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Our Performance in 1961

I have consistently told partners that it is my expectation and hope (it's alwa: hard to tell which is which) that we will do relatively well compared to the ge eral market in down or static markets, but that we may not look so good in a vancing markets. In strongly advancing markets I expect to have real diffic keeping up with the general market.

Although 1961 was certainly a good year for the general market and, in addi a very good year for us on both an absolute and relative basis, the expectati in the previous paragraph remain unchanged.

During 1961, the general market as measured by the Dow-Jones Industrial A age (hereinafter called the "Dow") showed an over-all gain of 22.2% includir dividends received through ownership of the Dow. The gain for all partners operating throughout the entire year, after all expenses of operation, but be payments to limited partners or accrual to the general partner, averaged 4! The details of this gain by partnership are shown in the appendix along with sults for the partnerships started during the year.

We have now completed five full years of partnership operation, and the re of these five years are shown below on a year-by-year basis and also on a c lative or compounded basis. These results are stated on the basis describ the preceding paragraph; after expenses, but before division of gains amon partners or payments to partners.

Year	Partnerships Operating Entire Year	Partnership Gain	Dow-Jones Industrials Gain *
1957	3	10.4%	-8.4%
1958	5	40.9	38.5
1959	6	25.9	19.9
1960	7	22.8	-6.3
1961	7	45.9	22.2

* Including dividends received through ownership of the Dow.

On a compounded basis, the cumulative results have been:

Year	Partnership Gain	Dow-Jones Industrials Gain
1957	10.4%	-8.4%
1957-8	55.6	26.9
1957-9	95.9	52.2
1957-60	140.6	42.6
1957-61	251.0	74.3

These results do not measure the gain to the limited partner, which of course, is the figure in which you are most interested. Because of the varying partner ship arrangements that have existed in the past, I have used the over-all net gain (based on market values at the beginning and end of the year) to the partne ship as being the fairest measure of over-all performance.

On a pro-forma basis adjusted to the division of gains entailed in our present Buffett Partnership, Ltd. agreement, the results would have been:

Year	Limited Partners' Gain	Dow Gain
1957	9.3%	-8.4%
1958	32.2	38.5
1959	20.9	19.9
1960	18.6	-6.3
1961	35.9	22.2
	COMPOUNDED	
1957	9.3%	-8.4%
1957-8	44.5	26.9
1957-9	74.7	52.2
1957-60	107.2	42.6
1957-61	181.6	74.3

A Word About Par

The outstanding item of importance in my selection of partners, as well as in my subsequent relations with them, has been the determination that we use th same yardstick. If my performance is poor, I expect partners to withdraw, and indeed, I should look for a new source of investment for my own funds. I performance is good, I am assured of doing splendidly, a state of affairs to which I am sure I can adjust.

The rub, then, is in being sure that we all have the same ideas of what is goo and what is poor. I believe in establishing yardsticks prior to the act; retro spectively, almost anything can be made to look good in relation to somethin or other.

I have continuously used the Dow-Jones Industrial Average as our measure of par. It is my feeling that three years is a very minimal test of performance, and the best test consists of a period at least that long where the terminal leve of the Dow is reasonably close to the initial level.

While the Dow is not perfect (nor is anything else) as a measure of performanc it has the advantage of being widely known, has a long period of continuity, anc reflects with reasonable accuracy the experience of investors generally with th market. I have no objection to any other method of measurement of general market performance being used, such as other stock market averages, leadin diversified mutual stock funds, bank common trust funds, etc.

You may feel I have established an unduly short yardstick in that it perhaps ap pears quite simple to do better than an unmanaged index of 30 leading common stocks. Actually, this index has generally proven to be a reasonably tough co petitor. Arthur Wiesenberger's classic book on investment companies lists performance for the 15 years, 1946-60, for all leading mutual funds. There presently over $20 billion invested in mutual funds, so the experience of these funds represents, collectively, the experience of many million investors. My own belief, though the figures are not obtainable, is that portfolios of most le ing investment counsel organizations and bank trust departments have achieve results similar to these mutual funds.

