Part One
The Beginning

“Table 5 is the record of a friend of mine who is a Harvard Law Graduate, who set up a major law firm. I ran into him in about 1960 and told him that law was a fine hobby but he could do better...”— Warren Buffett’s introduction to Charlie Munger in his essay: The Superinvestors of Graham-and-Doddsville.

While growing up Omaha, Charlie Munger had his first run-in with the Buffett family, although he didn’t meet Warren until several years later. During his teen years Charlie worked at Buffett & Son, a grocery store owned by Warren Buffett’s grandfather.

The next few years of Charlie Munger’s life were filled with hard work, love and tragedy. Charlie left Omaha to attend the University of Michigan in 1941, and left school in 1943 to enlist in the Army Air Corps. During this time he met and married Nancy Huggins. The couple moved to Boston so Charlie could attend Harvard Law School, where Charlie graduated magna cum laude despite having no undergraduate degree.

During 1949, Charlie, Nancy, and their three children moved to California where Charlie joined the law firm Wright & Garrett. Then in 1953, the Mungers divorced. Munger made his first foray into the business world at this time. One of his legal clients owned a troubled transformer company and Charlie brought part of the business.

Tragedy followed when Charlie Munger’s father passed away during 1959. Chalier moved back to Omaha to help his family, a move which turned out to be the most important decision of his life.

Charlie Munger meets Warren Buffett

While at home in Omaha, Charlie Munger was introduced, through mutual friends, to Warren Buffett for the first time and the two immediately became friends. The two friends began speaking for hours every week discussing potential investment ideas, and eventually in 1962, Buffett convinced Munger to quit his law job and start his own investment partnership.
Charlie Munger’s investment partnership opened for business during 1962 and immediately started to outperform. Over its life, from 1962 to 1975, the partnership returned an average of 24.3% per annum for partners, compared to the DJIA, which returned 6.4% over the same period.

Charlie Munger quality over value

Charlie’s investment style differed to that of Warren Buffett and other value investors. Rather than seeking out deep value, Munger looked for quality and during 1965 he convinced Warren Buffett to adopt the same style.

Indeed, that year he encouraged Buffett to make one of his more famous bolt-on acquisitions for Berkshire; See’s Candies.

See’s was a legendary West Coast manufacturer and retailer of boxed chocolates, then annually earning about $4 million pre-tax while utilizing only $8 million of net tangible assets. Alongside the tangible asset balance, See’s had one huge asset that did not appear on its balance sheet: a broad and durable competitive advantage that gave it significant pricing power:

“...The family controlling See’s wanted $30 million for the business, and Charlie rightly said it was worth that much. But I didn’t want to pay more than $25 million and wasn’t all that enthusiastic even at that figure. (A price
that was three times net tangible assets made me gulp.) My misguided caution could have scuttled a terrific purchase. But, luckily, the sellers decided to take our $25 million bid. To date, See’s has earned $1.9 billion pre-tax, with its growth having required added investment of only $40 million. See’s has thus been able to distribute huge sums that have helped Berkshire buy other businesses that, in turn, have themselves produced large distributable profits. (Envision rabbits breeding.) Additionally, through watching See’s in action, I gained a business education about the value of powerful brands that opened my eyes to many other profitable investments.”– Warren Buffett Berkshire 2014 letter.

At first, Buffett was reluctant to pay more than book value because he was schooled in value investing. However, Munger was adamant that he do the deal.

As it turns out the deal has been wildly successful, producing more than $1bn in pretax earnings since, a return of more than 4,000%.

Joining Berkshire

Charlie Munger quit the money management business during 1978 and moved to join forces with Buffett full-time, by becoming Berkshire Hathaway Inc. (NYSE:BRK.A) (NYSE:BRK.B)’s vice chairman.

On another, rather more interesting note. As it turns out, Charlie Munger was well aware that the New England textile business — Berkshire Hathaway and later Waumbec — was doomed to fail in the long-term. Last year at the annual meeting of the Daily Journal Corp., a publishing firm where he serves as chairman he commented that:

“[The] textile business in New England... was totally doomed because textiles are congealed electricity and the power rates were way higher in New England than they were down in TVA country in Georgia. A totally doomed, certain-to-fail business,”

If Buffett and Munger had joined forces earlier in their careers, who knows what could have happened.

End of part one

That’s the end of part one of this series on Charlie Munger. Stay tuned for the rest of the series.
Part Two
Quality Over Value

“Warren talked me into leaving the law business, and that was a very significant influence on me. I was already thinking about becoming a full-time investor, and Warren told me I was far better suited to that. He was right. I would probably have done it myself, but he pushed me to it. I have to say, it isn’t an easy thing to work very hard for many years to build up a significant career, as I had done, and then to destroy that career on purpose. That would have been a lot harder to do if not for Warren’s influence on me.

It wasn’t a mistake. It worked out remarkably well for both of us and for a lot of other people…


When Charlie Munger came to Berkshire in the late 60s, Warren Buffett was still investing according to the Graham-and-Dodd handbook. Buffett was taught how to invest by Benjamin Graham, and had followed his deep value cigar butt style of investing for years while running the Buffett partnerships.

However, Charlie Munger had no such attachment to Benjamin Graham, or his cigar butt style of investing, which as it turns out, had a dramatic effect on Berkshire Hathaway Inc. (NYSE:BRK.A) (NYSE:BRK.B)’s direction in the last 1960’s/early 1970’s — as covered in part one of this series.

“I don’t love Ben Graham and his ideas the way Warren does. You have to understand, to Warren — who discovered him at such a young age and then went to work for him — Ben Graham’s insights changed his whole life, and he spent much of his early years worshiping the master at close range. But I have to say, Ben Graham had a lot to learn as an investor. His ideas of how to value companies were all shaped by how the Great Crash and
the Depression almost destroyed him, and he was always a little afraid of what the market can do. It left him with an aftermath of fear for the rest of his life, and all his methods were designed to keep that at bay.

I think Ben Graham wasn’t nearly as good an investor as Warren Buffett is or even as good as I am. Buying those cheap, cigar-butt stocks was a snare and a delusion, and it would never work with the kinds of sums of money we have. You can’t do it with billions of dollars or even many millions of dollars. But he was a very good writer and a very good teacher and a brilliant man, one of the only intellectuals — probably the only intellectual — in the investing business at the time.” — Charlie Munger The Wall Street Journal September 2014.

Strictly speaking, in the early days of the Buffett partnerships, Warren wasn’t a deep value investor, he bought a controlling share in companies and then pushed management teams to unlock value through asset sales and other forms of restructuring.

**Intangible qualities**

Charlie Munger had no real desire to follow Buffett’s activist style. Instead, Munger was happy to buy quality, seek out arbitrage opportunities and look for cigar butts. His style differed greatly from that of Buffett.

