# Making smart business bets

Warren
**Buffett**

*Investor, philanthropist*

I have an old-fashion belief that **I only should expect to make money in things that I understand,** and when I say understand, I don't mean understand, you know what the product does or anything like that.

I mean, understand what the economics of the business are likely to look like ten years from or twenty from now. I know in general what the economics of, let's say, Wrigley chewing gum will look like ten years from now.

The internet isn't going to change the way people chew gum. It isn't going to change which gum they chew, you know, if you own the chewing gum market in a big way, and you've got Double Mint, Spearmint, and Juicy Fruit.

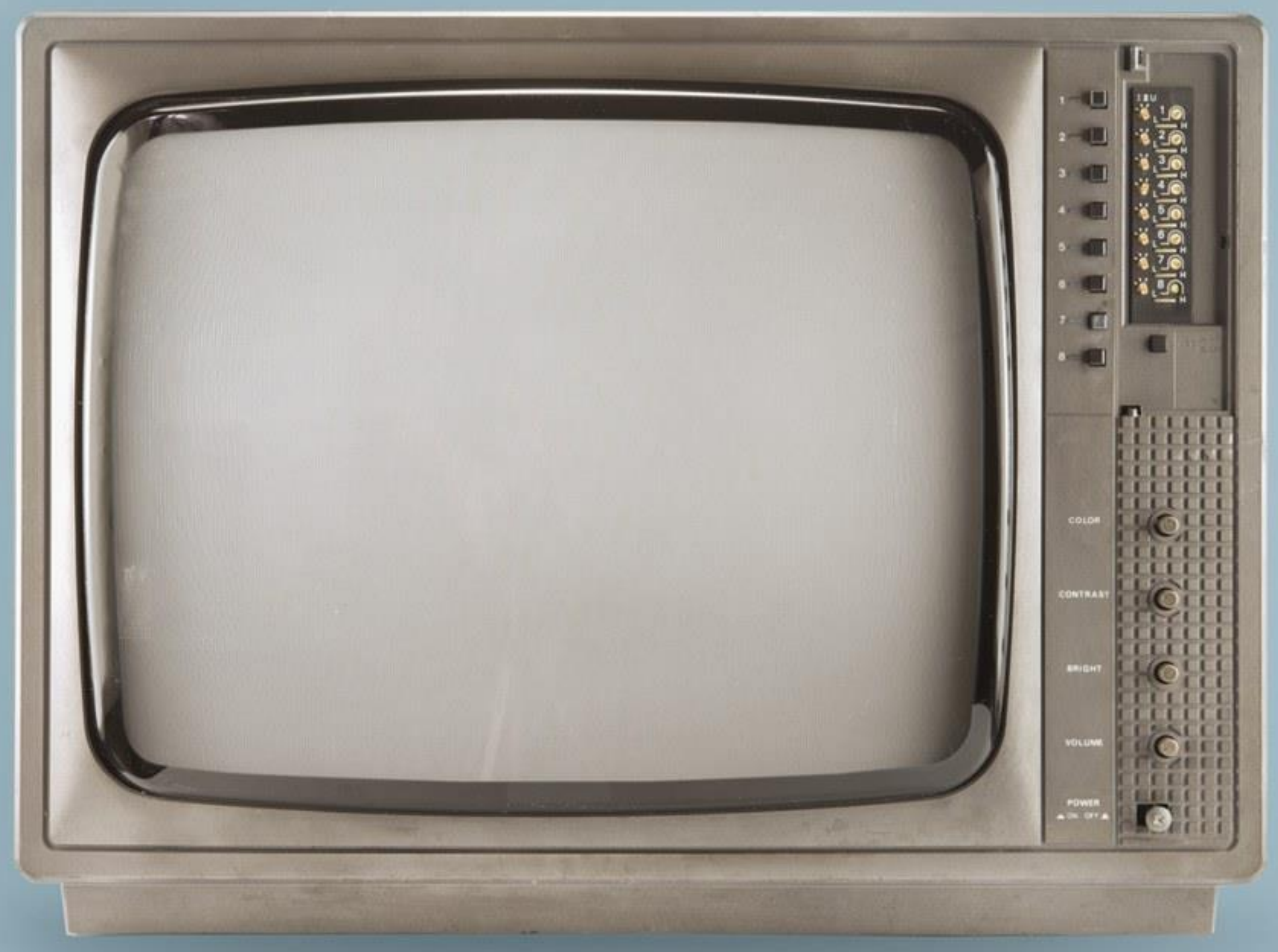
Those brands will be there ten years from now. So, *I can't pinpoint exactly what the numbers are going to look like on Wrigley, but I'm not going to be way off if* I try to look forward on something like that.

