1234

What Warren Buffett's Investment Checklist Can Teach Aussie Investors

Owen Raszkiewicz
Founder, The Rask Group

GENERAL ADVICE WARNING

This document, issued by Rask Group Pty Ltd, provides general information only. That means, the information included in this eBook does not take into account your objectives, financial situation or needs. Because of that, you should consider if the information is appropriate to you and your needs, before acting on it.

Please remember, past performance is not indicative of future performance, as an investment's past performance may not be reflective of its potential future returns. That is, investment returns are not guaranteed.
You should consider obtaining independent financial, legal and taxation advice before acting on the information presented here. Please read our Financial Services Guide before reading this report. The Rask Group Pty Ltd (ACN: 622 810 995) is a Corporate Authorised Representative (no. 1264179) of MSC Advisory Pty Ltd (ACN: 607 459 441) (AFSL: 480 649).

About The Author

Owen Raszkiewicz is the Founder of Rask ***Finance*** and Rask ***Invest***.

A former investment analyst and business writer by trade, Owen is completely nuts about business and investing, and has applied himself to helping others understand their finances. Owen's free financial education videos and courses have been viewed tens of thousands of times for thousands of hours.

Owen has appeared on Channel 10's *The Project* talking Chinese stocks and written for or been quoted in many prominent financial publications.

He holds a Master's of Applied Finance, Master's of Financial Planning, Bachelor of Technology and Advanced Diploma of Financial Services. He has also completed Level 1 of the Chartered Financial Analyst (CFA®) program.

In addition to starting The Rask Group, which includes Rask ***Finance*** and Rask ***Invest***; Owen launched Rask ***Media***, a free financial news platform which reaches thousands of people every month.

Owen is a signatory of the *Banking + Finance Oath*, and The Rask Group is 100% Committed to promoting ethics in business and finance.

You can reach Owen on Twitter: @OwenRask

What Aussie Investors Can Learn From Warren Buffett's Investing Strategy

It's amazing, isn't it?
According to Forbes[1], Warren Buffett is worth a mind-blowing **$US84 billion**, or $US84,000,000,000 -- even more if it's converted to Aussie dollars!

Something that's often forgotten about Buffett is that he was worth 'just' $300 million when he blew out the candles at his 50th birthday.
Let's think about that for just a moment…

That means he **made more than 99% of his wealth *after 50*** despite being a millionaire in his late 20's[2]. Not only is Buffett an excellent investor, clearly, he used **time** to his advantage by letting his money compound over and over and over again….

The Young Buffett

From a young age Buffett knew the power of saving money to invest in *businesses*.
As a kid, he owned coin operated games.
He also had a newspaper run.
"He was earning $175 a month - what many a young man was earning as a full-time wage - and saving every dime," Roger Lowenstein wrote in his great book, *Buffett: The Making of An American Capitalist*[3]. *"In 1945, when he was still only fourteen, he took $1,200 of his profits and invested it in forty acres of Nebraska farmland."*

Fast-forward to today and Buffett's **Berkshire Hathaway Inc.** (BRK) is one of America's -- and the world's -- largest companies, owning huge chunks of public and private companies like **Apple Inc**, **Coca-Cola**, **GEICO** and more[4].
He and his investing partner, Charlie Munger, oversee the investing of hundreds of billions of dollars.

But how *exactly* did he do it?

---

[1] Forbes website, *The Billionaires 2018*, accessed: May 24, 2018
[2] Morgan Housel, *The Freakishly Strong Base,* Collaborative Fund, October 31, 2017
[3] Roger Lowenstein, *Buffett: The Making of an American Capitalist*, April 29, 2008
[4] Berkshire Hathaway Inc, *2017 Annual Letter To Shareholders*, February 24, 2018

The Buffett & Munger Investing Checklist

Despite their enviable track record and wealth, the Buffett and Munger investing checklist doesn't require access to a fancy computer, a secret database or the fastest trading platform. In fact, it has remained virtually unchanged for *decades*[5].

Over the decades and again in 2009, as the *Global Financial Crisis* raged on, Munger revealed their 4-step investing checklist in an interview with the *BBC*[6].

Below, I'll explain each of the four steps in my own words and how I think Aussie investors can apply these investing principles with some quick tricks.

It's the same set of principles **I use to invest my family's money in Australian and international shares** -- and the same rules I follow when I produce share ideas for members of Rask ***Invest***.