“Munger bought cigar butts, did arbitrage, even acquired small businesses...he said to Ed Anderson, “I just like the great businesses.” He told Anderson to write up companies like Allergan, the contact-lens-solution maker. Anderson misunderstood and wrote a Grahamian report emphasizing the company’s balance sheet. Munger dressed him down for it; he wanted to hear about the intangible qualities of Allergan: the strength of its management, the durability of its brand, what it would take for someone else to compete with it.

Munger had invested in a Caterpillar tractor dealership and saw how it gobbled up money, which sat in the yard in the form of slow-selling tractors...Munger wanted to own a business that did not require continual investment, and spat out more cash than it consumed...Munger was always asking people, “What’s the best business you’ve ever heard of?”

He wanted to get really rich, really fast. He and Roy Tolles made bets on whose portfolio would be up more than one hundred percent in a year. And he was willing to borrow money to make money, whereas Buffett had never borrowed a significant sum in his life...

Munger did enormous trades [with borrowed money] like British Columbia Power, which was selling at around $19 and being taken over by the Canadian government at a little more than $22. Munger put not just his whole partnership, but all the money he had, and all that he could borrow into an arbitrage on this single stock—but only because there was almost no chance that this deal would fall apart.” — The Snowball: Warren Buffett and the Business of Life.

Still, it wasn’t until the late 1990’s/early 2000’s that Charlie Munger’s quality over value slant
started to really shine through in both his and Warren’s writings. For example, in Charlie’s speech “A Lesson on Elementary, Worldly Wisdom As It Relates to Investment Management & Business.” given in 1995 he stated that:

“We’ve really made the money out of high quality businesses. In some cases, we bought the whole business. And in some cases, we just bought a big block of stock. But when you analyze what happened, the big money’s been made in the high quality businesses. And most of the other people who’ve made a lot of money have done so in high quality businesses.

Over the long term, it’s hard for a stock to earn a much better return than the business which underlies it earns. If the business earns 6% on capital over 40 years and you hold it for that 40 years, you’re not going to make much different than a 6% return—even if you originally buy it at a huge discount. Conversely, if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive looking price, you’ll end up with a fine result.

So the trick is getting into better businesses. And that involves all of these advantages of scale that you could consider momentum effects.

How do you get into these great companies? One method is what I’d call the method of finding them small get ‘em when they’re little. For example, buy Wal-Mart when Sam Walton first goes public and so forth. And a lot of people try to do just that. And it’s a very beguiling idea. If I were a young man, I might actually go into it.”

Then during 2003, Warren Buffett made the following statement regarding Coca-Cola, See’s Candies, and Buffalo News at the 2003 Berkshire Hathaway meeting:

“The ideal business is one that generates very high returns on capital and can invest that capital back into the business at equally high rates. Imagine a $100 million business that earns 20% in one year, reinvests the $20 million profit and in the next year earns 20% of $120 million and so forth. But there are very very few businesses like this. Coke has high returns on capital, but incremental capital doesn’t earn anything like its current returns. We love businesses that can earn high rates on even more capital than it earns. Most of our businesses generate lots of money, but can’t generate high returns on incremental capital — for example, See’s and Buffalo News. We look for them [areas to wisely reinvest capital], but they don’t exist.

So, what we do is take money and move it around into other businesses. The newspaper business earned great returns but not on incremental capital. But the people in the industry only knew how to reinvest it [so they squandered a lot of capital]. But our structure allows us to take excess capital and invest it elsewhere, wherever it makes the most sense. It’s an enormous advantage.”
This mentality had a dramatic effect on Berkshire Hathaway’s performance over the years. All you need to do is to look at Buffett’s acquisition of See’s Candies in the late 1960’s, to realize that without Charlie Munger’s quality over value influence on Buffett, Berkshire wouldn’t have become the American corporate giant it is today.

**Buffett’s Early Investment Performance Was Driven By Activism**

Warren Buffett’s investment strategy has changed over the years. From a deep-value nets-nets investing methodology to today’s, quality at a reasonable price philosophy, Buffett’s portfolio has undergone several changes.

But in the early days of Buffett’s partnerships, the then undiscovered Oracle of Omaha used an activist strategy to get results, the use of which allowed him to make big bets with a highly concentrated portfolio. Indeed, reading through Buffett’s early partnership letters to shareholders (mid 50’s to late 60’s), almost all of the investment examples he gives are activist situations. He often devoted around a fifth or more of assets under management into each situation.

**Buffett’s activism in Dempster Mill**

For example, Buffett started acquiring stock in Dempster Mill, a manufacturer of farm implements and water systems, during 1956 when the stock was selling at $18, while book value stood at $72 per share — current assets amounted to $50 per share.
Dempster had been highly profitable for many years, although when Buffett entered the picture the company was only breaking even, hence the low valuation.

Buffett’s Dempster position was acquired over a period of five years, from 1956 to 1961 and as Buffett sat on the board of directors, he became increasingly frustrated with the way the business was being run. Then during 1961 Buffett used his financial firepower to acquire 70% of Dempster stock, push out the management team, bring in new managers and instigate change. Eventually during 1963 Buffett sold Dempster’s assets for around $80 per share.

This kind of activism investing is common with most of Buffett’s bigger positions all the way up to the late 60s.

The Sanborn Map trade

Take the Sanborn Map trade (this can be considered a trade because Buffett was not involved for much more than a year). Before taking a position, Buffett had computed how long he was willing to hold the company’s stock and what returns he wanted to make within the time period. He expected to realize value from the deal within a year and took a huge bet, using 35% of net partnership assets to acquire stock.

Like Dempster, Sanborn offered value. The company produced maps of all cities of the United States, but due to falling profitability the company’s stock price had fallen significantly below its asset value. (Sanborn was a special situation, the company owned a portfolio of securities value at $65 per share, while the company’s stock only traded at $45. The map business was value at 0 and portfolio of securities value at $0.70 on the dollar.)

Through various means Buffett and other parties, all of which wanted change, acquired around 50% of Sanborn’s outstanding stock and put forward a motion to separate the investment portfolio and maps businesses. The reorganization was eventually pushed through, unlocking value from the investment portfolio and revaluing the map business.

Buffett’s acquisition of Berkshire Hathaway

And finally there’s Berkshire Hathaway Inc. (NYSE:BRK.A) (NYSE:BRK.B), which was acquired for Buffett’s portfolio at a price of $7.60 per share, while the firm had working capital of $19 per share. Buffett, by his own admission should have cut and run with Berkshire but he stayed, took the company over and tried to turn things around. Buffett calls this his “$200 billion mistake”.

While these are only three examples from Buffett’s early career, the weight in his portfolio and speed that these situations were completed, hints at activism. The Oracle of Omaha consistently refers to, ‘beating the Dow’ within his early letters and he is always on the lookout for investments where he can drive out-performance over a set time frame, often appearing unwilling to wait for situations to play out.