***Evaluating that company is within, what I call, my circle of competence,*** I understand what they do, I understand the economics of it, I understand the competitive aspects of the business. So, figuring out the economic consequences.

TV, I think there's, I don't know, twenty twenty-five million sets a year sold in the United States. I don't think there's anyone made in the United States anymore. I mean, you'd say, TV set manufacturing, what a wonderful business, and nobody had a TV in 1950; thereabouts forty-five to fifty.

Everybody has multiple sets now.

Nobody in the United States has made any real money making the sets, they're all out of business. You know the Magnavoxes the RCAs all of those companies. Radio was the equivalent at the...over five-hundred companies making radios in the 1920s, again I don't think there's a U.S. radio manufacturer at the present time.



But Coca Cola, you know, when was it 1884, Jacobs Farmacy, or whatever this fellow comes up with something, a lot of copiers over the years.

But now you've got a company that is selling roughly 1.1 billion 8-ounce servings of its product, not all Cokes, Sprite and some others daily throughout the world, 117 years later. *So, understanding the economic characteristics of a business is different than predicting the fact that an industry is going to do wonderfully.*

So, when I look at the internet businesses or I take a look at tech businesses I say, this is a marvelous thing and I love to play around on the computer and I order my books from Amazon and all kinds of things, ***but I don't know who's going to win.***

***Unless I know it's going to win I'm not interested in investing***, I'll just play around on the computer.

**Defining your circle of competence is the most important aspect of investing.** <u>It's not how large your circle is, you don't have to be an expert on everything.</u>

*But knowing where* ***the perimeter of that circle of what you know on what you don't know is*** and staying inside of it, is all-important.

Tom Watson senior who started IBM said in his book. He said, **"I'm no genius, but I'm smart in spots and I stay around those spots."** You know that is the key.

***So, if I understand a few things, and I stick in that arena I'll do okay.*** And if I don't understand something but I get all excited about it because my neighbors are talking about it, stocks are going up and everything.

They start fooling around someplace else eventually I'll get creamed, and I should.

The whole long-term capital management and I hope most of you are familiar with it, but the whole story is really fascinating.

If you take John Meriwether and Eric Rosenfeld, Larry Hildebrand, Greg Hawkins, Victor Haghani the two Nobel prize winners Merton and Scholes.

If you take the sixteen of them, they probably have as high an average IQ as any sixteen people working together in one business in the country, including at Microsoft or wherever you want a name. So, an incredible amount of intellect in that room.

