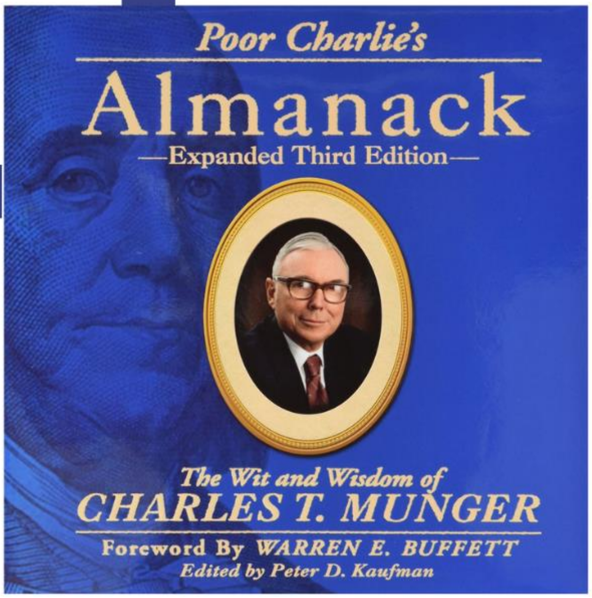

CLIFFS NOTES

POOR CHARLIE'S ALMANACK

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POOR CHARLIE'S ALMANACK – CLIFFSNOTES

Along with his business partner Warren Buffett, Charlie Munger is easily one of the world's most successful investors.

In these Cliffs Notes, you'll discover that Munger himself is a very down-to-earth person. His style of investing is deeply principled, from honest reporting of figures to avoiding tax havens. Then again, we're scratching the surface here. If you don't already have the book, you can order it from your nearest bookstore.

Charlie Munger's Background Story

As a teenager, Munger worked at a grocery store run by Warren Buffett's grandfather. He put in 12-hour work shifts without a break. It was his work ethic that set him up throughout the rest of his career. Oftentimes, Munger would leave for work in the morning and be back for dinner only to continue working after that.

Munger is known to instill his work ethic in his children, stressing **hard work, responsibilities, and job ownership**.

Munger is also a well-known philanthropist, making substantial contributions to universities, hospitals, as well as causes that are close to his heart.

Munger loves reading, often looking for knowledge everywhere he can. His parents always encouraged their children to read and often gave them books as gifts.

As a teenager, Munger immersed himself in medical journals, building a lifelong fascination in science and medicine. Years later, during his college years, Munger would pour his time into mathematics and physics – subjects he believes contributed to his success because it taught him how to solve complex problems with logical theory.

After finishing his sophomore year in college, Munger joined the Army Air Corps and was sent to study science and engineering at the University of New Mexico. Later on, he was sent to California Institute of Technology to study meteorology.

After he was discharged from the military, Munger applied to Harvard Law School and graduated as one of the top students in his class.

After graduating from Harvard, Munger joined a law firm in California and became successful. In 1962, he started his own firm: Munger, Tolles & Olson. However, despite all the success, Munger wasn't content.

In 1959, at a family dinner, he met Warren Buffett, a man whom like Munger, was deeply into business and investing. They would talk nonstop at dinner covering different topics from history to finance to business. Buffett convinced Munger that his skills would be of better use in the world of finance and investing.

Munger left his law firm in 1965 and started his own investment partnership along with a law colleague but ultimately decided that he didn't want to manage funds directly for investors. In the end, Munger decided to join Buffett in managing Berkshire Hathaway, which paved the way to it becoming one of the most successful investment companies in the world.

Learning Principles

Munger denounces practices like window dressing to make investments look healthier. For example, some investment managers sell stocks with large losses and buy high-flying stocks near the end of the quarter or year to show their clients that the fund is doing well. In doing so, it adds pressure for other investment managers to follow suit.

The same can be said about tax evasion. Some companies place their headquarters in tax havens to avoid paying taxes. While these are socially accepted ways of bending the law, Munger has zero tolerance for such practices. **By making sure there is no moral ambiguity in the way Berkshire Hathaway shareholders and employees run its business, Berkshire Hathaway has largely maintained a good reputation over the last 50 years**.

Munger strongly believes that the people you deal with share the same ethical standards as you.

"It takes 20 years to build a reputation

and five minutes to ruin it."

Munger also condemns the practice of creative accounting. Before the 2008 crash, Munger noticed that accounting firms were more concerned about profit, and helping their client find loopholes.

One of the most unethical practices is that of accounting for derivatives. This is the practice of creating financial contracts based on speculative value of an underlying asset.