Perhaps then, if you’re looking to replicate Buffett’s earlier success, it might be better to follow the likes of outperforming activist investors such as Bill Ackman, who runs a concentrated portfolio and has returned 1,199% since starting his fund in 2004. Berkshire stock has only returned 135% over the same period.
Part Three
Sit on your ass

Charlie Munger was never attached to the deep value, Graham esque mentality like many of his value peers. In fact, Munger always preferred quality over value. A high quality business trading at an attractive valuation was Charlie Munger’s Holy Grail.

It wasn’t until the turn of the century that Munger was able to give a name to this style of investing. The name he chose was; sit on your ass investing.

The concept of sit on your ass investing was introduced at the 2000 Berkshire Hathaway Inc. (NYSE:BRK.A) (NYSE:BRK.B) Annual meeting. The essence of this new school of investment theory; find a few outstanding companies, buy them, and hold them forever.

In many ways this style of investment management can be traced back to Berkshire Hathaway’s early days. See’s Candies, Coca-Cola and American Express Company (NYSE:AXP) were all quality business brought at an attractive price with the intention of holding them forever. According to Charlie Munger — a view that’s also affected Warren Buffett’s style — you should only buy a stock if you are not willing to hold for ten years, and if you are willing to commit a substantial portion of your money to it.

Up until the late 1980’s, even Warren Buffett didn’t follow this school of thought. He traded in and out of undervalued stocks, selling them when they reached full value and positions were rarely held for more than a year or two.

Buffett’s active style of management didn’t suit Charlie Munger, anyway, the figures showed that a more passive style of management would be better over the long-term.
The power of compounding
The success of sit on your ass investing is driven by a company’s ability to successfully compound shareholder equity at an attractive rate over the long-term — if this isn’t possible, the strategy won’t work and it’s easier to buy low and sell high.

Charlie Munger’s speech, “A Lesson on Elementary, Worldly Wisdom As It Relates To Investment Management & Business”, breaks it down nicely:

“Over the long term, it’s hard for a stock to earn a much better return than the business which underlies it earns. If the business earns 6% on capital over 40 years and you hold it for that 40 years, you’re not going to make much different than a 6% return—even if you originally buy it at a huge discount. Conversely, if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive looking price, you’ll end up with a fine result.”

Similarly, here’s what Warren Buffett said about Coca-Cola, See’s Candies, and Buffalo News at the 2003 Berkshire Hathaway meeting:

“The ideal business is one that generates very high returns on capital and can invest that capital back into the business at equally high rates. Imagine a $100 million business that earns 20% in one year, reinvests the $20 million profit and in the next year earns 20% of $120 million and so forth. But there are very very few businesses like this. Coke has high returns on capital, but incremental capital doesn’t earn anything like its current returns. We love businesses that can earn high rates on even more capital than it earns. Most of our businesses generate lots of money, but can’t generate high returns on incremental capital — for example, See’s and Buffalo News. We look for them [areas to wisely reinvest capital], but they don’t exist.

So, what we do is take money and move it around into other businesses. The newspaper business earned great returns but not on incremental capital. But the people in the industry only knew how to reinvest it [so they squandered a lot of capital]. But our structure allows us to take excess capital and invest it elsewhere, wherever it makes the most sense. It’s an enormous advantage.”

At the same meeting, Charlie Munger added the following statement:

“There are two kinds of businesses: The first earns 12%, and you can take it out at the end of the year. The second earns 12%, but all the excess cash must be reinvested — there’s never any cash. It reminds me of the guy who looks at all of his equipment and says, “There’s all of my profit.” We hate that kind of business.”

How do you get into these great companies?

Of course, if good businesses were easy to find, investing would be easy. Half the battle is finding these
great companies at great prices.

This is a broad topic and not one that I have space to go into here. Nonetheless, Charlie Munger does have some views on the topic:

“How do you get into these great companies? One method is what I’d call the method of finding them small get ’em when they’re little. For example, buy Wal-Mart when Sam Walton first goes public and so forth. And a lot of people try to do just that. And it’s a very beguiling idea. If I were a young man, I might actually go into it.

But it doesn’t work for Berkshire Hathaway anymore because we’ve got too much money. We can’t find anything that fits our size parameter that way. Besides, we’re set in our ways. But I regard finding them small as a perfectly intelligent approach for somebody to try with discipline. It’s just not something that I’ve done.

Finding ’em big obviously is very hard because of the competition. So far, Berkshire’s managed to do it. But can we continue to do it? What’s the next Coca-Cola investment for us? Well, the answer to that is I don’t know. I think it gets harder for us all the time….

And ideally and we’ve done a lot of this—you get into a great business which also has a great manager because management matters. For example, it’s made a great difference to General Electric Company (NYSE:GE) that Jack Welch came in instead of the guy who took over Westinghouse—a very great difference. So management matters, too.

Occasionally, you’ll find a human being who’s so talented that he can do things that ordinary skilled mortals can’t. I would argue that Simon Marks—who was second generation in Marks & Spencer of England—was such a man. Patterson was such a man at National Cash Register. And Sam Walton was such a man.

These people do come along—and in many cases, they’re not all that hard to identify. If they’ve got a reasonable hand—with the fanaticism and intelligence and so on that these people generally bring to the party—then management can matter much.

However, averaged out, betting on the quality of a business is better than betting on the quality of management. In other words, if you have to choose one, bet on the business momentum, not the brilliance of the manager.

But, very rarely, you find a manager who’s so good that you’re wise to follow him into what looks like a mediocre business.” — Charlie Munger’s speech, “A Lesson on Elementary, Worldly Wisdom As It Relates To Investment Management & Business”.
Part Four
**Investment Advice**

Following on from part three of this series, which explored Charlie Munger’s ‘sit on your ass’ method of investing, in this part I’m going to take a look at some of the investment advice that Charlie Munger has dished out over the years.

Charlie Munger’s age and experience means that he has become one of the most quotable investors of all time. He says what’s on his mind, without fear of offending anyone, often making statements others would have trouble making in public.

Unfortunately, it’s not possible to cram all of Munger’s investment wisdom into one article. So with the limited space available here, I’m going to try and condense a few of Charlie’s best nuggets of advice on to this page.

**Cash is king**

“The way to get rich is to keep $10 million in your checking account in case a good deal comes along…There are worse situations than drowning in cash and sitting, sitting, sitting. I remember when I wasn’t awash in cash — and I don’t want to go back.”

In part three, I looked at Charlie Munger’s idea that the best way to build wealth is to buy great businesses at rock bottom prices. You’ll have trouble following this strategy if you don’t have cash ready to deploy at a moment’s notice. Cash offers flexibility, and while it may not be earning interest with rates near zero, cash’s value isn’t its ability to earn interest. Providing flexibility and options is how it earns its keep.

When you keep cash on hand, you need to be patient and wait for the perfect opportunity. Patience is a fundamental element of Charlie Munger’s sit on your ass strategy:

“I did not succeed in life by intelligence. I succeeded because I have a long attention span.”

If you’re concerned about what’ll happen in the markets over the next five months, you are doing it wrong. Look to the long-term. As covered in part three:

“…if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive looking price, you’ll end up with a fine result.”

