. I always try and think about the good along with what's not good, and I think some of this stuff where they're reexamining options about the whole tax system of the country, I think that's a very constructive thing. When Donald Trump says he wouldn't touch Social Security, when a lot of highfalutin Republicans have all kinds of schemes for [unintelligible] Social Security, I'm with Donald Trump. If I were running the world I'd have his exact attitude about Social Security, I wouldn't touch it. So, he's not wrong on everything and just because he isn't like us...roll with it. Accept a little danger. What the hell, you're not going to live forever anyhow.

MALE SPEAKER:

Hi, Charlie. I was wondering what was the most meaningful thing that you did with your life?

CHARLIE MUNGER:

Well, I think that family and children is the most meaningful thing that most people do with their life, and I've been reasonably fortunate. I don't think I am a perfect husband. I'm lucky to have had as much felicity as I got, and I always needed a certain amount of toleration from the fair sex. I started wrong and I never completely fixed myself. I can tell this group about...you come here as a cult to talk to the cult leader? I want to take you back in history again. You'll see what an inferior person you're now trusting.

When I was a freshman in Omaha Central High, there was a family friend, a girl my age, and she had gone off to summer camp the year before and she met a blonde goddess, a voluptuous 13-year-old, and I was a skinny underdeveloped whatever and so forth. "You gotta take my blonde goddess to this dance". And so, I wanted to impress this blonde goddess and so I pretended to smoke, which I didn't, and she was wearing a net dress and I set her on fire, but I was quick-witted, and I threw a Coca-Cola all over her and in due time the fire was out, and that's the last I saw of the blonde goddess.

And then I said, well, I've got to make more time with the girls, and I wanted to get a letter at Omaha Central High. Of course, I was no good at any sport. So, I went down to the rifle range and learned they gave letters in rifle shooting, and I was so skinny that I could shoot a hundred every time in the sitting position by sitting cross-legged and putting one elbow on each foot, try it, you'll break your neck, but I could shoot a hundred every time. So I was a good rifle shooter and they gave me a letter, but I was so skinny and short and underdeveloped that it went from one armpit to the other, and I walked down the hallway trying to impress the girls and they wouldn't turn their head. What they said was, how did a skinny little unattractive little runt like that get a letter?

And then I had another experience. There was a girl who had a name, I still remember it, Zibby Bruington. She was a senior and a very popular senior, and I was a nerd sophomore, and somehow she agreed to go with me to a party in one of the out-buildings of the Omaha Country Club, perhaps because she liked one of my friends, who was a big strapping fellow. So I took Zibby to this party in my 1934 Ford, and it sleeted and got rainy and so forth, and I managed to stick the Ford in the mud and I couldn't get out of it, and Zibby and I had to walk for several miles through sleet. That was the last I ever saw of Zibby Bruington. And then my car stayed in the mud and I neglected to put in antifreeze, and the temperature went way down and suddenly the block broke. It was too expensive to fix. Then I lost my car and my father wouldn't buy a new one because he said why should I buy a new car for a guy whose dumb enough not to put antifreeze in it? This is the person you're coming for miles to see. And so, I didn't get a new car.

My life is just one long litany of mistakes and failure and it went on and on and on. And politics...I ran to be the president of the DSIC in grade school, The Dundee School Improvement

Association. I had the most popular boy in school as my campaign manager. I came in second by miles. I was a total failure in politics. There's hardly anything I succeeded at. Now, I tell you all of this because I know a nerd when I see one and there are a lot of nerds here who can tell stories like mine, and I want you to feel it's not hopeless. Just keep trying.

Oh, yeah, Guerin wants me to repeat the story of Max Plank. According to the story, Max Plank when he won the Nobel Prize was invited to run around Germany giving lectures and a chauffeur drove him, and after giving the lecture about 20 times, the chauffeur memorized it and he said, you know, since Professor Plank it's so boring, why don't you just sit in the audience and I, the chauffeur, will give your talk. And so, the chauffeur got up and gave Max Plank's talk on physics and some professors started asking some terrible questions and the chauffeur said, well, I'm surprised that in an advanced city like Munich, people are asking elementary questions like that. I'm going to ask my chauffeur to answer that.

While I'm telling jokes I might tell one of my favorite stories about the plane that's flying over the Mediterranean. The pilot's voice comes on and he says, 'A terrible thing just happened. We're losing both engines. We're going to have to land in the Mediterranean'. And he says, 'The plane will stay afloat for a very short time, and we'll be able to open the door just long enough so that everybody can get out. We have to do this in an orderly fashion. Everybody who can swim, go to the right wing and stand there, and everybody who can't swim go to the left wing and just stand there. And he says, those of you on the right wing, you'll find a little island in the direction of the sun, it's two miles off, and as the plane goes under just swim over to the island, you'll be fine, and for those of you on the left wing, thank you for flying Air Italia.

WILLIAM:

Hello, Mr. Munger. William [unintelligible]. Wonderful stories. With regard to the proliferation of index funds, do you think that there may be issues with liquidity any time we go through another large crisis? And then, do you think that that will create large discrepancies between the price of the index fund and the values of the securities underneath?

CHARLIE MUNGER:

Well, the index funds of the S&P, it's like 75 percent of the market, so I don't think the exact problem you're talking about is going to be a big problem because you're talking about the S&P index. But is there a point where index funds theoretically can't work? Of course. If everybody bought nothing but index funds, the whole world wouldn't work as people expect.

There's also the problem...one of the reasons you buy a big index like the S&P is because if you buy a small index and it gets popular, you have a self-defeating situation. When the Nifty 50 were the rage, JP Morgan talked everybody into buying just 50 stocks and they didn't care what the price was, they just bought those 50 stocks. Of course in due time, their own buying forced those 50 stocks up to 60 times earnings whereupon it broke and everything went down by like two-thirds quite fast. In other words, if you get too much faddishness in one sector or in one narrow index,

of course you can get catastrophic changes like they had with the Nifty 50 in that former era.

