Sampling the Breakfast Buffett at NAPFA

By Editor Test *Thu, Nov 8, 2012*

At the 2012 NAPFA East conference in Baltimore this week, Warren Buffett biographer Alice Schroeder identified the next big growth industries. Attendees seemed to need some post-election tonic.

It's safe to say that most if not all of the advisors attending the NAPFA East conference in Baltimore admire Warren Buffett, the "Oracle of Omaha." So when Buffett biographer Alice Schroeder rose to give the first keynote address Wednesday morning, the Hilton ballroom grew hushed.

Schroeder shared her insights into Buffett's investing style, and I'll relate those comments in a moment. First, let me pass along Schroeder's investment tips.

"The great growth industry of the 21st century will involve risk management and risk mitigation," she said. "I don't mean derivatives. I mean insurance. I mean esoteric businesses like staffing companies—businesses that take the risk of having employees off of other companies' balance sheets. Risks are going to grow, but the sophistication of handling risks will grow even faster.

"The second big trend, and one that's underrated by economists, is what's happening in the digital scientific world. If you hang with West Coast venture capitalists, you will find out that all of us will soon have 3-D printers that will let us do things like design our own shoes and make them at home. Someone has already designed an artificial intelligence doctor that diagnoses more accurately than a human doctor.

"You should be short 'stuff,' she said. "Be short on the people who make Hummel china, and the stores that retail that kind of stuff. The generation behind us, those who are 35 and under, they don't want stuff. They don't want antiques or art. Younger people have digital collections, like photographs, apps, games, and they want disposable furniture and clothes. Just as our 19th century robber barons hauled old stuff back from Europe, people in Shanghai will be carting home old stuff from the U.S. Your grandmother's good china will be going to China."

'Warren likes cash'

Getting back to Buffett: I haven't read Schroeder's bestseller about the great investor, "The Snowball: Warren Buffet and the Business of Life" (Bantam, 2008). So I can't say if it improved on Roger Lowenstein's masterpiece, "Buffett: The Making of an American Capitalist," (Random House, 1995) which revealed how Buffett had a huge cash hoard when the DJIA dropped to 577 at the end of 1974, and took full advantage of what turned out to be historic bargains.

But Buffett clearly allowed Schroeder almost unlimited access for this authorized biography, so she had ample opportunity to observe him up close. She described his ability to shut out distractions, his brown-on-brown corner office like the "inside of a cuckoo clock," his belief that "valuation is the ultimate protection against risk" and that "you don't have to worry about the future if you don't overpay for an asset."

What impressed Schroeder most was Buffett's attitude toward cash. Her conclusions were consistent with Lowenstein's.

"Most money managers are under pressure not to hold cash, because it doesn't earn anything. But Warren likes cash. He likes having it around him. He would bathe in cash. He thinks of cash as a call option on every asset class, with no strike price and no expiration date. The premium for the option might be high or low, depending on the interest rate, but that doesn't matter to him.

"Berkshire Hathaway currently has $47 billion in cash, and Warren feels like he has a huge cash option on whatever happens in the economy. Everyone wants to know where the economy is headed. But an investor's real goal, he thinks, is to exempt yourself from it and make it not matter. He wants to be in a position to take advantage of any economy. He never wants to feel like he's corralled. He's the only person I ever knew who has thought about cash in quite that way."

Election hangover

Schroeder's upbeat attitude was just the tonic that NAPFA advisors seemed to need Wednesday morning. Judging by a random sampling of opinions, few of them were celebrating the Obama victory. The people I spoke to would rather have watched the bubble economy deflate than see it kept afloat with stimulus and bailouts that, they bleakly suspect, will lead to higher taxes, inflation and slower growth.

And then, of course, there's the buzz-killing fiscal cliff, "sequestration" and the expiration of the Bush tax cuts.

One advisor was thumbing through the e-mail on his smartphone screen and sipping his first coffee of the day. I asked him to tell me the most pressing issue on his mind, investment-wise, given that the Democrats had retained the presidency and the Republicans still dominated the House.

His biggest challenge, he said, will be to protect his clients from the impact of the coming inflation. The trillion-plus dollars sitting in excess bank reserves at the Fed will eventually be loaned out, he believes, and inflation will follow.

What about bonds, I wanted to know. When bondholders start demanding better returns on government debt, he said, the prices of existing bonds will fall. Boomers' savings will evaporate just as the cost of living soars. And prices will inevitably soar, he said, because the Chinese will soon be paying their workers much more and passing the costs on to us.

For inflation protection, he has adopted what he calls a "Depression era strategy." He's begun recommending utilities to his clients. More specifically: he likes those trendy master limited partnerships that own gas transmission lines.

But wait. If the Great Depression was characterized by deflation, I asked, why use a Depression strategy against inflation? "Do you remember the '70s?" he asked rhetorically. He expects a return of *stagflation*, that limbo of rising energy costs and falling corporate profits that made the 1970s a dead zone for equity investors.

The most, or I should say, the only positive note that I heard about the election outcome was sounded by an advisor from Rochester, N.Y., who seemed to be glad that the Affordable Care Act won't be repealed. It will make it easier for some of her clients to retire before age 65, she said, because the universal mandate will make individual health insurance policies cheaper.

Of course, we may never know just how painful it would have been to let the financial crisis run its course, and to let the zombie banks and inefficient automakers die a more or less natural death. I imagine that the Oracle of Omaha, with his $47 billion war chest, would have emerged from the wreckage that much richer.