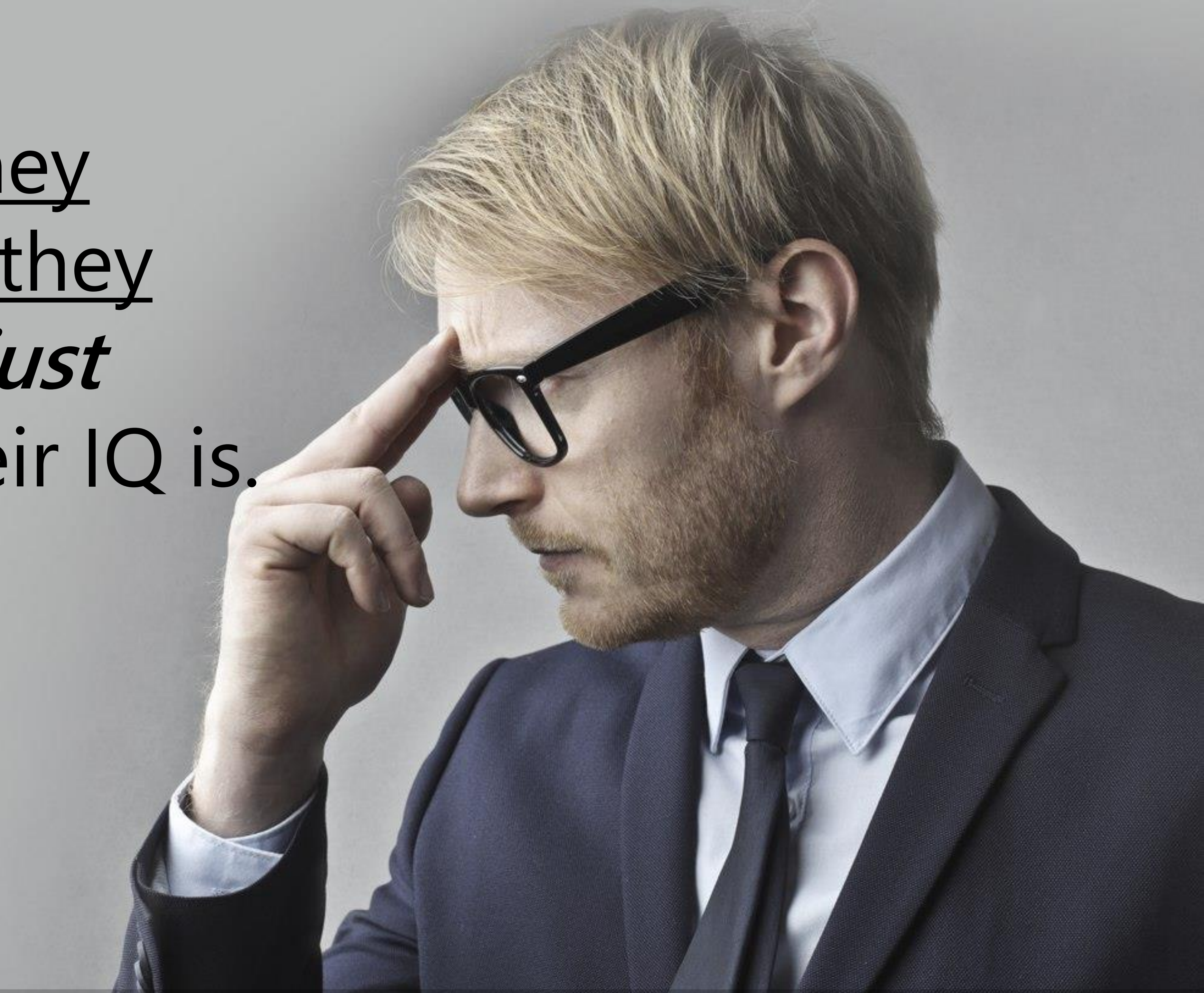
Now, you combine that with the fact that those sixteen had had extensive experience in the field they're operating. I mean, this was not a bunch of guys who had made their money, you know, selling men's clothing and then all of a sudden went into the securities business or anything.

They had in aggregate, the sixteen did probably have 350 or 400 years of experience doing exactly what they were doing.

And then you throw in the third factor, that most of them had virtually all of their very substantial net worths in the business, so they had their own money up. Hundreds and hundreds of millions of dollars of their own money up. Super high intellect working in a field they knew and essentially they went broke.

That to me is absolutely fascinating. I mean, if I ever write a book it's going to be called, **"Why Smart People do Dumb Things".** My partner says it should be autobiographical. But, this might be an interesting illustration, and these are perfectly decent guys. I respect them and they helped me out when I was at problems with Solomon.

So, they're not bad people at all. But, to make money they didn't have and didn't need, they risked what they did have and did need. ***And that's foolish, that is just plain foolish***. It doesn't make a difference what their IQ is.



***If you risk something that is important to you for something that is unimportant to you, it just does not make any sense.*** I don't care whether the odds are a hundred to one that you succeed or a thousand one to succeed.

If you hand me a gun with a thousand chambers, a million chambers in it and there's a bullet in one chamber, and you said, "put it up your temple and how much do you want to be paid to pull it once?"

I'm not going to pull it. You know, you can name any sum you want, but it doesn't do anything for me on the upside. And I think the downside is fairly clear.

So, I'm not interested in that kind of a game and yet people do it financially, without thinking about it very much.

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