I don't see that happening when the index is three-quarters of the whole market. The problem is the whole thing can't work perfectly forever, but it will work for a long time. The indexes have caused just absolute agony among the intelligent investment professionals because basically 95 percent of the people have almost no chance of beating it over time, and yet all the people expect, if they have some money, they can hire somebody who will let them beat the indexes, and of course the honest, sensible people know we're selling something they can't quite deliver and that has to be agony. Most people handle that with denial. They think that it will be better next year, or they just don't want to think about that and I understand that. I mean, I don't want to think of my own death either, but it's a terrible problem, beating those indexes, and it's a problem that investment professionals didn't have in the past.

And what's happening of course is that the prices for managing really big sums of money are going down, down, down, 20 basis points and so on. The people who rose in investment management didn't do it by getting paid 20 basis points, but that's where we're going I think in terms of people who manage big portfolios of the American Equities in the equivalent of the S&P. It's a huge, huge, problem. It makes your generation of money managers have way more difficulties and it causes a lot of worry and fretfulness, and I think the people who are worried and fretful are absolutely right.

I would hate to manage a trillion dollars in the big stocks and try and beat the indexes. I don't think I could do it. In fact if you look at Berkshire, take out a hundred decisions, which is like two a year, the success of Berkshire came from two decisions a year over 50 years. We may have beaten the indexes, but we didn't do it by having big portfolios of securities and having subdivisions managing the drugs and subdivisions, and so the indexes are a hell of a problem for you people, but you know, why shouldn't life be hard? It's what had to happen, what's happened now.

If you take these people doing some of those early trading by computer algorithms that worked, then somebody else would come in and do the same thing with the same algorithm and play the same game, and of course the returns went down. Well, that's what's happening in the whole field is the returns you're really going to get are being pushed down by the progress of the sums.

NICK ANDERSON:

Thank you, Mr. Munger. My name is Nick Anderson. I'm from Brooklyn, California. I have two questions for you. My first question is what books or experiences were the most formative to you in your early career? And the second question is where and how do you tell your most ambitious grandchildren to look for business opportunities?

CHARLIE MUNGER:

Well, I don't spend any time telling my grandchildren what business opportunities to look for. I don't have that much hope. I'm going to have trouble getting my grandchildren to work at all. Anyway, I don't think there's an easy way to handle a problem of doing better and better with

finances. Obviously, if you're glued together and honorable and get up every morning and keep doing and keep learning every day, and you're willing to go in for a lot of deferred gratification all your life, you're going to succeed. It may not be as much as you want, but you're going to succeed. And so, the main thing is to just keep in there and be glued together, and get rid of your stupidities as fast as you can, and avoid the bad people as much as you can and you'll do reasonably well, but try teaching that to your grandchildren. I think the only way you have a chance is sort of by example, so if you want to improve your grandchildren, the best way is to fix yourself.

Oh, books. You cultists send me so many books that I can scarcely walk into my own library, so I'm reading so many now because I never throw one away, I at least scan and so I've gotten so I make a kaleidoscope of those new books. I just read this new book by [Ed] Thorp, the guy who beat the dealer in Las Vegas, and then he did computer algorithm trading. I really liked the book. For one thing, the guy had a really good marriage and he seemed grateful for it and it was touching. For another, he was a very smart man. He was a mathematician using a high IQ to, a) beat the dealer in Las Vegas and so forth, and then, b), use these computer algorithms to do this massive trading. I found it very interesting, and since some of you people are nerds and maybe you might like a love story, I recommend Thorp's new book. It's an interesting thing to do to beat the dealer in Las Vegas...wearing disguises and so on.

And Peter Kaufman told me a story about somebody he knows that did the same thing as Thorp did, he said he did it more extreme. He wore disguises and so forth. He won 4 million dollars I think in the casinos, and that was hard to do because casinos don't like playing against people who might win, and then he went into the stock market where he made 4 billion dollars, again clever algorithms. You know, these people are mathematically gifted. It's still going on, and I don't think many of you are going to do it. There can't be many people who are mathematically gifted enough and manipulate statistics and everything else so well that they find little algorithms that will make them 4 billion dollars, but there are a few, and so some of them started just like Thorp. So, Thorp's book is interesting and I recommend it to you.

MALE SPEAKER:

Hi, Mr. Munger. Thanks for being such a great teacher. This question, a position for the idea of filial piety, the Confucian idea. In this generation, how can we fulfil our filial duties?

CHARLIE MUNGER:

I didn't quite catch.

MALE SPEAKER:

How can we in my generation, I at least will be staying far away from my parents, so how can I fulfil my filial duties the best way as you see it?

CHARLIE MUNGER:

I like filial piety. They worship old men, rich old men. That is my kind of a system. But I think the idea of caring about your ancestors and caring about your traditions, I think all that stuff is a big part of what's desirable. I really admire the Confucians for that notion that it's not a game that's played just in one life. It's a game where you're handing the baton off, and you're accepting the baton from your predecessor. So if filial piety is your game, why, I think it's a very good thing. Think about how rootless we'd all be if we had no families at all, no predecessors, no decedents, it would be a very different life. Think what we owe the people who figure out things in the past that make our civilization work. So, I'm all for filial piety and its close cousins.

JESSE KOLTES:

Good morning, Mr. Munger. Jesse Koltes from New York. You said that "any year in which you don't destroy one of your best loved ideas is a wasted year." It's well known that you helped coach Warren towards quality, which was a difficult transition for him. I was wondering if you could speak to the hardest idea that you've ever destroyed.

CHARLIE MUNGER:

Well, I've done so many dumb things that I think I'm very busy destroying bad ideas because I keep having them, so it's hard for me to just single out one from such a multitude. But I actually like it when I destroy a bad idea because I think I remember...I guess it's my duty to destroy old ideas. I know so many people whose main problem in life is that the old ideas displace the entry of new ideas that are better. That is the absolute standard outcome in life. There's an old German folk saying that describes that, it says, "We're too soon old and too late smart." That's everybody's problem, and the reason we're too late smart is the stupid ideas we already have, we can't get rid of.