For example, loans can be bundled and sold to investors based on the value the loans are projected to have once the debtors pay up. However, there are cases where the debtors can't pay off those loans. Thus, the value is clearly speculated than established.

This was what happened in the 2008 financial crisis. When subprime borrowers defaulted on their mortgage loans, the housing market crashed, and the mortgage-backed derivatives essentially became worthless, causing the entire economy to go into a huge recession.

Munger believes that to err is human. What matters is you own up and learn from them. Munger often cited that he makes mistakes too, often resulting in missing out an investment opportunity or simply not buying enough.

One example includes turning down an opportunity to invest in Walmart, which could have made Berkshire a few extra billion. In fact, Munger stated that he and Buffett also almost missed out on See's Candy had a colleague not talked them out of it.

Munger advocates a strategy he termed as "sit-on-ass" investing. He stressed that one of the most important qualities for a good investor is patience.

He and Buffett would wait until they see a good opportunity -- a quality company that's undervalued and will eventually become very successful. Once they find one, they'll act aggressively, usually buying a large portion of the company. After which, they'll hold their stakes for decades.

While this style of investing may not be exciting, it has paid off very handsomely for Berkshire Hathaway.

For example, in the crash of 1987, Berkshire Hathaway bought $1.3 billion worth of Coca-Cola shares. Those same shares are worth $8 billion today – excluding the dividends they have received over the years.

Based on the number of shares it owns,
Berkshire Hathaway received $656,000,000
in dividends from Coca-Cola in 2020 alone.

While they could have invested a smaller amount in a wider range of companies, Berkshire Hathaway prefers to **invest in quality over quantity**.

For Buffett and Munger, investing in a smaller number of companies allows them to buy more of a company, thus becoming a major shareholder and thereby gaining more influence over those companies' future.

To Munger, 10 quality companies are better than a huge mix of under and over-achievers.

"I didn't get to where I am by
going after mediocre opportunities."

Mental Models

Munger often recounts a parable about a workman who only has one tool: a hammer. Whenever he encounters a problem, his only solution was to swing the hammer. It is hard to become successful with that approach. Instead, an investor must be able to draw on diverse mental models.

One must be able to have a very broad and diverse range of tools taken from different disciplines.

In doing so, you will acquire the skillset to adapt your thinking and find the best solution to a problem.

An example would be of a pilot. In training, pilots are not only schooled in theory, they are also forced to apply their training in practice and demonstrate mastery over what they've learned.

The learning doesn't stop there, pilots must continuously update their knowledge, and practise their skills and expertise through flight simulators.

Even with all their knowledge and experience, pilots are still required to do perform checklist routines, making a mental inventory of the problem, and possible causes and solutions.

If investors approached their education this way, drawing on multi-disciplinary knowledge, applying it, updating it, and making mental checklists, they would see more success as an investor.

Psychology is key for an investor. Recognizing the *limitations* of your knowledge is even more crucial. Everyone has blind spots and we are often subconsciously manipulated by our environment.

The best way to combat our blind spots before making an investment decision is what Munger calls a two-track analysis.

First, **before making any judgement call, take a step back and consider all the information on the investment**.

What are the real risks and benefits? After that, consider the psychological factors at play in the situation that could be influencing your decisions on a subconscious level, which could lead you to an incorrect conclusion.

Munger and Buffett have a clearly defined 'circle of competence' that they use to determine if they are qualified to make an investment. They refuse to invest in things they don't know or have limited knowledge about. While they have missed several lucrative investment opportunities, it has also helped avoid devastating losses.

There are many investors who determine if an investment is worthwhile based on **value investing**, a strategy used by the legendary investor Benjamin Graham.

Graham would first calculate the value of the company and if the company is sold on the market for no more than a fifth of the actual value, it would be a good investment.

For Munger however, when shares are sold at such low valuations, it means that the business is usually failing. **Munger believes it's more lucrative to invest in great companies that keep getting better**.

So how do investors spot a great company?

First – Management

Management is especially important. A skillful CEO can turn a whole company around. Some examples of great CEOs include Jack Welch, former CEO of General Electric, and the late Steve Jobs, the founder of Apple.

Second – Positioning in the market

Products like Coca-Cola and Gillette have unrivaled brand recognition. In addition, over the many years, these two brands have established a huge distribution network all over the world. Products like these are almost infallible.

While good management and a good product will almost always mean a decent investment, the fastest way to make a huge fortune is to find a company that's poised to 'surf the wave of success'.

For example, Microsoft, which had a solid position at the beginning of the personal computing boom. Big opportunities like these doesn't come very often, and when you see it, don't hesitate to act.