Wiesenberger lists 70 funds in his "Charts & Statistics" with continuous reco since 1946. I have excluded 32 of these funds for various reasons since they were balanced funds (therefore not participating fully in the general market r specialized industry funds, etc. Of the 32 excluded because I felt a comparis would not be fair, 31 did poorer than the Dow, so they were certainly not ex-cluded to slant the conclusions below.

Of the remaining 38 mutual funds whose method of operation I felt was such a make a comparison with the Dow reasonable, 32 did poorer than the Dow, an did better. The 6 doing better at the end of 1960 had assets of about $1 billio and the 32 doing poorer had assets of about $6-1/2 billion. None of the six th were superior beat the Dow by more than a few percentage points a year.

Below I present the year-by-year results for our period of operation (excludi 1961 for which I don't have exact data, although rough figures indicate no var from the 1957-60 figures) for the two largest common stock open-end investr companies (mutual funds) and the two largest closed-end investment compani

Year	Mass. Inv. Trust	Investors Stock	Lehman	Tri-Cont.	Dow	Limited Partner
1957	-12.0%	-12.4%	-11.4%	- 2.4%	- 8.4%	+ 9.3%
1958	+44.1	+47.6	+40.8	+33.2	+38.5	+32.2
1959	+ 8.2	+10.3	+ 8.1	+ 8.4	+19.9	+20.9
1960	- 0.9	- 0.1	+ 2.6	+ 2.8	- 6.3	+18.6

(From Moody's Banks & Finance Manual, 1961)

COMPOUNDED

Year	Mass. Inv. Trust	Investors Stock	Lehman	Tri-Cont.	Dow	Limited Partners
1957	-12.0%	-12.4%	-11.4%	- 2.4%	- 8.4%	+ 9.3%
1957-8	+26.8	+29.3	+24.7	+30.0	+26.9	+44.5
1957-9	+37.2	+42.6	+34.8	+40.9	+52.2	+74.7
1957-60	+36.0	+42.5	+38.3	+44.8	+42.6	+107.2

Massachusetts Investors Trust has net assets of about $1.8 billion; Investors Stock Fund about $1 billion; Tri-Continental Corporation about $.5 billion; and Lehman Corporation about $350 million; or a total of over $3.5 billion.

I do not present the above tabulations and information with the idea of indictin investment companies. My own record of investing such huge sums of money with restrictions on the degree of activity I might take in companies where we had investments, would be no better, if as good. I present this data to indica the Dow as an investment competitor is no pushover, and the great bulk of investment funds in the country are going to have difficulty in bettering, or per even matching, its performance.

Our portfolio is very different from that of the Dow. Our method of operatio is substantially different from that of mutual funds.

However, most partners, as an alternative to their investment in the partner would probably have their funds invested in a media producing results compa to the Dow, therefore, I feel it is a fair test of performance.

Our Method of Operation

Our avenues of investment break down into three categories. These categor have different behavior characteristics, and the way our money is divided among them will have an important effect on our results, relative to the Dow in any given year. The actual percentage division among categories is to so degree planned, but to a great extent, accidental, based upon availability fac

The first section consists of generally undervalued securities (hereinafter c "generals") where we have nothing to say about corporate policies and no tir table as to when the undervaluation may correct itself. Over the years, thi has been our largest category of investment, and more money has been mad here than in either of the other categories. We usually have fairly large po tions (5% to 10% of our total assets) in each of five or six generals, with smaller positions in another ten or fifteen.

Sometimes these work out very fast; many times they take years. It is diff at the time of purchase to know any specific reason why they should appreci in price. However, because of this lack of glamour or anything pending wh might create immediate favorable market action, they are available at very cheap prices. A lot of value can be obtained for the price paid. This substa tial excess of value creates a comfortable margin of safety in each transacti This individual margin of safety, coupled with a diversity of commitments creates a most attractive package of safety and appreciation potential. Over the years our timing of purchases has been considerably better than our timi of sales. We do not go into these generals with the idea of getting the last nickel, but are usually quite content selling out at some intermediate level b tween our purchase price and what we regard as fair value to a private owne

The generals tend to behave market-wise very much in sympathy with the Do Just because something is cheap does not mean it is not going to go down. I ing abrupt downward movements in the market, this segment may very well down percentage-wise just as much as the Dow. Over a period of years, I believe the generals will outperform the Dow, and during sharply advancing years like 1961, this is the section of our portfolio that turns in the best results. It is, of course, also the most vulnerable in a declining market.

