12 Lessons on Money and More From Warren Buffett and Charlie Munger

Wisdom from two of the world's most successful investors.

Summarized by Haywood Kelly, CFA

Mentioned: Berkshire Hathaway Inc (BRK.A), Berkshire Hathaway Inc (BRK.B)
It's easy for me to make a list of ideas from Warren Buffett and his partner Charlie Munger at Berkshire Hathaway that have influenced my own thinking and that of my fellow Buffett-heads here at Morningstar. The hard thing is confining the list to only 12. But here goes.

1) Be Skeptical of Exotic Financial Instruments

Buffett and Munger have been consistent critics of derivatives, catastrophe bonds, crypto, and other types of financial "innovation." The way they run Berkshire Hathaway reflects this prudence. The company operates with very little debt and a large cushion of cash and investments, an approach that has influenced the way Morningstar manages its own balance sheet. The skepticism of Wall Street's creativity in new-product development has influenced our analysts over the years when faced with the latest and greatest product offering from asset managers or investment banks.

One of my favorite Buffett quotes is, "If you've been playing poker for a half an hour and you still don't know who the patsy is, you're the patsy." Unfortunately, the financial industry is chock-full of players eager to induce you to play the game on their terms, always with a hefty entry fee attached. To this day, I'll admit I've never bought or sold an option, shorted a stock, bought a triple-inverse-short ETF or 130/30 fund, dabbled in structured notes, or invested in a variable annuity. Simplicity is good. It certainly lowers costs.

2) Inflation Is Another Reason to Favor Moats

Until 2022, it had been easy to ignore inflation for about 40 years. But any student of Buffett's writings knows that inflation was a regular topic of his in the 1970s and early 1980s. What he emphasized then was the difficulty for companies, especially those most exposed to inflationary cost pressures, to earn decent returns for shareholders in a period of high inflation. Very few companies—those with strong economic moats—can raise prices to offset the erosion of purchasing power. This underlying pricing power is one reason we like wide-moat companies so much. They're better able to withstand what the macro environment throws their way. Now that inflation is back with a vengeance, it's a good time to reread Buffett's sobering inflation commentary.

3) Volatility Is Not Risk

My longtime boss at Morningstar was a Buffett and Munger fan, and the first words I ever heard out of her mouth were: "Beta is bullshit." (I knew then that Morningstar would be an interesting place to work.) Given that writing massive insurance policies is a significant part of Berkshire Hathaway's business, it's no surprise that risk has consumed a large part of Buffett's and Munger's attention. They have a very different conception of risk than academic finance and its emphasis on metrics like beta or standard deviation. Financial academics like using volatility as a proxy for risk (largely because it's so easy to measure), but that has the perverse effect of implying that an asset becomes riskier when it drops in price—the exact opposite of how a rational buyer thinks about a lower price. Risk, says Buffett, is the chance you suffer a permanent loss of capital. I've also appreciated that Buffett and Munger have consistently emphasized systemic and existential risks—for example, the risk that derivatives cause a series of financial institutions with interlocking exposures to collapse like dominoes, or the risk of nuclear war or biological infection (natural or otherwise). As investors and citizens, we need to acknowledge these risks and do what we can to minimize them.

4) Integrity Made Simple

Buffett famously said to the employees of Salomon Brothers when he stepped in to run the company in 1991: "Lose money for the firm, and I'll be understanding. Lose a shred of reputation for the firm, and I'll be ruthless." He also suggested the following as a guide to behavior: If you would be comfortable having your actions described in detail on the front page of your local newspaper, where your family and friends will read it, go ahead and do it. At Morningstar, we modified this to: Would you be comfortable with this appearing on page C1 of *The Wall Street Journal*?

5) Fund Boards Are Lap Dogs

That was Buffett's conclusion in his classic 2002 letter to shareholders, and it certainly jibes with what Morningstar has seen over the years. Despite their explicit role as guardians for fund shareholders, fund directors—even independent directors—rarely push back against fund managers, and almost never vote to fire the fund manager. Buffett criticized corporate boards for the same reason: Their culture of rubber-stamping what management or compensation consultants put in front of them. (He's even been critical of his own performance as a board member.) The lesson: Look for board members with business experience and skin in the game (in the form of meaningful ownership in the company they oversee), but even then don't expect much. Most important is that the management team and other employees have integrity (see previous point). Hoping that a board of directors, no matter how independent on paper, can effectively police a management team is a pipe dream.