What’s more:

“There are huge advantages for an individual to get into position where you make a few great investments and just sit back. You’re paying less to brokers. You’re listening to less nonsense…If it works, the governmental tax system gives you an extra one, two, or three percentage points per annum with compound effects.”
The ever-growing profit of Buffett’s See’s Candy. Credit Hurricane Capital case study of See’s Candy.

The underlying business

Just like Warren Buffett, Charlie believes that every stock should be viewed as the ownership rights to a business, not just a piece of paper, which may, or may not, increase in value over time:

“The number one idea is to view a stock as an ownership of the business and to judge the staying quality of the business in terms of its competitive advantage. Look for more value in terms of discounted future cash-flow than you are paying for. Move only when you have an advantage.”

Once again, the above piece of advice reiterates the fact that good businesses should be brought at attractive prices; it pays to wait for the right price. Additionally, for those investors that are concerned about short-term volatility, Munger gives the following advice:

“This great emphasis on volatility in corporate finance we regard as nonsense. Let me put it this way; as long as the odds are in our favor and we’re not risking the whole company on one throw of the dice or anything close to it, we don’t mind volatility in results. What we want are favorable odds.”

This statement has its roots in Benjamin Graham’s teachings. The definition of risk has changed over the past two or three decades. Indeed, many investors now view risk as short-term volatility, rather than its correct definition of long-term capital loss as Warren Buffett explained in his age-old essay, The Superinvestors of Graham-and-Doddsville:
“…to people that think beta measures risk, the cheaper price would have made it look riskier. This is truly Alice in Wonderland. I have never been able to figure out why it’s riskier to buy $400 million worth of properties for $40 million than $80 million. And, as a matter of fact, if you buy a group of such securities and you know anything at all about business valuation, there is essentially no risk in buying $400 million for $80 million…”

The most important advice

Finally, the two most important pieces of advice that Munger has issued over the years.

These two statements are surprisingly simple but at the same time, they are both fundamental factors of long-term wealth creation:

“Spend less than you make; always be saving something. Put it into a tax-deferred account. Over time, it will begin to amount to something. This is such a no-brainer.”

“Each person has to play the game given his own marginal utility considerations and in a way that takes into account his own psychology. If losses are going to make you miserable – and some losses are inevitable – you might be wise to utilize a very conservative patterns of investment and saving all your life. So you have to adapt your strategy to your own nature and your own talents. I don’t think there’s a one-size-fits-all investment strategy that I can give you.”

Trying to navigate the financial markets can be a tough sport, something Charlie Munger, one of the world’s most successful investors admits. However, if you play to your strengths, invest for the long-term and buy quality at a reasonable price, you stand a good chance of outperforming over the long-term.

If you’re looking for more of Charlie’s advice, below is a selection of links to various interviews.

Investing Advice from Warren Buffett’s Right-Hand Man – Time
Warren Buffett and Charlie Munger’s best advice
Make Money Like Munger
Charlie Munger’s Investing Principles
Some Good Advice from Berkshire Hathaway’s Charlie Munger
Part Five
Checklist Investing

Following on from parts three and four, in this, part five of a ten part series on Charlie Munger, I’m looking at Munger’s investment process and style of investing.

Checklists are an important tool for investors. The use of checklists to improve processes first started in aviation and medicine. They have become an important tool for doctors and pilots to help minimize mistakes. Atul Gawande’s book, Checklist Manifesto covers the subject in depth, although strictly speaking Checklist Manifesto isn’t a guide to financial checklists; it’s more of an essential primer on complexity in medicine. Indeed, doctors often overlook or omit steps in the multitude of tasks they have to perform every day, and as Atul Gawande argues, these are situations where a simple to-do list could help.

A quick example. According to the New York Times, during 2001 a simple five-point checklist put in place at Johns Hopkins Hospital virtually eradicated central line infections in intensive care. It’s estimated that over the period 43 infections and eight deaths over 27 months were prevented.

Charlie Munger – Poor Charlie’s Checklist

Charlie Munger is also an advocate of using checklists and the list that he has found most valuable to investing was published within Peter Kaufman’s book, “Poor Charlie’s Almanack”.

Poor Charlie’s Almanack is a collection of Charlie Munger’s speeches and ideas, many of which focus on the development of investors’ skills, or as Charlie Munger would put it, worldly wisdom.

Charlie Munger’s philosophy is that to become successful at stock picking, and life in general, you need to have a broad view of the world.

“What is elementary, worldly wisdom? Well, the first rule is that you can’t really know anything if you just remember isolated facts and try and bang ‘em back. If the facts don’t hang together on a latticework of theory, you don’t have them in a usable form. You’ve got to have models in your head. And you’ve got to array your experience ? both vicarious and direct ? on this latticework of models. You may have noticed students who just try to remember and pound back what is remembered… the wisdom of the world is not to be found in one little academic department. That’s why poetry professors, by and large, are so unwise in a worldly sense. They don’t have enough models in their heads…”

Charlie Munger’s checklist was designed to help investors deploy their worldly wisdom.

“Checklist routines avoid a lot of errors. You should have all this elementary [worldly] wisdom and then you should go through a mental checklist in order to use it. There is no other procedure in the world that will work as well.” — Charlie Munger speech to the University of Southern California Law School.
Charlie Munger – Condensed checklist

Charlie Munger’s full checklist, as published within Poor Charlie’s Almanack, is extensive and difficult to follow. With that in mind, here is a condensed version as published on Stockopedia. Charlie’s full checklist is published below.

**Measure risk:** All investment evaluations should begin by measuring risk, especially reputational. This is said to involve incorporating an appropriate margin of safety, avoiding permanent loss of capital and insisting on proper compensation for risk assumed.

**Be independent:** Only in fairy tales are emperors told they’re naked. Remember that just because other people agree or disagree with you doesn’t make you right or wrong – the only thing that matters is the correctness of your analysis.

**Prepare ahead:** The only way to win is to work, work, work, and hope to have a few insights. If you want to get smart, the question you have to keep asking is “why, why, why?”

**Have intellectual humility:** Acknowledging what you don’t know is the dawning of wisdom. Stay within a well-defined circle of competence & identify and reconcile disconfirming evidence.

**Analyze rigorously:** Use effective checklists to minimize errors and omissions. Determine value apart from price; progress apart from activity; wealth apart from size. Think forwards and backwards – Invert, always invert.

**Allocate assets wisely:** Proper allocation of capital is an investor’s No. 1 job. You should remember that good ideas are rare – when the odds are greatly in your favor, bet heavily. At the same time, don’t “fall in love” with an investment.

**Have patience:** Resist the natural human bias to act. “Compound interest is the eighth wonder of the world” (Einstein); never interrupt it unnecessarily and avoid unnecessary transactional taxes and frictional costs.

**Be decisive:** When proper circumstances present themselves, act with decisiveness and conviction. Be fearful when others are greedy, and greedy when others are fearful. Opportunity doesn’t come often, so seize it when it comes.

