ECONOMY

The Oracle of Omaha serves burgers and Coke

THINK STRATEGICALLY:

Warren Buffet's Annual Letter

BY FRANCISCO RODRÍGUEZ-CASTRO | frc@birlingcapital.com

The Oracle of Omaha Speaks, Investors Listen

This weekend, the most sought after and analyzed shareholder letter in the world, the one written by Berkshire Hathaway's Warren Buffet, was published.

In it Buffet, whose nickname is the Oracle of Omaha, reports that Berkshire Hathaway—which is trading near its all-time highs, having closed last week at $364,580—earned $42.5 billion in 2020, with operating earnings of $21.9 billion, $4.9 billion of realized capital gains, another $26.7 billion in unrealized capital gains, and included a write-down totaling $11 billion from the loss in the value of Precision Castparts (PCC).

"I paid too much for the company," Buffet said. I guess everyone is allowed to make an $11 billion mistake.

For Buffet, the operating earnings are what truly counts, and the focus is on increasing income and acquiring large and favorably situated businesses. As is evidenced in the report, Berkshire was unable to meet either goal last year as it made no significant acquisitions, while operating earnings fell 9 percent. However, Berkshire was able to take advantage of the pandemic and increased its per-share intrinsic value through a 5 percent stock repurchase plan and by retaining earnings.

Berkshire's holdings of marketable stocks at the end of 2020 were worth a whopping $281 billion, with a robust and diversified business portfolio.

A comparison of Berkshire Hathaway versus the S&P 500 stock market index follows:

Berkshire's performance in 2020, 2.4 percent; S&P 500, 18.4 percent

Berkshire's compound gain from 1965-2020, 20 percent; S&P 500, 10.2 percent.

Berkshire's overall gain 1965-2020, 2,810,325 percent versus the S&P, 23,454 percent

Buffet—who is considered the most successful investor in America and is a down-to-earth person with a unique, folksy demeanor—shared a story about a book by Phil Fisher on investing that he read in 1958. The book is superb. In it, Fisher makes a comparison between running a public company to managing a restaurant. He said that if you are seeking customers, "You can attract a clientele and prosper featuring either hamburgers served with a Coke or a French cuisine accompanied by exotic wines. But you must not switch from one to the other." The message to your potential customers has to be consistent with your offering and what they will find when they visit you.

Buffet closed by saying: "At Berkshire, we have been serving hamburgers and Coke for 56 years. We cherish the clientele this fare has attracted."

With the Dow Jones at 30,932.37 points this past week, we must remember the Oracle of Omaha's best investment advice ever: "Be greedy when others are fearful."

Week in Markets: Massive Government Bond Sell-off, Powell won't Raise Rates and Wall Street Falls

Last week, the U.S. stock market had the most extensive government bond sell-off in years, and investors were keenly focused on interest rates.

The sell-off spilled over to equities, forcing an increase in stock rotation as investors doubled down on buying the stocks most affected by the pandemic in place of those most benefited from the pandemic. The cruise ship industry is seeing robust gains, with Norwegian Cruise Line Holdings Ltd (NCLH) rising from $10.03 on March 27 to close at $29.58, an increase of 194 percent; and Royal Caribbean Group (RCL) going from $34.50 to close at $93.37, or 170 percent higher.

While the government bonds' yields are still meager from a historical perspective, yields have marched steadily higher over the last two months due to the prospects of a sustained economic recovery that accelerates rapidly.

The sell-off in U.S. Treasury bonds continued taking the yield on the 10-year Treasury note to 1.44 percent.

These rates are rising for a reason, and not a bad one at that. First, inflation is now at its highest level since 2013, and higher inflation expectations determine a rebound in economic activity.

Secondly, rates are just adjusting to where they were in February 2020, so as the market normalizes, it was about time these rates went back to where they were a year ago.

However, in his testimony to Congress last week, Federal Reserve Chairman Jerome Powell said: "The Fed expectation was not to raise interest rates from their current levels to allow the economy to reach full employment."

The Fed chair also said he was cautiously optimistic that "a return to more normal conditions would occur this year," and reaffirmed the bank's intention to continue its strong support of the U.S. economy.

At this juncture, good news for the economy is bad news for the market. This phenomenon often occurs at the end of multiyear expansions, as robust economic data change expectations for Fed policy. Unlike now, when the Fed has stated that interest rates will not rise, short-term rates tend to increase in other circumstances.

What should investors expect?

The economic growth outlook has improved during the last 60 days, and the much-alluded-to V-shaped recovery is looking like it may materialize.

President Biden's $1.9 trillion bazooka stimulus package will hit the economy as massive vaccine distribution takes shape and can take the economy into ludicrous growth mode.

U.S. GDP is forecast to rise to $23.97 trillion, up from $23.84 trillion, or 0.51 percent, from last quarter. The GDP could grow at its fastest rate in 35 years, exceeding 5 percent.

Stock sector rotation will create volatility, but the outlook remains relatively bright.

The overall outlook and sentiment remain positive, supported by fiscal stimulus, low-interest rates, a massive vaccine distribution effort that now includes a one-dose fourth vaccine, and robust corporate-earnings trends. Good news for the economy will likely continue to be good news for the markets for a while longer.

In conclusion, as the economy normalizes, investors are in for quite a ride; however, these rides are full of buying opportunities that translate into outsize profits.

The Final Word: Oversight Board's Plan Support Agreement

The Financial Oversight and Management Board for Puerto Rico announced a new plan of adjustment for the public debt, reducing $18.8 billion by 61 percent, to $7.4 billion; and reducing debt service payments to $1.15 billion a year. The new agreement is with general obligation (GO) and Public Buildings Authority (PBA) bondholders.

- It Reduces $18.8 billion of commonwealth debt held by GO and PBA bondholders by 61 percent, to $7.4 billion.
- Reduces total debt service payments by 62 percent, from $90.4 billion under the original contractual debt agreements before the Puerto Rico Oversight, Management and Economic Stability Act (Promesa) came into force, to $34.1 billion under the new debt restructuring agreement.

In our view, the new agreement places Puerto Rico in a more favorable financial position and would allow the island to emerge from bankruptcy sooner than anticipated. The plan will allow Puerto Rico to resolve its insolvency once and for all. This is a plan that must be respected and supported.

Weekly Market Close Comparison	2/26/21	2/19/21	Return	YTD
Dow Jones Industrial Average	30,932.37	31,494.32	-1.78%	1.06%
Standard & Poor's 500	3,811.15	3,906.71	-2.45%	1.47%
Nasdaq	13,102.34	13,874.46	-5.57%	2.36%
Birling Puerto Rico Stock Index	2,269.48	2,170.65	4.55%	10.98%
U.S. Treasury 10-Year Note	1.44%	1.34%	7.46%	0.50%
U.S. Treasury 2-Year Note	0.14%	0.11%	27.27%	0.60%

Francisco Rodríguez-Castro is president and CEO of Birling Capital LLC. Think Strategically© is a publication by Birling Capital LLC that summarizes recent geopolitical, economic, market and other developments This report is intended for general information purposes only and does not represent investment, legal, regulatory, or tax advice. Recipients are cautioned to seek appropriate professional counsel regarding any of the matters discussed.