UNDERSTANDING INVESTMENTS

A FEW MINUTES AT A TIME

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INTRODUCTION

This book is written in deliberately short, independent summaries of many different topics. It is easy to read for a few minutes at a time.

When I began writing, I intended to keep my personal investment strategies completely out of this book in order to present an unbiased view of the general concepts. After much reflection, in consideration of their value to me, I decided to share them with you. On the next page, I offer a brief outline of my strategy. Please always keep in mind that there is no one right strategy.

Most importantly, I hope this book will help you make investments in a strategy best suited for you and your personal situation.

In order to protect yourself from common but costly errors, even if you have a professional adviser, you need to understand the basic concepts. In order to manage your own portfolio or have an in depth strategy discussion, you really need a thorough understanding of the advanced concepts.

Chapters 1 through 7 of this book cover basic concepts. That does not necessarily mean they are simple or that you'll grasp them on the first pass. It means that if you aren't familiar with these concepts, you are putting yourself at a significant disadvantage.

An advisor can assist you in investing and financial planning, and as an advisor I certainly ascribe value to those services. It's not enough for you to trust your advisor. You need to know why you can trust your advisor, and it will serve you well to maintain a regular dialogue. These concepts will help you develop the terminology that is a prerequisite to a deeper understanding.

Chapters 8 through 13 cover more advanced concepts for the investor who wants to understand the tactics of portfolio management or manage their own portfolio. It is worth your time to learn these advanced concepts, at least well enough to make certain your advisor knows them. No matter how smart you are, if investment management isn't something you personally enjoy, taking charge of your own portfolio is probably a bad idea. I find it fascinating and enjoyable, and I am fortunate to work in this business.

MY INVESTMENT STRATEGY: CORE CONCEPTS

- ***Value investing:*** It is the responsibility of every investor to analyze and understand not only the business in which he invests but to also have an understanding of the approximate value of each investment in public and private terms (liquid and illiquid).

- ***Reduce uncertainty:*** Most valuation methodologies underestimate the impact of uncertainty or, even worse, confuse uncertainty with risk and reward. I divide this into three themes:

1) I have confidence in the ability of executives to earn a profit given a reasonably clear operating environment. Uncertainty exponentially complicates this task, and the best sight lines are limited. In addition, other factors change: government policy, labor issues, inflation, currency exchange, new technology, or commodity prices can wreak havoc on the best laid business plans.

2) It is critical to know what we don't know. Warren Buffet put it this way: "No one has the ability to evaluate every investment possibility. But omniscience isn't necessary; you only need to understand the actions you take."[1]

3) Prudence dictates that we always operate with a margin of safety.

Limit volatility: By reducing fluctuations in the market value of our investments, we exploit two major advantages:

- The lower our portfolio's volatility, the lesser the difference is between its compounded annual growth rate (geometric mean) and its average return (arithmetic mean). See Chapter 8.

In down markets, lower volatility preserves more capital for new investments at lower prices. The same applies in reverse. The portfolio will respond more slowly to rapid gains. During up markets, I'm less interested in new investments. Value investors desire to buy low and sell high.

http://www.berkshirehathaway.com/letters/1987.html