**Be ready for change:** Accept unremovable complexity. Continually challenge and willingly amend your “best-loved ideas” and recognize reality even when you don’t like it – especially when you don’t like it.

**Stay focused:** Keep it simple and remember what you set out to do. Remember that reputation and integrity are your most valuable assets – and can be lost in a heartbeat. Face your big troubles; don’t sweep them under the rug.

**Charlie Munger’s full checklist**

Risk — All investment evaluations should begin by measuring risk, especially reputational

- Incorporate an appropriate margin of safety
- Avoid dealing with people of questionable character
- Insist upon proper compensation for risk assumed
- Always beware of inflation and interest rate exposures
- Avoid big mistakes; shun permanent capital loss –
Independence — “Only in fairy tales are emperors told they are naked”

Objectivity and rationality require independence of thought
Remember that just because other people agree or disagree with you doesn’t make you right or wrong – the only thing that matters is the correctness of your analysis and judgment
Mimicking the herd invites regression to the mean (merely average performance)

Preparation — “The only way to win is to work, work, work, work, and hope to have a few insights”

Develop into a lifelong self-learner through voracious reading; cultivate curiosity and strive to become a little wiser every day
More important than the will to win is the will to prepare
Develop fluency in mental models from the major academic disciplines
If you want to get smart, the question you have to keep asking is “why, why, why?”

Intellectual humility — Acknowledging what you don’t know is the dawning of wisdom

Stay within a well-defined circle of competence
Identify and reconcile disconfirming evidence
Resist the craving for false precision, false certainties, etc.
Above all, never fool yourself, and remember that you are the easiest person to fool –

Analytic rigor — Use of the scientific method and effective checklists minimizes errors and omissions

Determine value apart from price; progress apart from activity; wealth apart from size
It is better to remember the obvious than to grasp the esoteric
Be a business analyst, not a market, macroeconomic, or security analyst
Consider totality of risk and effect; look always at potential second order and higher level impacts
Think forwards and backwards – Invert, always invert –

Allocation — Proper allocation of capital is an investor’s number one job

Remember that highest and best use is always measured by the next best use (opportunity cost)
Good ideas are rare – when the odds are greatly in your favor, bet (allocate) heavily
Don’t “fall in love” with an investment – be situation-dependent and opportunity-driven –

Patience — Resist the natural human bias to act

“Compound interest is the eighth wonder of the world” (Einstein); never interrupt it unnecessarily
Avoid unnecessary transactional taxes and frictional costs; never take action for its own sake
Be alert for the arrival of luck
Enjoy the process along with the proceeds, because the process is where you live –

Decisiveness — When proper circumstances present themselves, act with decisiveness and conviction

Be fearful when others are greedy, and greedy when others are fearful
Opportunity doesn’t come often, so seize it when it comes
Opportunity meeting the prepared mind; that’s the game –

**Change** — Live with change and accept unremovable complexity

Recognize and adapt to the true nature of the world around you; don’t expect it to adapt to you
Continually challenge and willingly amend your “best-loved ideas”
Recognize reality even when you don’t like it – especially when you don’t like it

**Focus** — Keep things simple and remember what you set out to do

Remember that reputation and integrity are your most valuable assets – and can be lost in a heartbeat
Guard against the effects of hubris (arrogance) and boredom
Don’t overlook the obvious by drowning in minutiae (the small details)
Be careful to exclude unneeded information or slop: “A small leak can sink a great ship”
Face your big troubles; don’t sweep them under the rug
Part Six
The Daily Journal

Charlie Munger is best known for his career as Vice-Chairman of Berkshire Hathaway Corporation and for being Warren Buffett’s right hand man. He is also chairman of the Daily Journal Corporation and has been instrumental in the Journal’s growth over the past six years.

The Daily Journal is a publisher specializing in legal text. The Daily Journal provides news of interest to members of the legal profession, specializes in public notice advertising, publishing state-mandated notices of death, fictitious business names, and sells software used to administer court cases. Charlie Munger started his working life as a lawyer, so the Daily Journal is a natural fit for him.

The Daily Journal was a strong business up until the financial crisis. Return on equity averaged 25% to 30% per annum; cash conversion was 70% per annum on average, and book value doubled between 2005 and 2008. However, since 2010 revenue growth has slowed to around 2.6% per annum and net income has fallen by 75%. EBITDA has more than halved.

Luckily, during the first quarter of 2009, Charlie Munger used $15.5 million of the Daily Journal’s cash to purchase a number of securities for the company. At first, neither Charlie Munger nor the Journal disclosed these positions, (although with both Munger and Rick Gurin working at the Journal, these positions we certain to value orientated and low-risk). This post from The Value Investors Club blog post, written only a few months after Munger started buying shows the secrecy surround the transactions:

“During the first quarter of 2009, Charlie Munger, Chairman of Daily Journal Corp. (DJCO), made a significant redeployment of the company’s excess cash into an investment in common equities. Based on circumstantial evidence, we believe (but cannot be 100% certain since the Company has not disclosed what its invested in) that Munger purchased shares of Wells Fargo & Co (NYSE:WFC) and/or possibly U.S. Bancorp (NYSE:USB) at their recent early-March lows.”

“As such, DJCO now contains a hidden asset that may not be fully reflected in its current share price.”

“Based on circumstantial evidence, it appears possible that Munger plunked $15.5mm of DJCO cash to buy WFC (or USB or both). If this speculation on DJCO’s equity purchase(s) is correct, then that $15.5 million investment which rose to $24.7mm at the end of March would now be up to $33-42 million at today’s prices for USB/WFC. Thus in summary, DJCO looks cheap at a market cap of $64.5 million…we believe there is good value in DJCO based on the strength of Munger’s legendary capital allocation skills.” — Value Investors Club July 2009.

Time to buy

Charlie Munger started buying securities with the Journal’s cash for two reasons. Firstly, value:
“We bought Wells Fargo & Co (NYSE:WFC) stock when it was at $8, and I don’t think we will have another opportunity like that.” — Charlie Munger Daily Journal 2015 Meeting [FULL NOTES]

Secondly, the Journal’s board believed that jumping into stocks was the safest move during the financial crisis:

“The board recognized that this decision would be contrary to the conventional (but questionable) notion that the least risky way to preserve corporate capital for the long-term benefit of stockholders is to invest it in government bonds at interest rates approximating zero,” Source.

From a starting point of just under $16 million, the Daily Journal’s portfolio had grown to $135.3 million as of 31 December last year. The portfolio’s holding were revealed for the first time during 2014, and they are typical Buffett/Munger style investments. Four main companies account for the bulk of the portfolio; Wells Fargo (by far the largest position around 70% of portfolio), Bank of America, U.S. Bancorp and Korean steel producer Posco.