Our second category consists of "work-outs." These are securities whose financial results depend on corporate action rather than supply and demand factors created by buyers and sellers of securities. In other words, they a securities with a timetable where we can predict, within reasonable error limits, when we will get how much and what might upset the applecart. Co porate events such as mergers, liquidations, reorganizations, spin-offs, e lead to work-outs. An important source in recent years has been sell-outs oil producers to major integrated oil companies.

This category will produce reasonably stable earnings from year to year, t large extent irrespective of the course of the Dow. Obviously, if we opera throughout a year with a large portion of our portfolio in work-outs, we wil look extremely good if it turns out to be a declining year for the Dow or qui bad if it is a strongly advancing year. Over the years, work-outs have prc our second largest category. At any given time, we may be in ten to fiftee these; some just beginning and others in the late stage of their developmen believe in using borrowed money to offset a portion of our work-out portfol since there is a high degree of safety in this category in terms of both ever results and intermediate market behavior. Results, excluding the benefits rived from the use of borrowed money, usually fall in the 10% to 20% rang My self-imposed limit regarding borrowing is 25% of partnership net wortl Oftentimes we owe no money and when we do borrow, it is only as an offse against work-outs.

The final category is "control" situations where we either control the com or take a very large position and attempt to influence policies of the comp Such operations should definitely be measured on the basis of several yea a given year, they may produce nothing as it is usually to our advantage t the stock be stagnant market-wise for a long period while we are acquirin These situations, too, have relatively little in common with the behavior Dow. Sometimes, of course, we buy into a general with the thought in mi that it might develop into a control situation. If the price remains low en for a long period, this might very well happen. If it moves up before we have a substantial percentage of the company's stock, we sell at higher levels and complete a successful general operation. We are presently acquiring stock in what may turn out to be control situations several years hence.

Dempster Mill Manufacturing Company

We are presently involved in the control of Dempster Mill Manufacturing Com pany of Beatrice, Nebraska. Our first stock was purchased as a generally undervalued security five years ago. A block later became available, and I went on the Board about four years ago. In August, 1961, we obtained majori control, which is indicative of the fact that many of our operations are not ex actly of the "overnight" variety.

Presently we own 70% of the stock of Dempster with another 10% held by a fe associates. With only 150 or so other stockholders, a market on the stock is virtually non-existent, and in any case, would have no meaning for a controll block. Our own actions in such a market could drastically affect the quoted p

Therefore, it is necessary for me to estimate the value at yearend of our con trolling interest. This is of particular importance since, in effect, new part are buying in based upon this price, and old partners are selling a portion of their interest based upon the same price. The estimated value should not be what we hope it would be worth, or what it might be worth to an eager buyer, etc., but what I would estimate our interest would bring if sold under curren conditions in a reasonably short period of time. Our efforts will be devoted ward increasing this value, and we feel there are decent prospects of doing t

Dempster is a manufacturer of farm implements and water systems with sal in 1961 of about $9 million. Operations have produced only nominal profits i relation to invested capital during recent years. This reflected a poor mana ment situation, along with a fairly tough industry situation. Presently, cons dated net worth (book value) is about $4.5 million, or $75 per share, consoli working capital about $50 per share, and at yearend we valued our interest a $35 per share. While I claim no oracular vision in a matter such as this, I this is a fair valuation to both new and old partners. Certainly, if even mod ate earning power can be restored, a higher valuation will be justified, and even if it cannot, Dempster should work out at a higher figure. Our control interest was acquired at an average price of about $28, and this holding cur rently represents 21% of partnership net assets based on the $35 value.

Of course, this section of our portfolio is not going to be worth more money merely because General Motors, U. S. Steel, etc., sell higher. In a ragin bull market, operations in control situations will seem like a very difficult to make money, compared to just buying the general market. However, I a more conscious of the dangers presented at current market levels than the o portunities. Control situations, along with work-outs, provide a means of sulating a portion of our portfolio from these dangers.