Now it's a good thing that we have that problem. In marriage that may be good for the stability of marriage that we stick with our old ideas, but in most fields you want to get rid of your old ideas. It's a good habit, and it gives you a big advantage in the competitive game of life, other people are so very bad at it. What happens is as you spout ideas out, what you're doing is you're pounding them in, and so you get these ideas and then you start agitating and saying them and so forth and of course, the person you're really convincing is you who already had the ideas. You're just pounding them in harder and harder.

One of the reasons I don't spend much time telling the world what I think about how the Federal Reserve System should behave, and so forth, is I know that I'm just pounding the ideas into my own head when I think I'm telling the other people how to run things. So, I think you have to have mental habits that...I don't like it when young people get violently convinced on every damn cause or something. They think they know everything. Some 17-year-old wants to tell the whole world what ought to be done about abortion or foreign policy in the Middle East or something. All he's doing when he or she spouts about what he deeply believes is pounding the ideas he already has in, which is a very dumb idea when you're just starting and have a lot to learn.

So, it's very important, that habit of getting rid of the dumb ideas. One of the things I do is pat myself on the back every time I get rid of the dumb idea. You'd say, could you really reinforce your own good behavior? Yeah, you can. When other people don't praise you, you can praise yourself. I have a big system of patting myself on the back. Every time I get rid of a much-beloved idea I pat myself on the back, sometimes several times, and I recommend this same mental habit to all of you. The price we pay for being able to accept a new idea is just awesomely large. Indeed, a lot of people die because they can't get new ideas through their head.

DONALD SCHAFFER:

Hello, Charlie. My name's Donald Schaffer. I used to work as a petroleum engineer and from my experience of that, and I was kind of in it through all of the whole shale stuff that's happened, and my perception is that as an industry itself it just continuously has gotten more and more complex and more technical, and that as the economy in general expands and you have more division of labor and specialization, it seems to me that it will be very hard, like it could be a challenge for investors unless there is some more specialization or something. I guess my question is as it gets more...do you think that capital allocators are going to need to become more specialized going forward?

CHARLIE MUNGER:

Well, you petroleum people of course have to get more specialized because the oil is harder to get, and you have to learn new tricks to get it, and so you're absolutely right. Generally, specialization is the way to go with people. It's just I have an example of something different. It's awkward for me because...but I don't want to encourage people to do it the way I did because I don't think it will work for most people. I think the basic ideas of being rational and disciplined and deferring gratification, those will work good. If you want to get rich the way I did by learning a little bit about a hell of a lot, I don't recommend it to others.

Now, I've got a story there that I tell. A young man comes to see Mozart and says, I want to compose symphonies. And Mozart says, you're too young to compose symphonies. He's 20 years old. He says, but you were composing symphonies when you were 10 years old and Mozart says, yeah, but I wasn't running around asking other people how to do it.

I don't think I'm a good example to the young. I don't want to encourage people to follow my particular path. I like all the general precepts, but I would not...if you're a proctologist, I do not want a proctologist that knows Schopenhauer, or astrophysics, I want a man who's specialized. That's the way the market is and you should never forget that. On the other hand, I don't think you'd have much of a life if all you did was proctology.

PHILIP:

Hi. Philip [unintelligible]. The question is for Charlie. Warren and you are known for saying that you worked with a small sum of capital, maybe like even 10 million dollars.

Warren publicly said that he could guarantee that if you compound that at 50 percent a year. So my question is can you provide some examples, and then I would kindly ask that you provide as many examples as possible, and be as specific as possible.

CHARLIE MUNGER:

Well, the minute I hear somebody that really wants to get rich at a rapid rate with specifics, that is not what we're trying to do here. You want to leave some mystery so that you yourself can amuse yourself, finding your own way. You know, the ideas that I've had in my life are quite few, but the lesson I can give you is a few, is all you need and don't be disappointed. When you find the few of course, you've got to act aggressively, that's the Munger system, and I learned that indirectly from a man I never met, which was my mother's maternal grandfather.

He was a pioneer when he came out to Iowa and fought in the Black Hawk War and so on, and eventually after enormous hardship...well, he was the richest man in town and he owned the bank and so on. As he sat there in his old age, my mother knew him because she'd go to Algona, Iowa, where he lived, had the big house in the middle of town, iron fence, capacious lawns, big barns. What Grandpa Ingham used to tell her is, there's just a few opportunities you get in a whole life. This guy took over Iowa when the land was black topsoil in Iowa was cheap, but he didn't get that many opportunities. It was just a few that enabled him to become prosperous.

He bought a few farms every time there was a panic, you know, and he'd lease them to thrifty Germans, you couldn't lose money with leasing a farm to a German in Iowa, but he only did a few things, and I'm afraid that's the case. You're not going to find a million wonderful ideas. These people with the computer algorithms do it, but they have a computer sifting the whole world. It's like placer mining, and of course every niche they're in, if somebody else comes in, the niche starts leaching away, and I don't think it's that honorable to make a living that way. I would rather make my money in some other way than outsmarting the trading system, so I have a little computer algorithm that just leaches a little out of everybody's trade.

I always say that those people have all the social utility of a bunch of rats in a granary. It's not that great a way to make money. I would say that if you make your money that way that you should be very charitable with it because you've got a lot to atone for. I don't think it's an ambition we should encourage, and the rest of us who aren't just leaching a little off the top because we're great at computer science, and that's what this room is full of, and if you're not finding it harder now, you don't understand it. That's my lesson.

CAMDEN:

Hi, Mr. Munger. My name is Camden [unintelligible] and I'd like to know what's your favorite industry and why it's your favorite industry?

CHARLIE MUNGER:

I didn't quite follow that.

CAMDEN:

All I wanted to know, what's your favorite industry and why it's your favorite industry?

CHARLIE MUNGER:

My favorite industry. Well, my favorite industry is taking care of my own affairs, and it's fun, it's creative, and it's the job that life has given me, and I think that you should do the job well that life gives you. A lot of the places where the industries are doing a great job for the world, it's very hard to make money out of it because these wild enthusiasms come into it. So, I don't have a favorite industry.

MALE SPEAKER:

Charlie, a few years ago you were [unintelligible] on and identifying the monkey business account. Is there any current monkey business in Corporate America that worries you?