"It's a very simple set of ideas. The reason our ideas have not spread faster is they're too simple…" - C. Munger, BBC interview, 2009

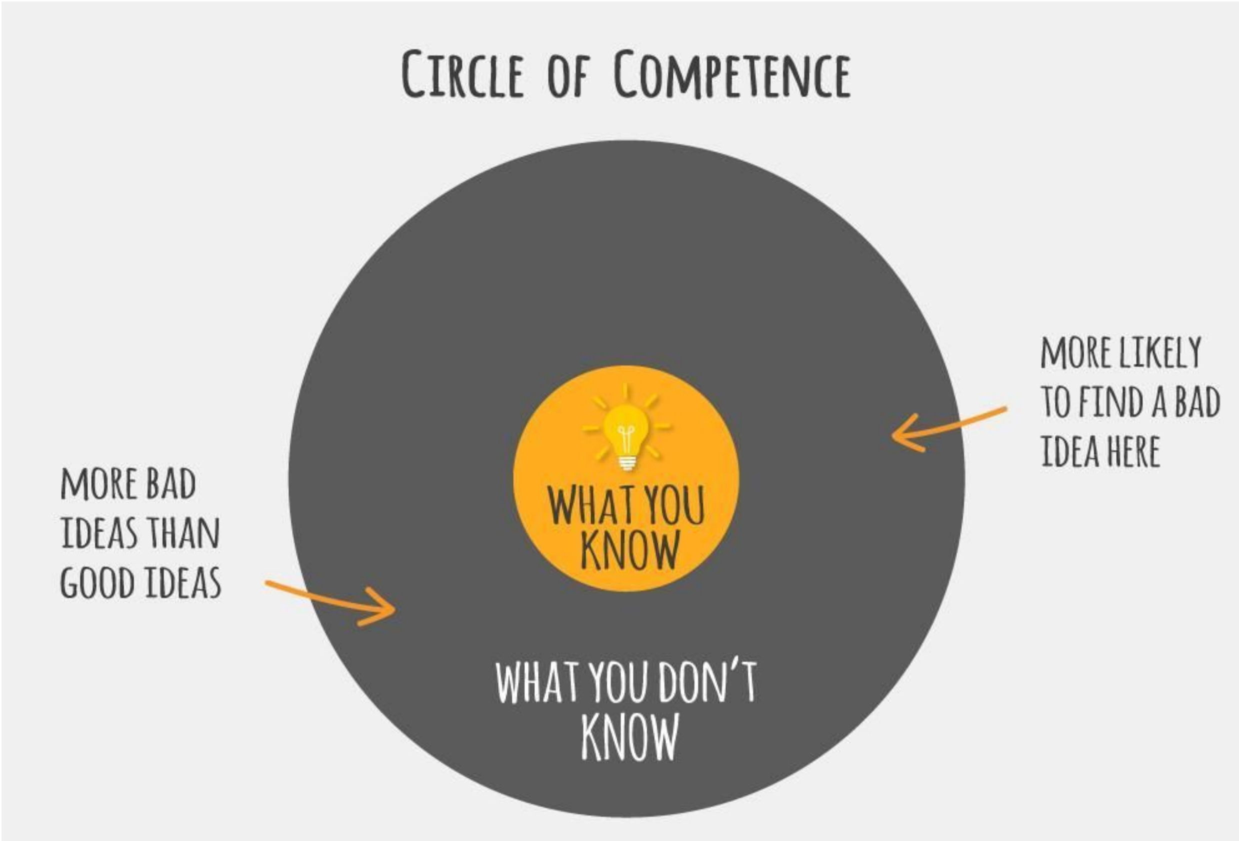
1. Buffett Buys Shares of Companies He Can Understand.

The first principle is obvious.
As the famed investor Peter Lynch once wrote[7]: *"If you're prepared to invest in a company, then you ought to be able to explain why in simple language that a fifth grader could understand, and quickly enough so the fifth grader won't get bored."*

How can Aussie investors apply this principle? It's pretty simple.
First, investors must know the boundaries of their knowledge.
Second, they must use what they know to their advantage.

---

[5] See Berkshire Hathaway Inc, *1977 Annual Letter To Shareholders,* March 14, 1978
[6] BBC News, sourced May 2018 from YouTube (channel: "valueinvestingpro"), published October 27, 2009
[7] Peter Lynch, *Beating the Street*, P. 105, Simon and Schuster



Inside our 'circle of competence' is where we'll find the best investing ideas.
For example, a mechanic might be better at understanding a car parts business than me -- a guy whose knowledge of cars starts and ends at the petrol station.

The way I stay inside my circle of competence is by taking a checklist to my wife and getting her to ask me a series of questions. If I can't answer them succinctly, I don't know enough about the company.

2. The Business Must Have a Durable Competitive Advantage

A competitive advantage is a set of features that gives a business **the ability to make more money than its competitors for many years**[8]. It might be the business' location, brand, a network of users or legal contracts.