“Posco is the most efficient steel company in the world. It had a pretty close to a local monopoly position in its country for a long time. It is very hard to avoid being commoditized in the modern world. In the places like The The Dow Chemical Company (NYSE:DOW) Company (NYSE:DOW) with complex chemical process, with 1000 PhDs, it is still hard to not be commoditized. Posco was able to do so.” — Charlie Munger Daily Journal 2015 Meeting [FULL NOTES]


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<td>$63.17</td>
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Data from Morningstar

Running out of space

It’s almost impossible to cover Charlie Munger’s whole career at the Daily Journal in only one article. Nevertheless, this brief history of the Journal’s share portfolio, and how it has changed the company’s fortunes since inception, does shed a great deal of light on Charlie Munger’s investing style, as well as what he looks for when buying a stock and how he would run his own stock portfolio.
As I have run out of space here, I’ve included a selection of articles below that provide more information on Charlie Munger’s time at the Journal.

Notes From Charlie Munger’s Daily Journal Meeting 2015
Munger’s Daily Journal Lifts Curtain of Secrecy on Bets
Charlie Munger’s Portfolio At Daily Journal
Warren Buffett sidekick Munger creates a mini-Berkshire at Daily Journal
Daily Journal Corp Annual Meeting Notes (Feb 6, 2013)
What’s Up With Charlie Munger’s Other Company
The SEC Thought Charlie Munger Was Hiding A Hedge Fund
A Fireside Chat With Charlie Munger
Part Seven
Part seven: Poor Charlie’s Almanack

Without a doubt, the best resource you can get on Charlie Munger is the book, Poor Charlie’s Almanack: The Wit and Wisdom of Charles T. Munger.

Poor Charlie’s Almanack was constructed by Peter D. Kaufman (the production team also included Travis Gallup, Carl Foote, Scott Rule, Dwight Tompkins, Michael Broggie, Steve Mull, Pamela Koch, Eric Hartman-Birge, Paul Hartman, Charles Belser, Ed Wexler, Whitney Tilson, Marcus Kaufman, Peter Kaufman, Carol Loomis, Debbie Bosanek, and Doerthe Obert) and groups together a broad selection of Charlie Munger’s essays, memoirs, interviews, and speeches. The book is based on Benjamin Franklin’s Poor Richard’s Almanack, a popular collection of calendars, weather-related and astrological material that was published from 1733 to 1758.

Poor Charlie’s breakdown

The first chapter of the book includes a biography of Munger, a short version of which you can find here — the start of this series. Poor Charlie’s Almanack then goes on to discuss “the Munger approach to life, learning, decision-making, and investing”. This part of the book is just as important as any other. Poor Charlie’s Almanack was one of the first publications to draw attention to Munger’s ‘multiple mental models’ approach to evaluating businesses. Key to this approach is Charlie’s investing checklist, which I covered in part five of this series.

Also introduced alongside Charlie Munger’s mental models, is his “Lollapalooza Effect”.

The “Lollapalooza Effect” is, in Charlie’s words, the “multiple biases, tendencies or mental models all acting at the same time in the same direction to produce extreme outcomes and investor misjudgement”. Or in other words, the “Lollapalooza Effect” describes the mentality of short-term investors, who chase wild market gyrations in an attempt to profit.

Charlie’s essays

Chapter three of Poor Charlie’s Almanack covers material from Berkshire Hathaway Inc. (NYSE:BRK.A) (NYSE:BRK.B) and WescoFinancial meetings. The rest of the book is devoted to ten stand-out talks from Munger given over his 20-year career.

Poor Charlie’s Almanack is essential reading for all value investors. Not only does it provide essential investing advice, but it also guides on the psychological side of investing and life in general.

Below are just two excerpts from the book. These two short lessons are taken from Charlie Munger’s lecture to the students of Professor Guilford Babcock, at the University of Southern California Marshall School of Business. the lecture was titled, “A Lesson On Elementary, Worldly Wisdom As It Relates To Investment Management & Business.”
If you’re interested in more of Charlie Munger’s musings, but don’t have access to Poor Charlie’s Almanack, here’s a PDF compilation of documents.

YOU’LL FAIL IN BUSINESS AND IN LIFE.

Without a latticework of models, you’ll fail in school and life.

Munger: What is elementary, worldly wisdom? Well, the first rule is that you can’t really know anything if you just remember isolated facts and try and bang ‘em back. If the facts don’t hang together on a latticework of theory, you don’t have them in a usable form.

You’ve got to have models in your head. And you’ve got to array your experience – both vicarious and direct – on this latticework of models. You may have noticed students who just try to remember and pound back what is remembered. Well, they fail in school and fail in life. You’ve got to hang experience on a latticework of models in your head.

Absent enough models, your brain will torture reality.

Munger: What are the models? Well, the first rule is that you’ve got to have multiple models – because if you just have one or two that you’re using, the nature of human psychology is such that you’ll torture reality so that it fits your models, or at least you’ll think it does. You become the equivalent of a chiropractor who, of course, is the great boob in medicine.

It’s like the old saying, “To the man with only a hammer, every problem looks like a nail.” And of course, that’s the way the chiropractor goes about practicing medicine. But that’s a perfectly disastrous way to think and a perfectly disastrous way to operate in the world. So you’ve got to have multiple models.

And the models have to come from multiple disciplines – because all the wisdom of the world is not to be found in one little academic department. That’s why poetry professors, by and large, are so unwise in a worldly sense. They don’t have enough models in their heads. So you’ve got to have models across a fair array of disciplines.

Fortunately, it isn’t all that tough….

Munger: You may say, “My God, this is already getting way too tough.” But, fortunately, it isn’t that tough – because 80 or 90 important models will carry about 90% of the freight in making you a worldly-wise person. And, of those, only a mere handful really carry very heavy freight.

YOU’RE GIVING A HUGE ADVANTAGE TO OTHERS IF YOU DON’T LEARN THIS SIMPLE TECHNIQUE.

…Obviously, you’ve got to be able to handle numbers and quantities – basic arithmetic.

And the great useful model, after compound interest, is the elementary math of permutations and combinations. And that was taught in my day in the sophomore year in high school. I suppose by now in great private schools, it’s probably down to the eighth grade or so.
It’s very simple algebra. And it was all worked out in the course of about one year in correspondence between Pascal and Fermat. They worked it out casually in a series of letters.

Your brain isn’t designed to figure it out spontaneously.

Munger: It’s not that hard to learn. What is hard is to get so you use it routinely almost everyday of your life. The Fermat/Pascal system is dramatically consonant with the way that the world works. And it’s fundamental truth. So you simply have to have the technique.

Many educational institutions – although not nearly enough – have realized this. At Harvard Business School, the great quantitative thing that bonds the first-year class together is what they call decision tree theory. All they do is take high school algebra and apply it to real life problems. And the students love it. They’re amazed to find that high school algebra works in life—

By and large, as it works out, people can’t naturally and automatically do this. If you understand elementary psychology, the reason they can’t is really quite simple: The basic neural network of the brain is there through broad genetic and cultural evolution. And it’s not Fermat/Pascal. It uses a very crude, shortcut-type of approximation. It’s got elements of Fermat/Pascal in it. However, it’s not good.

