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Our Performance in 1968

Everyone makes mistakes.

At the beginning of 1968, I felt prospects for BPL performance looked poorer than at any time in our history. However, due in considerable measure to one simple but sound idea whose time had come (investment ideas, like women are often more exciting than punctual), we recorded an overall gain of $40,032,691.

Naturally, you all possess sufficient intellectual purity to dismiss the dollar result and demand an accounting of performance relative to the Dow-Jones Industrial Average. We established a new mark at plus 58.8% versus an overall plus 7.7 % for the Dow, including dividends which would have been received through ownership of the Average throughout the year. This result should be treated as a freak like picking up thirteen spades in a bridge game. You bid the slam, make it look modest, pocket the money and then get back to work on the part scores. We will also have our share of hands when we go set.

The following summarizes the year-by-year performance of the Dow, the Partnership before allocation (one quarter of the excess over 6%) to the General Partner and the results for limited partners:

Year	Overall Results From Dow (1)	Partnership Results (2)	Limited Partners' Results (3)
1957	-8.4%	10.4%	9.3%
1958	38.5%	40.9%	32.2%
1959	20.0%	25.9%	20.9%
1960	-6.2%	22.8%	18.6%
1961	22.4%	45.9%	35.9%
1962	-7.6%	13.9%	11.9%
1963	20.6%	38.7%	30.5%
1964	18.7%	27.8%	22.3%
1965	14.2%	47.2%	36.9%
1966	-15.6%	20.4%	16.8%
1967	19.0%	35.9%	28.4%
1968	7.7%	58.8%	45.6%

(1) Based on yearly changes in the value of the Dow plus dividends that would have been received through ownership of the Dow during that year. The table includes all complete years of Partnership activity.

(2) For 1957-61 consists of combined results of all predecessor limited partnerships operating throughout the entire year after all expenses, but before distributions to partners or allocations to the General Partner.

(3) For 1957-61 computed on the basis of the preceding column of Partnership results allowing for allocation to the General Partner based upon the present Partnership Agreement, but before monthly withdrawals by limited partners.

On a cumulative or compounded basis, the results are:

Year	**Overall Results From Dow**	**Partnership Results**	**Limited Partners' Results**
1957	-8.4%	10.4%	9.3%
1957 – 58	26.9%	55.6%	44.5%
1957 – 59	52.3%	95.9%	74.7%
1957 – 60	42.9%	140.6%	107.2%
1957 – 61	74.9%	251.0%	181.6%
1957 – 62	61.6%	299.8%	215.1%
1957 – 63	95.1%	454.5%	311.2%
1957 – 64	131.3%	608.7%	402.9%
1957 – 65	164.1%	943.2%	588.5%
1957 – 66	122.9%	1156.0%	704.2%
1957 – 67	165.3%	1606.9%	932.6%
1957 – 68	185.7%	2610.6%	1403.5%
Annual Compounded Rate	**9.1%**	**31.6%**	**25.3%**

Investment Companies

On the following page is the usual tabulation showing the results of what were the two largest mutual funds (they stood at the top in size from 1957 through 1966 - they are still number two and three) that follow a policy of being, typically, 95 -100% invested in common stocks, and the two largest diversified closed-end investment companies.

Year	Mass. Inv. Trust (1)	Investors Stock (1)	Lehman (2)	Tri-Cont (2)	Dow	Limited Partners
1957	-11.4%	-12.4%	-11.4%	-2.4%	-8.4%	9.3%
1958	42.7%	47.5%	40.8%	33.2%	38.5%	32.2%
1959	9.0%	10.3%	8.1%	8.4%	20.0%	20.9%
1960	-1.0%	-0.6%	2.5%	2.8%	-6.2%	18.6%
1961	25.6%	24.9%	23.6%	22.5%	22.4%	35.9%
1962	-9.8%	-13.4%	-14.4%	-10.0%	-7.6%	11.9%
1963	20.0%	16.5%	23.7%	18.3%	20.6%	30.5%
1964	15.9%	14.3%	13.6%	12.6%	18.7%	22.3%
1965	10.2%	9.8%	19.0%	10.7%	14.2%	36.9%
1966	-7.7%	-10.0%	-2.6%	-6.9%	-15.6%	16.8%
1967	20.0%	22.8%	28.0%	25.4%	19.0%	28.4%
1968	10.3%	8.1%	6.7%	6.8%	7.7%	45.6%
Cumulative Results	**189.3%**	**167.7%**	**225.6%**	**200.2%**	**185.7%**	**1403.5%**
Annual Compounded Rate	**9.3%**	**8.6%**	**10.3%**	**9.6%**	**9.1%**	**25.3%**

(1) Computed from changes in asset value plus any distributions to holders of record during year.
(2) From 1968 Moody's Bank & Finance Manual for 1957-1967. Estimated for 1968.