CHARLIE MUNGER:

Well, the answer is yes, but not as extreme as Valeant. That was really something. That was really something. I probably shouldn't have done that, but you come so far, and since you're cult members you like being here, and I feel an obligation to tell you something sort of interesting, and I just went straight into Valeant that year. It was really pretty disgusting.

The interesting thing is how many high-grade people that took in. It was too good to be true. There was a lot wrong with Valeant. It was so aggressive. It was drugs people needed. It was just...take the difference between Valeant and the Daily Journal Company, and the foreclosure boom came, we had 80 percent of the foreclosure business in our area. It's a big area, Southern California and Northern California too. It would have been very easy for us to raise the prices and make, I don't know, 50 million more or something like that. All these people were losing their houses, a lot of them perfectly decent people.

It never...the idea that just right in the middle of that we'd make all the money we could, which some of our competitors did by the way. We just didn't do it. I don't think capitalism requires that you make all the money that you can. I think there are times when you should be satisfied with less based on just ideas of decency, and at Valeant they just looked at it like a game like chess. They didn't think about any human consequences, they didn't think about anything but getting what they wanted, which was money and glory, and they just stepped way over the line, and of course in the end they were cheating.

But I don't have a new one. I got a lot of publicity over that Valeant thing. I'm not looking for...I don't want this room to have twice as many people next year, and I don't want me not to be here either.

TIM MEDLEY:

Mr. Munger, Tim Medley. Thank you for your advice over the past 30 years. My question relates to a talk you gave to the Foundation Financial Officers in 1998 here in California, and in that talk you were critical of the complexity and the expense of many foundation portfolios and you said specifically, “An institution with almost all wealth invested long-term in just three fine domestic corporations is securely rich.” And you gave as an example the Woodruff Foundation in Coca-Cola. So if you had a foundation today with let’s say a billion dollars, would you be comfortable with it being invested in just three stocks?

CHARLIE MUNGER:

Well, let’s take the foundation. I’ll change your question around in order to answer it. Am I comfortable with a non-diversified portfolio? Of course I am. If you say the Mungers, I care about the Mungers. The Mungers have three stocks. We have a block of Berkshire, we have a block of Costco, we have a block of Li Lu’s Fund, and the rest is dribs and drabs. So am I comfortable? Am I securely rich? You’re damn right I am.

Could other people be just as comfortable as I who didn’t have a vast portfolio with a lot of names in it, many of whom neither they nor their advisors understand? Of course they’d be better off if they did what I did. And is three stocks enough? What are the chances that Costco’s going to fail? What are the chances that Berkshire Hathaway’s going to fail? What are the chances that Li Lu’s portfolio in China is going to fail? The chances that any one of those things happening is almost zero, the chances that all three of them are going to fail.

That’s one of the good ideas I had when I was young. When I started investing my little piddly savings as a lawyer, I tried to figure out how much diversification I would need if I had a 10 percentage advantage every year over stocks generally. I just worked it out. I didn’t have any formula. I just worked it out with my high school algebra, and I realized that if I was going to be there for 30 or 40 years, I’d be about 99 percent sure that it would be just fine if I never owned more than three stocks and my average holding period is three or four years.

Once I had done that with my little pencil, I just...I never for a moment believed this balderdash they teach about. Why diversification? Diversification is a rule for those who don’t know anything. Warren calls them “know-nothing investors”. If you’re a know-nothing investor of course you’re going to own the average, but if you’re not a know-nothing investor, if you’re actually capable of figuring out something that will work better, you’re just hurting yourselves looking for 50 when three will suffice. Hell, one will suffice if you do it right, one. If you have one cinch, what else do you need in life?

And so, the whole idea that the know-something investor needs a lot of diversification, to think we’re paying these professors to teach this crap to our young, and people think they should be paid by telling us to diversify. Where it’s right, it’s an idiot decision, and where it’s wrong, you shouldn’t be teaching what’s wrong.

What's gone on in corporate finance teaching is that people are getting paid for dispensing balderdash, and since I never believed that it was a great help to me, it helps if you're out in the market and the other people are believing balderdash and you know what the hell's going on, it's a big help. So of course you don't want a lot.

If you're Uncle Horace, who has no children, has an immense business which is immensely secure and powerful and he's going to leave it all to you, if you come to work in the business you don't need any diversification. You don't need any corporate finance professors. You should go to work for Uncle Horace. It's a cinch. You only need one cinch, and sometimes the market gives you the equivalent of an Uncle Horace and when it does, step up to the pie-cart with a big pan. Pie carts like that don't come very often. When they do you have to have the gumption and the determination to seize the opportunity assuredly.

I was lucky. Imagine learning that from your dead great-grandfather at a very young age, but you know, I spent my whole life with dead people. They're so much better than many of the people I'm with here on earth. All the dead people in the world, you can learn a lot from them and they're very convenient to reach. You reach out and grab a book, none of those problems with transportation, so I really recommend making friends among the imminent dead, which of course I did very early, and it's been enormously helpful. Some of you wouldn't go with me, but Adam Smith really did.

MALE SPEAKER:

My question is about the Irish economy and Irish banking. I know that Berkshire Hathaway was a shareholder in Irish banks pre-2008. I'm wondering if you could you comment on how the Irish economy and the Irish banking system proceeds, with the UK not being part of the European Union, going forward.

CHARLIE MUNGER:

Well, that of course was a mistake, and it was a mistake that we shouldn't have made because both Warren and I know you can't really trust the figures put out by the banking industry, and the people who run banks are subject to enormous temptations that lead them astray because it's easy to make a bank report from earnings. But a thing that any idiot could do, which is make it a little more gamey, and of course that's dangerous and yet the temptations are very great. So we shouldn't have made that mistake, but we did. And that's a good lesson too that even if you're really good at something you will occasionally drift and do a dumb mistake.

And now what's the question about the bank? They went crazy in Ireland, the bankers, and we went crazy when we trusted their damn statements and it was a mistake. Now, what Ireland has done was very smart in reducing all these taxes. Not all the English-speaking people with practically no taxes, and there's a fair amount of charm and so forth in Ireland. It's not like it's a terrible place to be. They just sucked in half the world into Ireland where they got these... Gates went there very early with Microsoft, and so on, and they took a place that was really a backward place that had a sort of internal civil war for 60 or 70 years and bad opportunities, and they really

brought in a lot of prosperity, and they did that by this competitive lowering of taxes and so on.