Without it, you’re giving a huge advantage to others—

Munger: So you have to learn in a very usable way this very elementary math and use it routinely in life – just the way if you want to become a golfer, you can’t use the natural swing that broad evolution gave you. You have to learn to have a certain grip and swing in a different way to realize your full potential as a golfer.

If you don’t get this elementary, but mildly unnatural, mathematics of elementary probability into your repertoire, then you go through a long life like a one-legged man in an ass-kicking contest. You’re giving a huge advantage to everybody else. O

One of the advantages of a fellow like Buffett, whom I’ve worked with all these years, is that he automatically thinks in terms of decision trees and the elementary math of permutations and combinations—

YOU HAVE TO KNOW ACCOUNTING – ALONG WITH ITS LIMITATIONS.

Double-entry bookkeeping was a hell of an invention.

Munger: Obviously, you have to know accounting. It’s the language of practical business life. It was a very useful thing to deliver to civilization. I’ve heard it came to civilization through Venice which of course was once the great commercial power in the Mediterranean. However, double entry bookkeeping was a hell of an invention.

And it’s not that hard to understand. But you have to know accounting’s limitations—

Munger: But you have to know enough about it to understand its limitations – because although accounting is the starting place, it’s only a crude approximation. And it’s not very hard to understand its limitations. For example, everyone can
Part Eight
Part eight: Berkshire at 50

In part seven of this series, I looked at the book Poor Charlie’s Almanack, a compilation of Charlie Munger’s speeches, presentations and letters. One essay that wasn’t included in Poor Charlie’s Almanack (mainly because it was written almost a decade after the book was published — it’s still essential reading) is Charlie Munger’s contribution to the Berkshire Hathaway 50th anniversary letter.

Across five pages of the Berkshire Letter, Charlie Munger takes a look at the factors have been key to Berkshire’s success over the years.

And the commentary from Charlie Munger really does offer an invaluable insight into how Berkshire operates. However, these reflections are not just relevant to Berkshire. Charlie’s observations can also help the average investor improve their investing process.

Unfortunately, there’s not enough space to cover Charlie Munger’s whole contribution to the Berkshire letter here. So, I’ve picked out a few key from the text. The full letter can be found at the link above.

Stick with what you know

“In buying a new subsidiary, Berkshire would seek to pay a fair price for a good business that the Chairman could pretty well understand. Berkshire would also want a good CEO in place, one expected to remain for a long time and to manage well without need for help from headquarters.”

Charlie Munger refers to Warren Buffett as ‘the Chairman’ throughout his writings to Berkshire shareholders. In this case, Munger highlights that Berkshire only invests in businesses that Buffett can understand. Invest inside your circle of competence.

“Buffett’s decision to limit his activities to a few kinds and to maximize his attention to them, and to keep doing so for 50 years, was a lollapalooza. Buffett succeeded for the same reason Roger Federer became good at tennis. Buffett was, in effect, using the winning method of the famous basketball coach, John Wooden, who won most regularly after he had learned to assign virtually all playing time to his seven best players.”

The key takeaway, stick with what you know. If you really know and understand the business that you are investing in, you won’t have a problem going overweight. Isolate your best ideas and don’t spread yourself too thinly.

Don’t be in a rush

“Why did Berkshire’s acquisition of companies outside the insurance business work out so well for Berkshire shareholders when the normal result in such acquisitions is bad for shareholders of the acquirer? Well, Berkshire, by design, had methodological advantages to supplement its better opportunities. It never had the equivalent of a “department of acquisitions” under pressure to buy...And, finally, even when Berkshire was getting much better opportunities than most others, Buffett often displayed almost inhuman patience and seldom bought. For instance, during his first ten years in control
of Berkshire, Buffett saw one business (textiles) move close to death and two new businesses come in, for a net gain of one.”

Patience is the name of the game, a point Charlie has pointed out many times before. Indeed, when Charlie Munger sat down for a ‘fireside chat’ with Jason Zweig last year, to talk about the secrets of Buffett’s success, he delivered the following statement:

Successful investing, Mr. Munger told me, requires “this crazy combination of gumption and patience, and then being ready to pounce when the opportunity presents itself, because in this world opportunities just don’t last very long.”

“It’s waiting that helps you as an investor, and a lot of people just can’t stand to wait,” he said. “If you didn’t get the deferred-gratification gene, you’ve got to work very hard to overcome that.”

Berkshire was built by investing in new businesses at just the right time. Buffett is never in a rush. The results speak for themselves.

**Berkshire's Performance vs. the S&P 500**

*Hypothetical performance of a $100 investment in Berkshire Hathaway on 1/1/1965 to 12/31/2014 relative to the S&P 500 with dividends included.*
Mistakes and a long-term outlook

“What were the big mistakes made by Berkshire under Buffett? Well, while mistakes of commission were common, almost all huge errors were in not making a purchase, including not purchasing Wal-Mart Stores, Inc. (NYSE: WMT) stock when that was sure to work out enormously well.”

Buffett himself has admitted that the biggest mistake he ever made was buying Berkshire in the first place. Nonetheless, Charlie Munger’s view of mistakes is more optimistic and doesn’t dwell on losses, only gains that were missed. It’s not wise to spend too long dwelling on your losers as this can start to affect your investing process.

“In its early Buffett years, Berkshire had a big task ahead: turning a tiny stash into a large and useful company. And it solved that problem by avoiding bureaucracy and relying much on one thoughtful leader for a long, long time as he kept improving and brought in more people like himself. Compare this to a typical big-corporation system with much bureaucracy at headquarters and a long succession of CEOs who come in at about age 59…”

Another great point Charlie Munger makes is that Berkshire’s success has been driven by Buffett’s long-term outlook. A long succession of new CEO’s, with different ideas and outlooks, can hold back business growth. Companies managed by CEO’s with a long-term outlook, a large stake in the businesses success, or family ties to the business will perform better than short-sighted peers on average.
Part Nine
Colorful Charlie and the Cinderella Principle

Charlie Munger’s age, experience and reputation in the investment world allows him to make statements that few others could get away with. And over the years, Charlie has earned a reputation for saying what’s on his mind, no matter who it offends, although in many cases he is only saying what others are already thinking.

At the Berkshire Hathaway Inc. (NYSE:BRK.A) (NYSE:BRK.B) 2013 annual meeting, Charlie really lived up to his reputation. In just one meeting he labeled bankers “heroin addicts”, accused the Fed of hurting savers because they were “convenient”, branded high frequency trading “legalized front-running” and stated that “letting Greece into the EU was sort of like serving up rat poison for whipping cream.” Warren Buffett later explained these statements:

On Greece: “…putting 17 countries into a monetary union where you synchronize the currency but you didn’t synchronize any other aspects of their economies, I mean the fiscal policies, the culture, costs of production, was doomed to failure.”