It is interesting that after twelve years these four funds (which presently aggregate well over $5 billion and account for over 10% of the investment company industry) have averaged only a fraction of one percentage point annually better than the Dow.

Some of the so-called “go-go” funds have recently been re-christened “no-go” funds. For example, Gerald Tsai's Manhattan Fund, perhaps the world's best-known aggressive investment vehicle, came in at minus 6.9% for 1968. Many smaller investment entities continued to substantially outperform the general market in 1968, but in nothing like the quantities of 1966 and 1967.

The investment management business, which I used to severely chastise in this section for excessive lethargy, has now swung in many quarters to acute hypertension. One investment manager, representing an organization (with an old established name you would recognize) handling mutual funds aggregating well over $1 billion, said upon launching a new advisory service in 1968:

“The complexities of national and international economics make money management a full-time job. A good money manager cannot maintain a study of securities on a week-by-week or even a day-by-day basis. Securities must be studied in a minute-by-minute program.”

Wow!

This sort of stuff makes me feel guilty when I go out for a Pepsi. When practiced by large and increasing numbers of highly motivated people with huge amounts of money on a limited quantity of suitable securities, the result becomes highly unpredictable. In some ways it is fascinating to watch and in other ways it is appalling.

Analysis of 1968 Results

All four main categories of our investment operation worked out well in 1968. Our total overall gain of $40,032,691 was divided as follows:

Category	**Average Investment**	**Overall Gain**
Controls	$24,996,998	$5,886,109
Generals – Private Owner	$16,363,100	$21,994,736
Generals – Relatively Undervalued	$8,766,878	$4,271,825
Workouts	$18,980,602	$7,317,128
Miscellaneous, primarily US Treasury Bills	$12,744,973	$839,496
Total Income		$40,309,294
Less – General Expense, including Interest		$276,603
Overall Gain		$40,032,691

A few caveats, as mentioned in my letter two years ago, are again in order (non-doctoral candidates may proceed to next section):

1. An explanation of the various categories listed above was made in the January 18, 1965 letter. If your memory needs refreshing and your favorite newsstand does not have the pocketbook edition. We'll be glad to give you a copy.

2. The classifications are not iron clad. Nothing is changed retroactively, but the initial decision as to category is sometimes arbitrary. Sometimes later classification proves difficult; e.g. a workout that falls through but that I continue to hold for reasons unrelated or only partially related to the original decision (like stubbornness).

3. Percentage returns calculated on the average investment base by category would be significantly understated relative to Partnership percentage returns which are calculated on a beginning investment base. In the foregoing figures, a security purchased by us at 100 on January 1 which appreciated at an even rate to 200 on December 31 would have an average investment of 150 producing a 66-2/3% result contrasted to a 100% result by the customary approach. In other words, the foregoing figures use a monthly average of market values in calculating the average investment.

4. All results are based on a 100% ownership, non-leverage basis. Interest and other general expenses are deducted from total performance and not segregated by category. Expenses directly related to specific investment operations, such as dividends paid on short stock, are

deducted by category. When securities are borrowed directly and sold short, the net investment (longs minus shorts) is shown for the applicable category's average investment.

5. The foregoing table has only limited use. The results applicable to each category are dominated by one or two investments. They do not represent a collection of great quantities of stable data (mortality rates of all American males or something of the sort) from which conclusions can be drawn and projections made. Instead, they represent infrequent, non-homogeneous phenomena leading to very tentative suggestions regarding various courses of action and are so used by us.

6. Finally, these calculations are not made with the same loving care we apply to counting the money and are subject to possible clerical or mathematical error since they are not entirely se1f-checking.

Controls

Overall, the controlled companies turned in a decent performance during 1968. Diversified Retailing Company Inc. (80% owned) and Berkshire Hathaway Inc. (70% owned) had combined after-tax earnings of over $5 million.

Particularly outstanding performances were turned in by Associated Cotton Shops, a subsidiary of DRC run by Ben Rosner, and National Indemnity Company, a subsidiary of B-H run by Jack Ringwalt. Both of these companies earned about 20% on capital employed in their businesses. Among Fortune's “500” (the largest manufacturing entities in the country, starting with General Motors), only 37 companies achieved this figure in 1967, and our boys outshone such mildly better-known (but not better appreciated) companies as IBM, General Electric, General Motors, Procter & Gamble, DuPont, Control Data, Hewlett-Packard, etc...

I still sometimes get comments from partners like: "Say, Berkshire is up four points - that's great!" or "What's happening to us, Berkshire was down three last week?" Market price is irrelevant to us in the valuation of our controlling interests. We valued B-H at 25 at yearend 1967 when the market was about 20 and 31 at yearend 1968 when the market was about 37. We would have done the same thing if the markets had been 15 and 50 respectively. ("Price is what you pay. value is what you get"). We will prosper or suffer in controlled investments in relation to the operating performances of our businesses - we will not attempt to profit by playing various games in the securities markets.