The Question of Conservatism

The above description of our various areas of operation may provide some cl as to how conservatively our portoflio is invested. Many people some years back thought they were behaving in the most conservative manner by purchas medium or long-term municipal or government bonds. This policy has prod substantial market depreciation in many cases, and most certainly has failec maintain or increase real buying power.

Conscious, perhaps overly conscious, of inflation, many people now feel tha they are behaving in a conservative manner by buying blue chip securities al regardless of price-earnings ratios, dividend yields, etc. Without the bene hindsight as in the bond example, I feel this course of action is fraught with ger. There is nothing at all conservative, in my opinion, about speculating to just how high a multiplier a greedy and capricious public will put on earni

You will not be right simply because a large number of people momentarily agree with you. You will not be right simply because important people agre with you. In many quarters the simultaneous occurence of the two above fac tors is enough to make a course of action meet the test of conservatism.

You will be right, over the course of many transactions, if your hypotheses correct, your facts are correct, and your reasoning is correct. True cons tism is only possible through knowledge and reason.

I might add that in no way does the fact that our portfolio is not conventional prove that we are more conservative or less conservative than standard met of investing. This can only be determined by examining the methods or exa ing the results.

I feel the most objective test as to just how conservative our manner of inve ing is arises through evaluation of performance in down markets. Preferab these should involve a substantial decline in the Dow. Our performance in t rather mild declines of 1957 and 1960 would confirm my hypothesis that we vest in an extremely conservative manner. I would welcome any partner's suggesting objective tests as to conservatism to see how we stack up. We h never suffered a realized loss of more than 1/2 of 1% of total net assets, ar our ratio of total dollars of realized gains to total realized losses is someth like 100 to 1. Of course, this reflects the fact that on balance we have beer operating in an up market. However, there have been many opportunities f loss transactions even in markets such as these (you may have found out ab a few of these yourselves) so I think the above facts have some significance

The Question of Size

Aside from the question as to what happens upon my death (which with a me physical twist, is a subject of keen interest to me), I am probably asked m often: "What affect is the rapid growth of partnership funds going to have u performance?"

Larger funds tug in two directions. From the standpoint of "passive" investments, where we do not attempt by the size of our investment to influence corporate policies, larger sums hurt results. For the mutual fund or trust department investing in securities with very broad markets, the effect of large sums should be to penalize results only very slightly. Buying 10,000 shares of General Motors is only slightly more costly (on the basis of mathematical expectancy) than buying 1,000 or 100 shares.

In some of the securities in which we deal (but not all by any means) buying 10,000 shares is much more difficult than buying 100 and is sometimes impossible Therefore, for a portion of our portfolio, larger sums are definitely disadvantageous. For a larger portion of the portfolio, I would say increased sums are only slightly disadvantageous. This category includes most of our work-outs and some generals.

However, in the case of control situations increased funds are a definite advantage. A "Sanborn Map" cannot be accomplished without the wherewithal. My definite belief is that the opportunities increase in this field as the funds increase. This is due to the sharp fall-off in competition as the ante mounts plus the important positive correlation that exists between increased size of company and lack of concentrated ownership of that company's stock.

Which is more important--the decreasing prospects of profitability in passive investments or the increasing prospects in control investments? I can't give a definite answer to this since to a great extent it depends on the type of market in which we are operating. My present opinion is that there is no reason to think these should not be offsetting factors; if my opinion should change, you will be told. I can say, most assuredly, that our results in 1960 and 1961 wou not have been better if we had been operating with the much smaller sums of 1956 and 1957.

And a Prediction

Regular readers (I may be flattering myself) will feel I have left the tracks when I start talking about predictions. This is one thing from which I have always shied away and I still do in the normal sense.

I am certainly not going to predict what general business or the stock market are going to do in the next year or two since I don't have the faintest idea.

I think you can be quite sure that over the next ten years there are going to be a few years when the general market is plus 20% or 25%, a few when it is mir on the same order, and a majority when it is in between. I haven't any notior as to the sequence in which these will occur, nor do I think it is of any great importance for the long-term investor.

Over any long period of years, I think it likely that the Dow will probably pro duce something like 5% to 7% per year compounded from a combination of dividends and market value gain. Despite the experience of recent years, anyone expecting substantially better than that from the general market probably faces disappointment.

