

## **The Warren Buffett Way** by Robert G. Hagstrom

“The best investment opportunities come around when excellent companies are surrounded by unusual circumstances that cause the stock to be misappraised.” -Warren Buffett. This is called risk-arbitrage when stock is purchased at a discount to future value.

The main source material which Warren Buffett uses for his investment decisions are based on the 10-K annual reports that a business is required to file with the SEC and those of their competitors. In the long term, trouble awaits public companies whose financial accounting does not make total sense as it signals an underlying operational problem. It's an obvious red flag if a business is not properly expensing their stock options. Don't assume it's your shortcoming if you cannot understand the footnotes since that too is a tool which deceitful managements use to hide unfavorable information.

Any business worth investing in must be simple and understandable good long-term prospects. ROE matters more than EPS. You should only look at companies with a decent profit margin as a margin of safety since market forces could otherwise depress a low margin business into unprofitability overnight. It's important to hold a portfolio of businesses with a history of predictable cashflows. The opportunity cost to the detriment of alternative present or future investments must also be considered before an investor prospects a new investment. The prospect must be uncommonly better than present investments.

It's best to know as much as you can about every investment available which means researching any publicly-traded company that meets your basic criteria. “Start with the A's” as Buffett once said. Acquisitions are not a proper means of growth unless there are true synergies to be accessed. Irrationality prevails within the investment world and a rational management team is a great asset within a company within which you are invested. However, you want to invest in businesses with barriers to entry and a trajectory so good that an idiot could run it since CEOs do change and boards do make mistakes.

It's prudent to only invest in as many companies of which you can truly understand with 20 holdings being the limit. “I like to put meaningful amounts of money in a few things.” -Warren Buffett. Companies that earnings projections and growth expectations should be suspect since no one can possibly know the future. No CEO claiming otherwise should be trusted. The best time to buy a stock is when it's selling at a significant discount to its intrinsic value.

Warren Buffett believes that EMT (Efficient Market Theorem) is fundamentally incorrect and that those who look at all available information will always have enough competitive advantage to beat the market over a fair duration. He also believes that volatility does not constitute risk and that you must be willing to accept more volatility in pursuit of higher net returns. Independent thinkings such as these have propelled Buffett to stay ahead of the competition throughout his career.

The most critical trait for extraordinary investment performance is temperament rather than IQ intelligence. True investors are calm, patient, rational, and disciplined. However, it helps to be acutely aware of economic stirrings that may upset holdings within your portfolio since there will be times when a purchase or sale is exactly the right thing to do.

Warren Buffett recommends reading Ben Graham books, Phil Fisher books, 10-K annual reports, and trade reports, but not doing fancy equations with Greek letters in them. It is prescribed that the ROE, operating margins, debt levels, capital expenditures, and income-producing abilities of present holdings be reviewed each year for any changes. The key differentiators that have set Buffett's portfolio apart have been less investment turnover, fewer holdings, and a focus on intrinsic business valuation.