While every company has some type of advantage, few companies have a *durable* advantage that allows them to make more cash than their competitors for many years.

A competitive advantage is more commonly called a "**moat**" and gets its name from the ring of water that surrounded a medieval castle.

This ring of water would protect the castle (a company's profit) from attack because soldiers in heavy armour couldn't swim across it to reach the walls. Just reaching the castle was difficult.

However, this defensive feature wasn't bulletproof (for lack of a better word). Armies could camp outside the moat and wait for the castle's supplies to run down. The castle might also be attacked from a distance -- which is similar to technological disruption in today's modern business world.

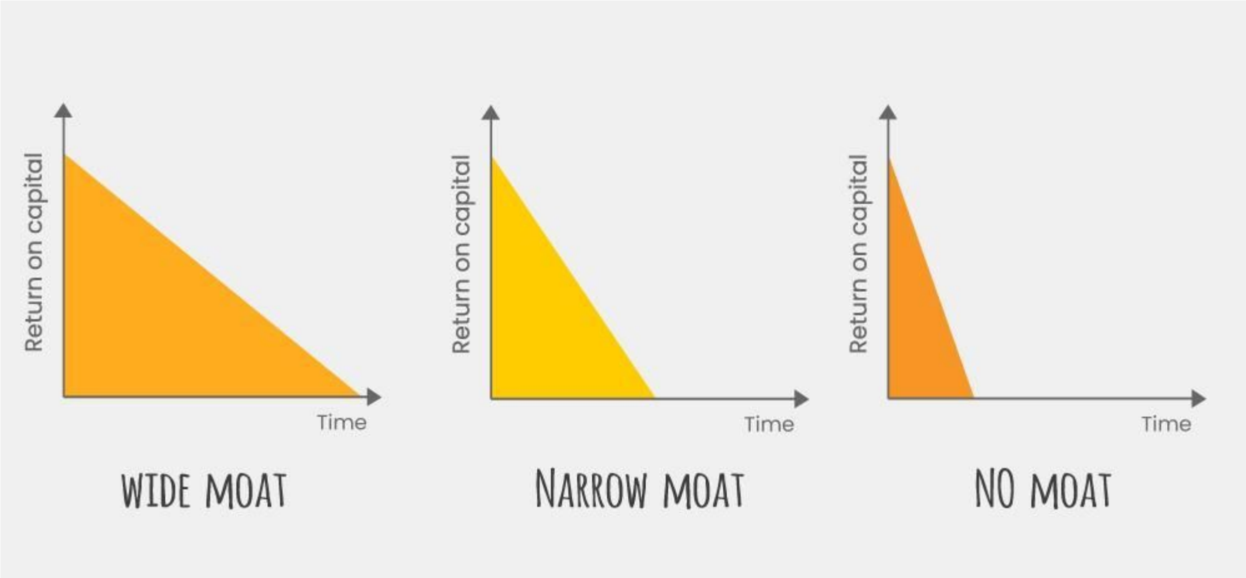
So although the 'moat' was a tool to protect a castle from being overrun in the near future, it wasn't perfect and often wouldn't last forever.

In business and investing, if a company doesn't maintain or grow its protective moat (e.g. its brand name), its competitors will eventually catch-up or beat it at its own game.

[8] Also read Morningstar Inc's unique definition of "Economic Moat"

Why Moats Are Vital

A moat matters because it means a company can reinvest in its business and earn more money than its peers.



See Jack Dorsey's MIT Sloan Presentation, "Competitive Advantage & Capital Allocation", March 2017

Companies with wider moats should do better than those without a moat.

For example, I think Buffett bought Coca-Cola shares many years ago knowing full-well that there was only one Coca-Cola. He bought GEICO, an insurance company, because he knew it could offer cheaper insurance policies for more customers and capture a big part of the booming US market.

When I'm investing for my family and releasing new ideas for Rask ***Invest*** members, I look for companies with advantages over their competitors.

The types of companies I buy shares in often have:

- **Intangible assets:** think of brands, patents and licences. These types of moats enable a business to charge the customer more for a product -- or protect the business from intense competition. Think of **Tiffany's** and **Zamels**. They sell virtually the same product (jewellery) but one of them comes with a $10,000 cardboard box!
- **Switching costs:** This advantage keeps the customer paying. Think of the computer program used at work. It might be used to manage customers or payroll. How hard would it be to stop paying the software owner, develop an in-house version of the product and train new staff while maintaining business as usual? My answer: very hard. I like technology companies that offer business-critical products because I think it makes the business more reliable and less likely to go out of business overnight.
- **Network Effects:** Ever heard of **Facebook** or **Visa**? Yeah, me neither… But, seriously, having more people use a network can make it much more profitable and valuable. For everything else…there's ***Mastercard***.

