LAMCO
LAMCO ADVISORY SERVICES, INC.

Investor Insight

MAY 19 | 2014

Why Critics of Warren Buffet Are Wrong

by Mark Lamoriello, President/Chief Investment Officer

So has Warren Buffett lost his touch? Is he the financial world's equivalent of Brett Favre, who hung on just a little too long? If you read Jeff Sommer's NY Times article, "*The Oracle of Omaha, Lately Looking a Bit Ordinary*", you may get that impression. Using data from statistician Salil Mehta, he discusses Buffett's recent underperformance. *"In four of the last five years, he has underperformed his own benchmark, the S&P 500 with dividends, often by significant margins. In addition, data provided by Morningstar shows that he underperformed the average stock mutual fund in four of the five years."*

This is not the first time that Mr. Buffett's performance has been called into question. In an aptly titled Barron's cover article *"What's Wrong, Warren"* (December 27, 1999) Andrew Bary opines that *"After more than 30 years of unrivaled investment success, Warren Buffett may be losing his magic touch."*

So what gives? How does an investor who has consistently demonstrated superior skill find that very same skill questioned by two major publications.

It's Fundamental

While each writer pontificated on the reasons for the underperformance (index fund superiority, ignoring tech stocks, clinging to underperforming stocks such as Coke, Gillette and American Express), neither really focused on the root cause of the problem; the market. That's right, it's not Warren's fault that the market stops making sense.

At any point in a market cycle, bolstered by investor enthusiasm, the value of an asset can become decoupled from the price someone is willing to pay for that asset. Tech stocks in the late nineties and real estate in the mid 2000's are two examples. In those environments, each incremental increase in price level was accompanied by greater and greater risk. Inevitably, the prices stopped going up. This provided seasoned professionals like Mr. Buffet an opportunity to profit from the misfortune of others as prices inevitably dropped below fair value.

Perception Plays an Important Role

Another factor to consider is that investors have been conditioned to consider their performance based on a calendar and relative to some benchmark (i.e., the "*Relative World*"). While such an exercise simplifies evaluation, it ignores the true absolute objective, to earn positive real returns over time (the "*Absolute World*"). In the Absolute World, investors have long time horizons. In the Relative World, long investment time horizons are replaced by patience horizons which are meaningfully shorter. Studies have shown that an investor will abandon a strategy after about 24 months if it is not delivering the expected performance.

In the Absolute World, investors focus on the real asset growth of their portfolio after inflation. In the Relative World, investors compare that performance with other investors and benchmarks to evaluate the success or failure of their strategy. In the Relative World, losing 10% can be considered successful if other investors and benchmarks lost more.

For a strategy such as Mr. Buffett's, a short investment horizon and relative comparisons are going to send mixed signals from time to time especially during irrational markets. As noted economist John Maynard Keynes stated, *"The market's can remain irrational, longer than you can remain solvent".* Investors who react to those signals are likely going to pay for the mistake. In reality, the only way to truly evaluate a strategy such as Mr. Buffett's is to evaluate the decisions that he made based on the information that he had available at that time.

Mr. Buffett rarely, if ever responds directly to these types of press inquiries. Doing so would, in some way, legitimize their content. So we will respond for him. To answer Mr. Bary's question, we constructed 2 portfolios. For both portfolios, the investor invested $500,000 in Berkshire Hathaway A (BRK.A) on January 1, 1999.

- *In **Portfolio A,** the investor remained invested in BRK.A.*
- *In **Portfolio B,** the investor liquidated BRK.A on 12/28/1999 (the day after the article was published) and purchased the Vanguard S&P 500 Index Fund.*

We compared both Investors to an Investor who purchased the S&P 500 Index Fund on January 1, 1999. The results are summarized below.

	Investor A	Investor B	S&P 500
Initial Investment	$500,000	$500,000	$500,000
Value on 12/27/1999	$381,429	$381,429	$600,208
Period Return 1/1/99 – 12/27/99	-23.71%	-23.71%	20.04%
Value on 3/31/2014	$1,340,727	$632,860	$996,357
Period Return 12/28/99 – 3/31/2014 [a]	9.21%	3.61%	3.61%
Total Return 1/1/99 – 3/31/2014 [a]	6.68%	1.56%	4.62%

In Summary

Successful investment strategies need to be considered in absolute terms and over the proper time horizon. While relative comparisons can help stimulate dialogue and discussion, this type of analysis is limited and can result in behavior which does more harm than good. This is a point both Mr. Sommer and Mr. Bary omit in their articles. Which investment strategy will be the best in the end? That is impossible to say. It would be like trying to predict the winner of a horse race without knowing where the finish line will be. To have a chance, however, you have to first pick a quality horse and avoid the temptation of switching horses in the middle of the race. ▪

Notes:

(a) *Annualized Returns*
(b) *This is not a solicitation or an offer to purchase or sell any security*
(c) *The analysis assumes the reinvestment of dividends and income and ignores any impact taxes may have.*
(d) *The performance of the S&P 500 Index Fund is net of 17 bps fee.*

For more information contact:

Lauren Bloom, Director of Business Development
lbloom@lamcogroup.com or call 407.585.1171

LAMCO Advisory Services, Inc.
1525 International Pkwy, Ste. 2071 ▪ Lake Mary, FL 32746

www.lamcoadvisory.com