So it worked for Ireland, so I think Ireland deserves a lot of credit for the way they advanced their country. And of course they were going to have a thing where all the countries keep trying to reduce their taxes to suck in the foreign...but it won't work for everybody, but it did work for Ireland. So I think Ireland deserves a lot of credit, and of course they recovered pretty well from a very major collapse. Irish are like the Scottish. I always think that those Gallics are pretty unusual people, and I'm very glad that I had a Scottish-Irish great-grandmother.

MALE SPEAKER:

Charlie, on your right.. I just want to thank you firstly and foremost for being such an amazing teacher to me and all the investors around the world. My question is in regards to Lee Kuan Yew, and you've on several occasions spoken about the economic miracle that is Singapore, and then how it was transferred on by Deng Xiaoping to China. What are your thoughts about India that's going through a similar change with the prime minister who also idolizes his people and wants to create a similar sort of situation? I'd like you're thoughts on that. Thank you.

CHARLIE MUNGER:

Well, that's a very intelligent question, and I'm not saying all the other questions weren't. I regard...Lee Kuan Yew may have been the best nation builder that ever lived. He took over a malarial swamp with no assets, no natural resources, nothing, surrounded by a bunch of Muslims who hated him, hated him. In fact, he was being spat out by the Muslim country. They didn't want a bunch of damn Chinese in their country. That's how Singapore was formed as a country, the Muslims spat it out. And so here he is, no assets, no money, no nothing. People were dying of malaria, lots of corruption, and he creates in a very short time, by historical standards, modern Singapore. It was a huge, huge, huge success. It was such a success, there is no other precedent in the history of the world that is any stronger.

Now China's more important because there are more Chinese, but you can give Lee Kuan Yew a lot of the credit for creating modern China because a lot of those pragmatic communist leaders, they saw a bunch of Chinese that were rich when they were poor and they said, to hell with this. Remember the old communist said, "I don't care whether the cat is black or white, I care whether he catches mice." He wanted some of the success that Singapore got and he copied the playbook. So I think the communist leadership that copied Lee Kuan Yew was right. I think Lee Kuan Yew was right. And of course, I have two busts of somebody else in my house, one is Benjamin Franklin, and the other is Lee Kuan Yew. So, that's what I think of him.

Now you turn to India, and I would say I'd rather work with a bunch of Chinese than I would Indian civilization mired down, caste system, over-population, assimilating the worst stupidities of the democratic system, which by the way Lee Kuan Yew avoided. It's hard to get anything done in India and the bribes are just awful. So all I can say is, it's not going to be easy for India to follow the example of Lee Kuan Yew.

I think that India will move ahead, but it is so defective as they get ahead, and of course the Indians I know are fabulous people. They're just as talented as the Chinese. I'm speaking about the Indian populace, but the system and the poverty and the corruption, and the crazy democratic thing where you let anybody that screams stop all progress, it mires India with problems that Lee Kuan Yew didn't have.

Now, I don't think those Indian problems are always easy to fix. Let me give you an example. The Korean steel company, POSCO, invented a new way of creating steel out of lousy iron ore and lousy coal. And there's some province in India that has lots of lousy iron ore and lots of lousy coal, which there's not much use for, and this one process would take their lousy iron ore and the coal and make a lot of steel, and they got a lot of cheap labor.

So. POSCO and India were made for each other, and they made a deal with the province to get together and use the POSCO know-how and the India lousy iron ore and lousy coal, and eight or nine or ten years later with everybody screaming and objecting and farmers lying down in the road, or whatever's going on, they canceled the whole thing. In China they would have just done it. Lee Kuan Yew would have done it in Malaysia. India is grossly defective because they've taken the worst aspects of our culture, allowing a whole bunch of idiots to scream and stop everything and they've copied it. And so, they have taken the worst aspects of democracy and then they forged their own chains and put them on themselves. So, no, I do not like the prospects of India compared to the prospects of...and I don't think that India's going to do as well as Lee Kuan Yew.

MALE SPEAKER:

Hi, my name's [unintelligible] and I'd like to ask a question about the [unintelligible] loss. In '73 your investment firm with Mr. Wheeler lost over 30 percent and again in '74. That's over half in two years, so what happened, and have you been doing it differently since then?

CHARLIE MUNGER:

Would you have him restate that for me because I don't hear as well as I used to?

MALE SPEAKER:

So, what happened in '73 and '74 when your investment firm lost over half?

CHARLIE MUNGER:

Oh, that's very simple. That is very easy. That's a good lesson. That's a good question. What happened is the value of my partnership where I was running, went down by 50 percent in one year, and the market went down by 40 percent or something. It was a once-in-30-year recession. I mean, monopoly newspapers were selling at three, four times earnings. At the bottom tick, I was down from the peak, 50 percent. You're right about that. That has happened to me three times in my Berkshire stock, so I regard it as part of manhood. If you're going to be in this game for the long pull, which is the way to do it, you'd better be able to handle a 50

percent decline without fussing too much about it. And so, my lesson to all of you is conduct your life so that you can handle a 50 percent decline with aplomb and grace. Don't try to avoid it. It will come. In fact, I would say if it doesn't come, you're not being aggressive enough.

WARREN:

Thank you for having us, and thank you for your awesome employees for tolerating many more people in here than normal. My question relates to...

CHARLIE MUNGER:

They might think it's their last chance.

MALE SPEAKER:

My question relates to your paper on the biases of psychology of human misjudgment. You spoke about choosing great people earlier, and I'm curious, how do you evaluate, handle, and manage people knowing they might exhibit or suffer from biases you are not? And how have you and Mr. Buffett become such fine judges of character, not just someone's skills and abilities?