Generals -Private Owner

Over the years this has been our best category, measured by average return, and has also maintained by far the best percentage of profitable transactions. This approach was the way I was taught the business, and it formerly accounted for a large proportion of all our investment ideas. Our total individual profits in this category during the twelve year BPL history are probably fifty times or more our total losses. The cash register really rang on one simple industry idea (implemented in several ways) in this area in 1968. We even received a substantial fee (included in Other Income in the audit) for some work in this field.

Our total investment in this category (which is where I feel by far the greatest certainty regarding consistently decent results) is presently under $2 million and I have nothing at all in the hopper to bolster this. What came through like the Johnstown flood in 1968 looks more like a leaky faucet in Altoona for 1969.

Generals - Relatively Undervalued

This category produced about two-thirds of the overall gain in 1966 and 1967 combined. I mentioned last year that the great two-year performance here had largely come from one idea. I also said, "We have nothing in this group remotely approaching the size or potential which formerly existed in this investment." It gives me great pleasure to announce that this statement was absolutely correct. It gives me somewhat less pleasure to announce that it must be repeated this year.

Workouts

This category, which was a disaster in 1967, did well during 1968. Our relatively heavy concentration in just a few situations per year (some of the large arbitrage houses may become involved in fifty or more workouts per annum) gives more variation in yearly results than an across-the-board approach. I feel the average profitability will be as good with our policy and 1968 makes me feel better about that conclusion than 1967 did.

It should again be stated that our results in the Workout area (as well as in other categories) are somewhat understated compared to the more common method of determining results computed on an initial base figure and utilizing borrowed money (which is often a sensible part of the Workout business).

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I can't emphasize too strongly that the quality and quantity of ideas is presently at an all time low - the product of the factors mentioned in my October 9th, 1967 letter, which have largely been intensified since then.

Sometimes I feel we should have a plaque in our office like the one at the headquarters of Texas Instruments in Dallas which reads: “We don't believe in miracles, we rely on them.” It is possible for an old, overweight ball player, whose legs and batting eye are gone, to tag a fast ball on the nose for a pinch-hit home run, but you don't change your line-up because of it.

We have a number of important negatives operating on our future and, while they shouldn't add up to futility, they certainly don't add up to more than an average of quite moderate profitability.

Memorabilia

As one of my older friends says, “Nostalgia just isn't what it used to be.” Let's take a stab at it, anyway.

Buffett Associates, Ltd., the initial predecessor partnership, was formed May 5, 1956 with seven limited partners (four family, three close friends), contributing $105,000, and the General Partner putting his money where his mouth was by investing $100. Two additional single-family limited partnerships were formed during 1956, so that on January 1, 1957 combined net assets were $303,726. During 1957, we had a gain of $31,615.97, leading to the 10.4% figure shown on page one. During 1968 I would guess that the New York Stock Exchange was open around 1,200 hours, giving us a gain of about $33,000 per hour (sort of makes you wish they had stayed with the 5-1/2 hour, 5 day week, doesn't it), or roughly the same as the full year gain in 1957.

On January 1, 1962 we consolidated the predecessor limited partnerships moved out of the bedroom and hired our first full-time employees. Net assets at that time were $7,178,500. From that point to our present net assets of $104,429,431 we have added one person to the payroll. Since 1963 (Assets $9,405,400) rent has gone from $3,947 to $5,823 (Ben Rosner would never have forgiven me if I had signed a percentage lease) travel from $3,206 to $3,603, and dues and subscriptions from $900 to $994. If one of Parkinson's Laws is operating, at least the situation hasn't gotten completely out of control.

In making our retrospective survey of our financial assets, our conclusion need not parallel that of Gypsy Rose Lee who opined, when reviewing her physical assets on her fifty-fifth birthday: “I have everything I had twenty years ago - it's just that it's all lower.”

Miscellaneous

Although the investment environment is difficult, the office environment is superb. With Donna, Gladys, Bill and John, we have an organization that functions speedily, efficiently and pleasantly. They are the best.

The office group, along with spouses (one apiece - I still haven't figured out how I should handle that plural) and children have over $27 million invested in BPL on January 1, 1969. Assorted sizes and shapes of aunts, uncles, parents, in-laws, brothers, sisters and cousins make the BPL membership list read like “Our Crowd” - which, so far as I am concerned, is exactly what it is.

Within a few days, you will receive:

1. A tax letter giving you all BPL information needed for your 1968 federal income tax return. This letter is the only item that counts for tax purposes.

2. An audit from Peat Marwick. Mitchell & Co. (they have again done an excellent job) for 1968, setting forth the operations and financial position of BPL, as well as your own capital account.

3. A letter signed by me setting forth the status of your BPL interest on January 1, 1969. This is identical with the figures developed in the audit.

Let me know if anything in this letter or that occurs during the year needs clarifying. My next letter will be about July 10th, summarizing the first half of this year.

Cordially,
Warren E. Buffett