Our job is to pile up yearly advantages over the performance of the Dow without worrying too much about whether the absolute results in a given year are a plus or a minus. I would consider a year in which we were down 15% and the Dow declined 25% to be much superior to a year when both the partnership and the Dow advanced 20%. I have stressed this point in talking with partners and have watched them nod their heads with varying degrees of enthusiasm. It is most important to me that you fully understand my reasoning in this regar and agree with me not only in your cerebral regions, but also down in the pit of your stomach.

For the reasons outlined in my method of operation, our best years relative to the Dow are likely to be in declining or static markets. Therefore, the advantage we seek will probably come in sharply varying amounts. There are bound to be years when we are surpassed by the Dow, but if over a long period we can average ten percentage points per year better than it, I will feel the result have been satisfactory.

Specifically, if the market should be down 35% or 40% in a year (and I feel this has a high probability of occuring one year in the next ten--no one knows which one), we should be down only 15% or 20%. If it is more or less unchanged during the year, we would hope to be up about ten percentage points. If it is up 20% or more, we would struggle to be up as much. The consequence of performance such as this over a period of years would mean that if the Dow produces a 5% to 7% per year over-all gain compounded, I would hope our results might be 15% to 17% per year.

The above expectations may sound somewhat rash, and there is no question bu that they may appear very much so when viewed from the vantage point of 1965 or 1970. It may turn out that I am completely wrong. However, I feel the partners are certainly entitled to know what I am thinking in this regard even though the nature of the business is such as to introduce a high probability of error in such expectations. In any one year, the variations may be quite substantial. This happened in 1961, but fortunately the variation was on the pleasant side. They won't all be!

Miscellaneous

We are now installed in an office at 810 Kiewit Plaza with a first-class secretary, Beth Henley, and an associate with considerable experience in my type of securities, Bill Scott. My father is sharing office space with us (he also shares the expenses) and doing a brokerage business in securities. None of our brokerage is done through him so we have no "vicuna coat" situation. Over-all, I expect our overhead, excluding interest on borrowings and Nebraska Intangibles Tax, to run less than .5 of 1% of net assets. We should get ou money's worth from this expenditure, and you are most cordially invited to drop in and see how the money is being spent.

With over 90 partners and probably 40 or so securities, you can understand that it is quite a welcome relief to me to shake loose from some of the details.

We presently have partners residing in locations from California to Vermont, and net assets at the beginning of 1962 amounted to $7,178,500.00. Susie and I have an interest in the partnership amounting to $1,025,000.00, and other relatives of mine have a combined interest totaling $782,600.00. The minimum for new partners last year was $25,000, but I am giving some thought to increasing it this year.

Peat, Marwick, Mitchell & Company did an excellent job of expediting the aud providing tax figures much earlier than in the past. They assure me this performance can be continued.

Let me hear from you regarding questions you may have on any aspects of this letter, your audit, status of your partnership interest, etc., that may puzzle you.

Cordially,

Warren E. Buffett

Warren E. Buffett

WEB:bh
Enc.

APPENDIX

Partnerships Operating Throughout 1961

Partnership	1/1/61 Capital at Market	Over-all Gain in 1961 *	Percentage Gain
Buffett Associates	$ 486,874.27	$ 225,387.80	46.3%
Buffett Fund	351,839.29	159,696.93	45.4
Dacee	235,480.31	116,504.47	49.5
Emdee	140,005.24	67,387.28	48.1
Glenoff	78,482.70	39,693.80	50.5
Mo-Buff	325,844.71	149,163.71	45.8
Underwood	582,256.82	251,951.26	43.3
	$2,200,783.34	$1,009,785.25	45.9%

Partnerships Started in 1961

Partnership	Paid-in	Over-all Gain in 1961	Percentage Gain
Ann Investments	$ 100,100 (1-30-61)	$ 35,367.93	35.3%
Buffett-TD	250,100 ($200,100 on 3-8-61, $50,000 on 5-31-61)	70,294.08	28.1
Buffett-Holland	125,100 (5-17-61)	16,703.76	13.3

* Gain in net assets at market values plus payments to limited partners during year.