CHARLIE MUNGER:

Well, I think partly we look smart because we pick such wonderful people to be our partners and our associates, even our employees and that's going on right here. Gerry Salzman is not normal. He looks normal, but he's a damn freak. Gerry does things across two or three disciplines that are almost beyond human and he's always been that way. By the way, he's just another Midwesterner. He's come out of the soil back there. So, we've been very lucky to have these wonderful people.

I wish...I'm not quite sure...I think one thing we've done that's helped us to get wonderful people, I always say the best way to get a good spouse is to deserve one, and the best way to get a good partner is to be a good partner yourself, and I think Warren and I have both done good with that, but whatever the reason we've had these marvelous partners, and they make us look a lot better than we are. You wouldn't even be here if Gerry Salzman weren't here. We did not have a number two choice to run the Daily Journal, and by the way, that happens to me all the time. We have an executive search or something, and there's a number one and number two is like going off a cliff and we really...we need one, but there aren't three good ones to pick where they're all good and one's a little better.

Every executive search I've had, it seems to me there's one guy who's fine and everybody else is the pigmy. I think good people are hard to find, and people like Warren and I have had wonderful people who we've worked with all our lives and time after time. That's one of the reasons Warren says he tap dances to work. You'd tap dance too if you interfaced with people Warren interfaces with all day. They're wonderful people and they win all the time instead of losing. Who doesn't like winning in good company? So, if you can duplicate that, why, you've got a great future. I think we were a little lucky, and I can't give you any luck.

MALE SPEAKER:

We have a Chinese platform that focuses on ready content on people trying to invest out of China, and China will become the largest pool of investment capital in the world just by nature of [unintelligible]. It's the largest economy in the world with 30 percent savings rate. So they haven't been able to invest because of capital controls, but that day will come, and since they're at least a half a century behind in understanding about investing, what would be the first thing that you would tell a Chinese person who wants to invest in the US? What should they do with their money when they're making their initial investment outside?

CHARLIE MUNGER:

Well, you've made an assumption I don't follow. If I were a Chinese person of vast intellect and talent, discipline, all the good qualities, I would invest in China, not the United States. I think the fruit is hanging lower there and some of the companies are more entrenched, so I don't agree with your proposition. I think they have a tendency to think we were backwards, therefore when we get rich we should go over and invest in America. I think it's always a mistake to look for a pie in the sky when you've got a big piece of pie right in your lap. And so, if I were...at current prices, I think an intelligent person would do better investing in China.

MALE SPEAKER:

First of all, thank you for being a great teacher. I have two questions. Right here you said everyone should spend 10 to 20 percent on some big ideas. What are one or two big ideas that you are talking about? And then second question is whether...

CHARLIE MUNGER:

I can't tell you what to invest in.

MALE SPEAKER:

No, I'm not saying the big idea is that you don't mean investment. You said specialize, but then spend time working on some big ideas.

CHARLIE MUNGER:

Well, the big ideas, I think you should be intelligent in improving yourself. You're way better to take on a really big important idea that comes up all the time than some little tiny idea that you might not face. So, I always tried to grab the really big ideas in every discipline because why piddle around with the little ones and ignore the big ones? Just all the big ideas in every discipline are just very, very, very useful.

Frequently, the problem in front of you is solvable if you reach outside the discipline you're in and the idea is just over the fence, but if you're trying to stay within the fence you won't find it. I've done that so much in my life it's almost embarrassing, and it makes me seem arrogant

because I will frequently reach into the other fellow's discipline and come up with an idea that he misses, and when I was young that caused me terrible problems. People hated me, and I probably shouldn't have been as brash as I was, and I probably shouldn't be as brash as I am now.

I haven't completed my self-improvement process. But it's so much fun to get the right idea a little outside your own profession, so if you're capable of doing it, by all means learn to do it, even if you just want to learn it defensively. I do not observe professional boundaries.

My doctor constantly writes PSA test, prostate specific antigen, and I just cross it out and he says, what the hell are you doing, why are you doing this? And I say, well now, I'm trying to give you an opportunity to do something dumb. If I've got an unfixable cancer that's growing fast in my prostate I'd like to find out three months in the future, not right now, and if I got one that's growing slowly, I don't want to encourage some doctor to do something dumb and intervene with it, so I say, I just cross it out. Most people are not crossing out their doctor's prescriptions, but I think I know better. I don't know better about the complex treatments and so forth, but I know it's unwise for me to have a PSA test, so I just cross it out. I'm always doing that kind of thing and I recommend it to you when you get my age, just go cross out that PSA test. Now the women I can't help.

MALE SPEAKER:

I want you imagine you had the opportunity to invest in a couple money managers that you really liked, and they offer you a couple different ways to invest in a strategy. So, one way is through a limited partnership that would flow through the taxes, and the other way is through a corporation that would pay tax on the gains and the dividends. So basically, the corporation would serve no other function though, other than paying taxes. So, I think you'd be crazy to say that there is two ways of investing equally desirable, so my question is...

CHARLIE MUNGER:

You're certainly right about that. It's plumb crazy, and that's exactly the way people who buy Berkshire are investing. It's plumb crazy to have a big common stock portfolio in a corporation and pay taxes compared to investing in a partnership that doesn't, and that's just the way the Berkshire shareholders have invested and they have made, whatever it is, 25 percent a year since we were there. But you're right, it's not the logical way to do it.

MALE SPEAKER:

So my question is if you had to decide to invest in pool A or pool B, how would you decide on it? What method you would use to figure out what discount would make you indifferent to whether you would invest through the corporate tax-paying structure when it flows to the...

CHARLIE MUNGER:

I think it is totally asinine to invest in a portfolio of common stock through a corporation taxed under the Internal Revenue Code under Subchapter C or something, totally asinine. At

Berkshire, the public securities keep going down and down as a percentage of the total value, so it doesn't matter, we're getting to be sort of a normal corporation, but I don't think anybody's right mind should invest through a corporation in a puddle of securities. In fact, the disadvantage is so horrible. So, I wouldn't even consider it. In other words...and I regard it as a minor miracle that we were able to get where we did. So, of course you'd invest in a partnership.

MALE SPEAKER:

So, when anyone who invests in Berkshire has to decide what discount to put on a pool of securities that has a future tax lien on the gains, do you have any mental model for...