On bankers: “…leverage has enticed people to do crazy things for time immemorial…And he would say that, probably say that that heroin, basically, is leverage and the ability to just borrow more and more money through deposits or whatever, and that that should be controlled.”

On the Fed: “…it had to hurt somebody. Bernanke had tough choices to make, but he decided to step on the gas pedal…and that really does hurt savers. I mean, it has made it extremely difficult for all kinds of people who live on fixed-income investments. But, unfortunately, that was a by-product.”

On high frequency trading: “That’s what it is [legalized front running]. Yeah, that’s what it is. I mean, that’s the whole game. Why a — let’s say that high-frequency trading produces gross income of X. That X comes out of somebody. It doesn’t make Berkshire Hathaway more productive. It doesn’t do anything of the sort. It comes, one way or another, it comes out of the pocket of investors. And the social purpose of it is rather hard to discern.”

When asked about short sellers at the Berkshire meeting, Charlie stated “We don’t like trading agony for money.” As Buffett explains:

“The reason he said that is because a stock, when you short it, can theoretically go to infinity. When you buy a stock at 10, you can only lose 10 points. When you short a stock at 10, it can go to 100 or 200…We like to sleep well, and you can’t sleep well if you’re short a lot of stocks.”
Charlie Munger – The Cinderella Principle

Throughout this series, I’ve discussed Charlie Munger’s investment style, process and early life but one thing that I have not discussed is the informal Cinderella Principle.

The Cinderella Principle is a fundamental part of investing and life in general. Charlie Munger is one of the greatest examples of the principle in action.

Put simply, the Cinderella Principle is an example of investors’ psychology. Everyone thinks life is one upward, smooth trajectory — like a The Walt Disney Company (NYSE:DIS) princess in her castle. But between “Once upon a time” and “Happily ever after” there’s a lot of work that needs to be done. Nothing comes easy.

Joshua Kennon gives the best example of Munger’s willingness to overcome unbelievable challenges and tragedies in order to achieve what he has:

In 1949, Charlie Munger was 25 years old. He was hired at the law firm of Wright & Garrett for $3,300 per year, or $29,851 in inflation-adjusted dollars as of 2010. He had $1,500 in savings, equal to $13,570 now.

A few years later, in 1953, Charlie was 29 years old when he and his wife divorced. He had been married since he was 21. Charlie lost everything in the divorce, his wife keeping the family home in South Pasadena. Munger moved into “dreadful” conditions at the University Club…Shortly after the divorce, Charlie learned that his son, Teddy, had leukemia…Rick Guerin, Charlie’s friend, said Munger would go into the hospital, hold his young son, and then walk the streets of Pasadena crying.

One year after the diagnosis, in 1955, Teddy Munger died. Charlie was 31 years old, divorced, broke, and burying his 9 year old son. Later in life, he faced a horrific operation that left him blind in one eye with pain so terrible that he eventually had his eye removed.

By the time he was 69 years old, he had become one of the richest 400 people in the world, been married to his second wife for 35+ years, had eight wonderful children, countless grandchildren, and become one of the most respected business thinkers in history.
Part Ten
Conclusion

In this concluding part of this series, I’m summing up the key points of Charlie Munger’s investment philosophy.

1. Quality over value

Charlie Munger looks for quality businesses when investing. Unlike Warren Buffett, Charlie Munger is willing to pay a high price for a great business.

“The ideal business is one that generates very high returns on capital and can invest that capital back into the business at equally high rates. Imagine a $100 million business that earns 20% in one year, reinvests the $20 million profit and in the next year earns 20% of $120 million and so forth. But there are very few businesses like this. Coke has high returns on capital, but incremental capital doesn’t earn anything like its current returns. We love businesses that can earn high rates on even more capital than it earns.”

“…if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive looking price, you’ll end up with a fine result.”

“…the big money’s been made in the high quality businesses. And most of the other people who’ve made a lot of money have done so in high quality businesses.”

2. Be ready

However, you need to wait for the perfect opportunity before you pounce. It pays to wait. Sometimes the best thing you can do is nothing.

“The way to get rich is to keep $10 million in your checking account in case a good deal comes along...There are worse situations than drowning in cash and sitting, sitting, sitting. I remember when I wasn’t awash in cash — and I don’t want to go back.”

“This great emphasis on volatility in corporate finance we regard as nonsense. Let me put it this way; as long as the odds are in our favor and we’re not risking the whole company on one throw of the dice or anything close to it, we don’t mind volatility in results. What we want are favorable odds.”

“Move only when you have an advantage.”
When you keep cash on hand, you need to be patient and wait for the perfect opportunity. Patience is a fundamental element of Charlie Munger’s sit on your ass strategy:

“I did not succeed in life by intelligence. I succeeded because I have a long attention span.”

3. Know what you want and be aware

Decide what you want in an investment and build a checklist to minimize mistakes.

“Checklist routines avoid a lot of errors. You should have all this elementary [worldly] wisdom and then you should go through a mental checklist in order to use it. There is no other procedure in the world that will work as well.” — Charlie Munger speech to the University of Southern California Law School.

What’s more, investors should keep up to date on developments around the world, build a “worldly wisdom” and incorporate this into their investing strategy.

“What is elementary, worldly wisdom? Well, the first rule is that you can’t really know anything if you just remember isolated facts and try and bang ‘em back. If the facts don’t hang together on a latticework of theory, you don’t have them in a usable form. You’ve got to have models in your head. And you’ve got to array your experience? Both vicarious and direct? On this latticework of models. You may have noticed students who just try to remember and pound back what is remembered… the wisdom of the world is not to be found in one little academic department. That’s why poetry professors, by and large, are so unwise in a worldly sense. They don’t have enough models in their heads…”

4. The most important lesson of all

The final takeaway from Charlie Munger’s speeches and writings over the years is this; in order to succeed you must constantly seek to learn, adapt, figure out what works for you and apply a technique that helps you understand the complexities of life.

YOU’RE GIVING A HUGE ADVANTAGE TO OTHERS IF YOU DON’T LEARN THIS SIMPLE TECHNIQUE.

...Obviously, you’ve got to be able to handle numbers and quantities – basic arithmetic.

And the great useful model, after compound interest, is the elementary math of permutations and combinations. And that was taught in my day in the sophomore year in high school...Your brain isn’t designed to figure it out spontaneously.

Munger: It’s not that hard to learn. What is hard is to get so you use it routinely almost everyday of your life...So you simply have to have the
Many educational institutions – although not nearly enough – have realized this. At Harvard Business School, the great quantitative thing that bonds the first-year class together is what they call decision tree theory. All they do is take high school algebra and apply it to real life problems. And the students love it. They’re amazed to find that high school algebra works in life….people can’t naturally and automatically do this...

To stand out from the rest of the crowd Charlie Munger believes that you need to develop a simple way of understanding complex problems. Without this method in place, you’re putting yourself at a huge disadvantage.