3. Management Must Have Integrity & Talent.

Like any employee or manager, CEOs must have a purpose for doing what they do.

Because I don't have control over my investments, my goal as a small investor is to do what I can to make sure the CEO's *purpose* or reason for doing something is aligned with mine. Buffett uses the same principle. CEOs must have **integrity**, **talent** and **energy**[9].

When I was younger my mother would say, *"it comes back to trust"*.

"Owen, you can love many people," she would explain. *"But it's much harder to find someone who you can trust."*

The CEO and management team in charge of the company I own (as a shareholder) must have their own interests aligned with mine.

Being a long-term investor, I need to see a management team that thinks long-term. That is, they can't be setting themselves up for a quick buck at my expense.

Therefore, I'll look for managers, directors and CEOs who meet some or all the following criteria:

- **Skin in the game.** There's a saying, *'CEOs buy shares in the company they run for one reason but sell for many'*. Ideally, I want my CEO and management team to hold lots of shares in the company they run. The more of their wealth in the shares of the company -- the better.

---

[9] Farnam Street blog, *Why Lazy and Smart People Make the Best Leaders*, September, 2013

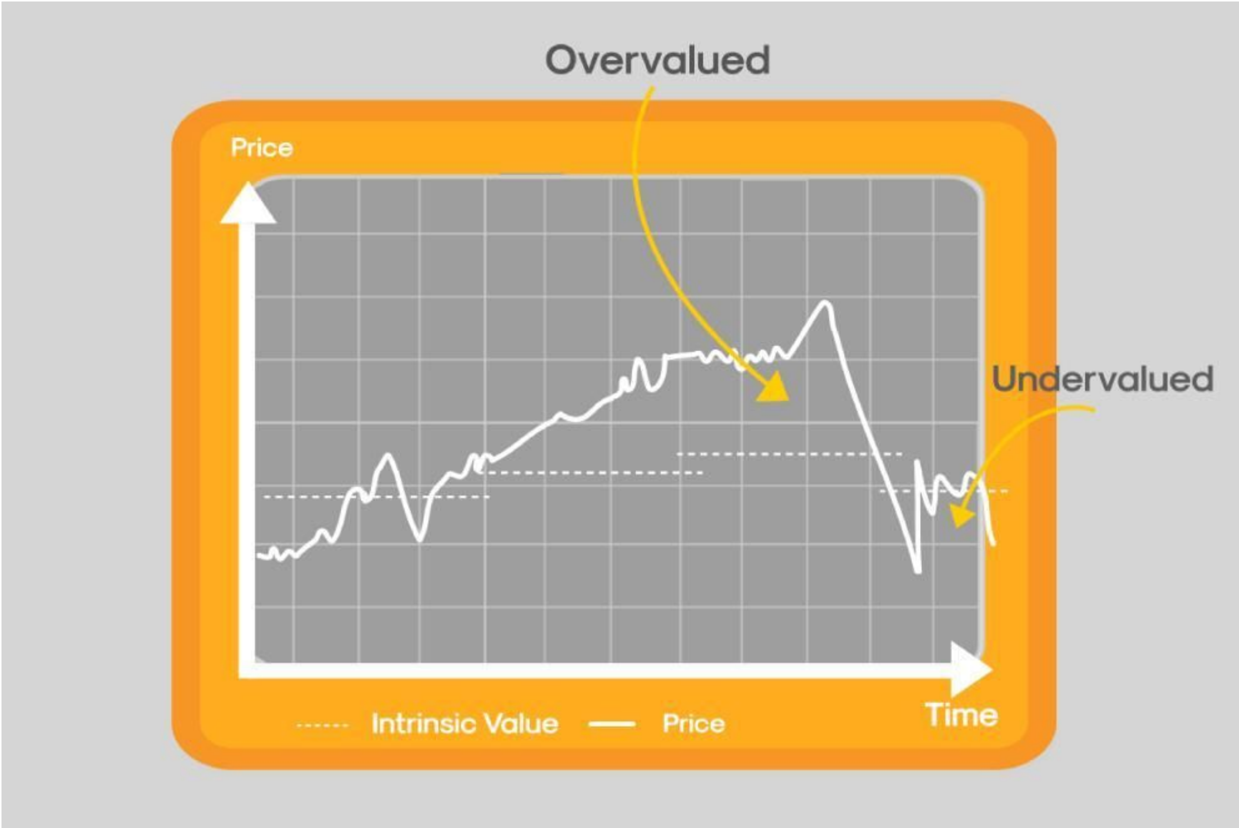
- **Salaries are tied to long-term performance.** Often, investors can find all they need to know in a company's annual report.
  A little angel dies inside my investing heart whenever I see a 12-month sales revenue target as the requirement for a CEO to receive a massive bonus. A board of directors will set these hurdles for their CEO to reward good performance. But short-term targets can result in disaster for long-term investors like me. Therefore, I like to see financial incentives aligned with the company's long-term interests.
- **Owner-run businesses are better.** Founder-run and family-run businesses get a big tick from me. Founders tend to have more on the line than just their financial interests — their reputation is also at stake. Their name is on the door, after all. Take it from me, the pressure of running your own company is not something to take half-hearted!
- **Management tenure.** Owner-run or not, I like to see management teams who stick around for years. **Apple's** CEO, Tim Cook, joined the company in 1998 — long before the iPhone, iPad and many other great gadgets were released. Years of experience often brings an intimate knowledge of the business and industry.
- **Avoid the use of debt.** Debt can be useful, but it can also make mediocre companies appear better than they are… yet sooner or later it can add lots of risk.
- **Gender equality.** I don't like to see companies that have a boys' or girls' club at the senior management level. Diversity is good for business, in my opinion. It lowers risk by countering emotional decision making and can unearth new strategies for the company to pursue.
- **Fairness to all shareholders.** If a company wants or needs cash they can sell new shares to investors. Issuing shares only to new investors -- and not existing ***loyal*** investors -- is one thing that grinds my gears. If a company needs to raise cash to grow, for example, they should offer loyal shareholders an opportunity to maintain or increase their position in the business.
- **Experience & education.** Does management have the skills and/or the relevant experience to run the business? Horses for courses. For example, I would expect at least one doctor to be on the board of a biotechnology business but none on the board of a pizza chain.