CHARLIE MUNGER:

Yeah, my model is to avoid it. We don't want to invest in a portfolio of securities in somebody else's corporation. You're totally right, which you already knew by the way.

SANDRA:

Mr. Munger, I am Sandra from China and I want to know what's your new findings of China, would you say business opportunities or just different because I remember you once said the Chinese were the first to be the one and got [unintelligible] years [unintelligible]. And also, a second question is after the US election the Hedge Fund Manager, Ray Dalio, said the new administration could unleash the animal spirits which could lead to a better US economy? Do you buy this theory? Thank you.

CHARLIE MUNGER:

Well, I'm not sure I understood that completely, but I'll do my best. What I like about China is that they have some companies that are very strong and still selling at low prices, and the Chinese are formidable workers and they make wonderful employees, and there's a lot of strength in that system. And the Chinese government really tries to help its businesses, it does not behave like the government of India, which I don't think runs its country right at all, and so that's what I like about China.

Of course, I have to admire taking a billion and half people in a state of poverty up that fast. That was never done in the history of the world and I admire them. You go to China, all those bullet trains that go into the heart of the city, what they've done is just an incredible achievement and they've done it not by borrowing money from Europe the way we did when we came up. They have taken a poor nation with a lot of poverty, and what they did is save half their income when they were poor and drive their nation way up with a lot of deferred gratification, so it was unbelievably admirable and unbelievably effective, so I admire that part of the Chinese picture.

China has one problem. The problem with the Chinese people is they like to gamble and they actually believe in luck. Now that is stupid. What you don't want to believe in is luck. You want to believe in odds and China, there's some reason in the culture,

too many people believe in luck and gamble and that's a national defect.

MS. ALEX MANFELD:

Hi. My name's Alex Manfeld. I work with John Griffin in New York. I was curious, if the world changes a lot during a lifetime, by the time I'm closer to your age, what do you think will not change about what makes a good successful business?

CHARLIE MUNGER:

What will not change is that it won't be that damned easy. There will be lots of... people will die that you love. You'll have close breaks where it goes against you. There's a lot of trouble that's sure to come, and at the end you'll know that it's all over, and that's the game. It's a very funny game when you know when you start you have to lose. See, a dog doesn't have to do that. We know from the start we can't win.

Somebody right said that the law of thermodynamics ought to be restated. You can't win, you must lose, and you can't get out of the game. So we all face this ultimate difficulty, but once you've accepted the limitations, you've got the problem how to get through your allot and expand reasonably well, and I don't think that's that hard to figure out because if you do pretty well, considering what you started with and so forth, and you stand at the end and you've done incredibly, you've helped other people who needed help because you had the capacity and intelligence to do it and so on, and so on. Set a reasonable example. It's a pretty good thing to do and it's quite interesting and the difficulties make it interesting.

And something else happens that is really weird. We were talking about, in our director's meeting that preceded this meeting, you always get glitches in something as complicated as a new software program going into a big new area, and you suddenly have reverses and troubles and you're scrambling. And what I said is that I've noticed in a long lifetime that the people who really love you are the people where you scramble together with difficulty and you've jointly gotten through, and in the end those people will love you more than somebody who's just shared in an even prosperity through the whole thing.

So, this adversity that seems so awful when you're scrambling through it actually is the [unintelligible] of your success, your affection, every other damn thing, and if you didn't have the adversity you wouldn't have the bonds which are so useful in life that are going to come from handling adversity well. The idea that life is a series of adversities and each one is an opportunity to behave well instead of badly is a very, very, good idea, and I certainly recommend it to everybody in the room, and it works so well in old age because you get so many adversities you can't fix, so you better have some technique for welcoming those adversities.

SHAREE:

Hi, Charlie. My name is Sharee. You tell somehow one should situate themselves in a way where they can deal with a 50 percent downturn in a portfolio. For investor forming a partnership in

today's competitive market, focus concentrating in those few and rare wonderful opportunities, do you believe that the 0/6/25 high watermark fees structure that the Buffett Partnership popularized is the fairest structure for both limited partners and the manager themselves? And could you also touch upon what fee structure you employed during your partnership? Thank you.

CHARLIE MUNGER:

Well, I did copy the Buffett formula more or less, and I do think it's fair, and I think it's still fair, and I'm looking at Mohnish who still uses it. I think it is fair and I wish it was more common. I basically don't like it where businesses are scraping it off the top. If you're advising other people, you ought to be pretty rich pretty soon. Why would I take a lot of advice from somebody who couldn't himself get pretty rich pretty soon? And if you're pretty rich, why shouldn't you put your money alongside your investors and grow up and down with them. And if there's a bad stretch, why should you scrape money off the top when they're going down and up? So I like the Buffett system, but it's like so many things I like, it's not spreading very much. My net influence in the world, even Warren's, has been pretty small. Imagine how much copying we have in our executive compensation methods. It's about three examples. Yes, I think it's a fine system.

MALE SPEAKER:

Hello. You spoke earlier about natural gas and the shipping of natural gas and that activity...

CHARLIE MUNGER:

If I were running the world as a benign despot, I wouldn't be shipping any natural gas outside of the United States.

MALE SPEAKER:

So, to tap into that view, you've been active in two states that are big in agriculture, Nebraska and California produce. What are your thoughts on the ag industry specifically tied to subsidies, all that stuff? I would think you'd view it as outdated and maybe it's threatening a lot of resources, maybe just inefficient and based on past metals. What's your thought on ag and subsidies?

CHARLIE MUNGER:

Well, the interesting thing about agriculture is what's happened in my lifetime, which is the productivity of naked land has gone up about 300 percent, and if it weren't for that there would be a lot of starvation on earth. So, the ag system is one of the most interesting things that has happened in the last 60 or 70 years, and we literally tripled the [unintelligible] of land and we did it all over the world, and there was just a few people who did it, the Rockefellers, Borlaug, and so forth. It was one of the most remarkable things in the whole history of the earth and we need another doubling, and we're probably going to get it and it's absolutely incredible how well we've done, and it's amazing how efficient our farmers are.