6) In Investing, It's OK to Do Nothing

Buffett compared investing to a baseball hitter waiting for a fat pitch—a nice straight ball down the heart of the plate. But unlike in baseball, in investing you're not called out after three strikes. You can let as many pitches whiz past as you want. This concept of patience has influenced the way we rate stocks at Morningstar in that we have no minimum number of stocks we have to rate 5-stars; sometimes we have very few stocks we recommend. In my personal portfolio, I've never felt pressure to swing if I'm not comfortable. Letting cash pile up is fine. There will usually be a market correction at some point to bring prices down again to attractive levels.

7) Always Be Learning

Both Buffett and Munger are always reading, and Munger in particular emphasizes the importance of science—including an understanding of evolution—as essential for understanding what makes people tick. Many of my favorite books were Munger recommendations, including *Influence: The Psychology of Persuasion*, by Robert Cialdini, *The*

Selfish Gene by Richard Dawkins, and *Guns, Germs, and Steel* by Jared Diamond. Such eclecticism has always influenced the hiring philosophy at Morningstar. We'd much rather hire someone with intellectual curiosity than a narrow focus on finance. Munger once said, "You'd be amazed at how much Warren reads—at how much I read. My children laugh at me. They think I'm a book with a couple of legs sticking out."

8) The Markets Are Good, but Not Perfect

Having studied economics at the University of Chicago, I started my professional career with a firm faith in the wisdom of markets. Fortunately (at least in retrospect), my first job was analyzing Japanese stocks just as the bubble in Japanese asset prices, arguably the most egregious asset-price bubble in history, was bursting. It was an early lesson that sometimes markets go haywire—or more precisely, the people who make up markets go haywire and come to believe that trees grow to the sky. It's amusing now to think about it now, but serious people in the late 1980s and early 1990s concocted stories about why price/earnings ratios of 80 or 90, which were common in Japan at the time, were reasonable, or recommended allocating 30% or 40% of a portfolio to Japanese stocks because that offered the optimal mix of risk and reward. Reading Buffett and the kinds of books Buffett and Munger recommend, you come to internalize that while markets usually do a wonderful job of allocating capital, they're only as reliable as the (imperfect) humans making up the market.

9) Index Funds Are a Wonderful Invention

This may appear at odds with the previous point about imperfect markets, but it's actually not. Markets may sometimes go haywire, but it's still mighty hard to outperform them. When I started at Morningstar in 1991, it seemed the only fans of index funds were Jack Bogle, a few university professors, and a handful of academically minded financial advisors. Index funds made up a tiny percentage of overall fund assets. My, how things have changed. One might think Buffett—the quintessential active investor—would have been among the biggest detractors of index funds. I remember many Morningstar conferences at which active managers pooh-poohed index funds as un-American or as settling for mediocrity. (Most of these managers are long gone.) Buffett, by contrast, has consistently heaped praise on index funds as the best way for most investors to gain exposure to the stock market. He repeatedly singled out Bogle for special praise for launching the index revolution. Buffett showed that intellectually you can embrace both active and passive investing—it's not either/or.

10) No Good Investor Is Either "Value" or "Growth"

Munger famously helped induce Buffett to move beyond Ben Graham's cigar-butt-style of value investing (which consists of looking for stocks with one good puff left in them) and embrace great companies—even if it means paying higher prices for them. The key insight is that the worth of any company is a function of its growth prospects and how confident one can be that the growth will materialize. You shouldn't analyze a "value" company any differently than a "growth" company. While we popularized the distinction between growth and value with the Morningstar Style Box—and it is a helpful shorthand to see what kind of companies a particular fund manager favors—from the perspective of a stock investor, to think of value and growth as separate investing styles is a mistake.

11) What It Means to Win the Birth Lottery

The final two lessons apply to life in general and not just the little corner of life we spend investing. Buffett has emphasized how lucky he was to be born where he was (the United States) and when he was (the 20th century). Had he been born in another time and place, his somewhat specialized talents of company assessment would have been worthless. He's called this the birth lottery. It's a good reminder to all of us the role luck has played in our lives. If you're reading this, chances are you've been pretty darn lucky. I know I have.

12) The Key to Happiness

The key to a happy marriage isn't a beautiful spouse, smart kids, or pleasant conversation. No, say Buffett and Munger, the key to a happy marriage is finding someone with low expectations.

The same holds for reading articles like this one; I hope you clicked on it with sufficiently low expectations. And the same holds true for investment success. I make a habit of mentally lopping off 30% of whatever my portfolio value happens to be, simply because stuff happens. Generalizing this bit of wisdom, I'd suggest that low expectations are pretty much the best way to ensure a lack of regrets on one's deathbed. And the best way not to be disappointed after death, too!

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