We don't have much socialization in farming. We've got a bunch of people who own the farms and manage them themselves. There's not much waste and stupidity in farming. Now people complain that we're using up the topsoil, which I think we are, and I think that's more of a mistake. I would fix that if I were a benign despot, but leaving aside using up the topsoil up too fast, I think farming is one of the glories of civilization, so I think it's been wonderful what's happened in farming.

Now in terms of subsidies, it matters to the farmers where they get their subsidies, and there's no question about the fact that we've protected our farmers with subsidies, and the farmers we're protecting are getting richer and richer because the farms are owned by fewer and fewer people, own more and more acres per person. So, it's very peculiar that we're subsidizing people who are already filthy rich, to use up our topsoil a little faster and create stuff which we turn into ethanol, which is one of the stupidest ideas the world ever...you know, I'm a specialist in stupid ideas, but I would say turning corn into gasoline is about as stupid an idea.

I would almost rather jump out of a 20-story building and think I could fly than turn daggamit corn into motor fuel, it's really stupid, and yet that's what our politics does. I've got no cure for the stupidity of politics. If I did the world it would be quite different, but I think that's pretty minor whether we have subsidies or not. The main thing that's happening that has enabled the present population of the world to stay alive is this agricultural revolution, and this very good management of our farmlands, and the improving agricultural standards in the rest of the world, and it's gone on quietly that we haven't even noticed it hardly.

How many of you are just deeply aware of the fact that grain per acre has gone up by 3 or 4 hundred percent? That's a huge stunt. And by the way, if you take those marigold seeds and don't use hydrocarbons, the yields are lousy. We're feeding ourselves because we don't know how to turn oil into food. That's one of the reasons I want to hold onto the oil. Something that can be turned into food is quite basic, and so I don't mind conserving the oil instead of producing every last drop as fast as one can. It's odd that my idea hasn't spread to more of the people. I may have three or four other people who agree with me in this room, but you're a bunch of admirers, in the rest of the world I'm all alone.

MALE SPEAKER:

Hello, Charlie. Thank you for mentoring us. My question is this. You talked about emotions, you talked about discipline, and you talked about facing adversity. Can you flesh out more about the spiritual side of this, about how do you deal with it to pass up adversity with dealing with the struggles and ultimately life? Yeah.

CHARLIE MUNGER:

Well, just because you don't have a specific theology and I don't...you know, when I was a little kid and my grandfather sent me to bible school and they told me there was a talking snake in the Garden of Eden, I was very young, but I didn't believe them and I haven't changed. It doesn't mean I am not spiritual. I just don't need a talking snake to make me

behave well, and I would say that the idea that came down to me, partly through my family, was that rationality is a moral duty. If you're capable of being reasonable, it's a moral failure to be unreasonable when you have the capacity to be reasonable. I think that's a hair shirt that we should all take on, even if we're pretty stupid because it's good to be less stupid.

So I think rationality is a moral duty and we all have a duty to get better, and of course we also have to adjust to the other people who we're going through our journey with. I think it would be crazy not to have a social safety net when you're as rich and successful as we are. Now I don't think it has to be as dumb as the one we have, but of course we need a solid social safety net and that's a moral idea. So I'm all for morality without the talking snakes.

GERRY:

We're going to take two or three more questions and then I think Charlie will be here immediately after. And we have copies of two of Charlie's writings. I think we made 400 copies and they would be available on your way out. And also you probably...

CHARLIE MUNGER:

I was cleaning out my office because we're moving and we just found these damn things, and [unintelligible] coming up from India and China. I gave them my old things. I haven't even read them in years and years, so I'm just revisiting some of my past screens.

DAVID:

Mr. Munger, Berkshire is the largest shareholder of Phillips 66, and Phillips 66 owns a general partner and limited partner stakes in two different MLPs. I was wondering what your thoughts are on the Master Limited Partnership structure in industry? And also, I was wondering if you have any preliminary thoughts on the proposed border adjustment tax.

CHARLIE MUNGER:

Well, let me take the last question first. David, we do not know what the border adjustment tax is. I don't think the people who are proposing it know what it is, and I don't think Trump and the Republicans in Congress have agreed on anything. So I think we're just talking about... but do I think that some people rewriting the tax system might be a very good idea? The answer is yes. Do I think we should rely on consumption tax more? The answer is yes. Do I really care if somebody piles up a lot of money and leaves it to some foundation? That's not my idea of a big evil. If they do want to live high on their private airplanes and their 300 dollar dinner checks, I'm all for taxing the people who are living high. So I like the idea of bigger consumption taxes, and I think there's a lot to be said for a different kind of a tax structure.

MALE SPEAKER:

Hi, Mr. Munger. You highlighted this idea of deferred gratification a lot today, and I just wanted to get your thoughts on what areas and aspects of life is it most valuable, and where should you not be [unintelligible] should you enjoy things now versus when you should just grind away and invest in the future? Thanks.

CHARLIE MUNGER:

Well, I don't think you should use up your body by being stupid in handling it, and I don't think you should be stupid in handling your money either, and I think there are a lot of things where the only way to win is to work a long time towards a goal that doesn't come easily. Imagine becoming a doctor. That is a long grind, all those night shifts in the hospital and so and so on, it's deferred gratification, but it's a very honorable activity, being a doctor, and by and large our doctors are very nice people and they've been through a lot. So, I tend to admire the life of a doctor more than I admire the life of a derivatives trader and I hope all of you do too, and I think deferred gratification in the way our doctors behave is a very good thing for all the rest of us.

MALE SPEAKER:

I had a very general question about the Circle of Competence. How do you know its limit and does it get redrawn from time to time, you think you know something and then you don't? Does it always expand or does it contract?

CHARLIE MUNGER:

Well of course, you know some things that aren't so. Of course if you're dealing with a complex system, the rules of thumb that worked in the complex system in year one may not work in year 40, so in both cases it's hard. The laws of physics you can count on, but the rules of thumb in a complex civilization changes as the civilization changes, and so you have to live with both kinds of uncertainty and you have to work longer. It's not a bad thing. It's interesting. We're all the same here...who would want to live in a state of sameness? You might as well be dead.