4. The Price Must "make sense" — You Must Have a Margin of Safety.

Price is what you are asked to pay but the ***value*** is what you're willing to pay.

A shopper wouldn't buy a pair of Nike shoes for $100 which she or he thought were worth $50. Likewise, an investor shouldn't do it with their investments.

Assessing value is important to do ***before*** buying because profits are created when an investor buys -- not when they sell.



See: Rask Finance, *"The Difference Between Price And Value"*, May 1, 2017

It can be tough to determine the *value* of a company, especially for a business with multiple products and services. An investor needs to understand the internal growth drivers for the business as well as the external risks and opportunities, like competition and market size.

On top of that, an investor has to deal with the stock market's wild swings. The random ups and downs are often called 'volatility'[10].

Buffett learned the difference between share *prices* (which are used to determine volatility) and *valuation* long ago. In fact, more than 50 years ago.

Ben Graham, Buffett's mentor and co-author of books like *Security Analysis* and *The Intelligent Investor*, is credited by Buffett as saying in the early part of the 1900's[11]:
'In the short run, the market is a voting machine but in the long run, it is a weighing machine.'

What Graham meant is, it can be hard to know the difference between the seemingly random fluctuations in share prices, which often depend on what is **popular at the time**; and changes in *value*, which is something an investor can only determine through proper analysis and valuing the expected cash flows of a business.

[10] See: The Motley Fool, *"How To Calculate Annualized Volatility"*
[11] Berkshire Hathaway Inc, 1993 Annual Letter To Shareholders, March 1, 1994. Note: Buffett uses Graham's quote when talking about a lesson learned from the market in the early 1900's.

But as difficult as it may be, Graham believed one thing is likely: **the longer we have to invest, the more likely the share price will move towards the true valuation.** If we know the *value* now, we may be able to lock in a bargain.

But how?

A long-term investor's job is to determine the present value of the company's cash flow and **buy the shares when the value *more* than the share price**.
In other words, it's similar to buying a pair of Nike shoes for $50 when we think we could sell them for $100.

"If you attempt to assess intrinsic value, it all relates to cash flow," Buffett was reported as saying at Berkshire's 1997 annual shareholder meeting[12].
"The only reason to put cash into any kind of investment now is that you expect to take cash out--not by selling it to somebody else, that's just a game of who beats who--but by the asset itself ... If you're an investor, you're looking on what the asset is going to do, if you're a speculator, you're commonly focusing on what the price of the object is going to do, and that's not our game."[13]

I use a method called discounted cash flow (DCF) analysis to value shares of businesses and often consider multiple outcomes. Why do I bother with multiple outcomes? I like to see what would have to happen for my investment to go wrong *first* -- only then do I focus on the potential.

2 Bonus Buffett Secrets

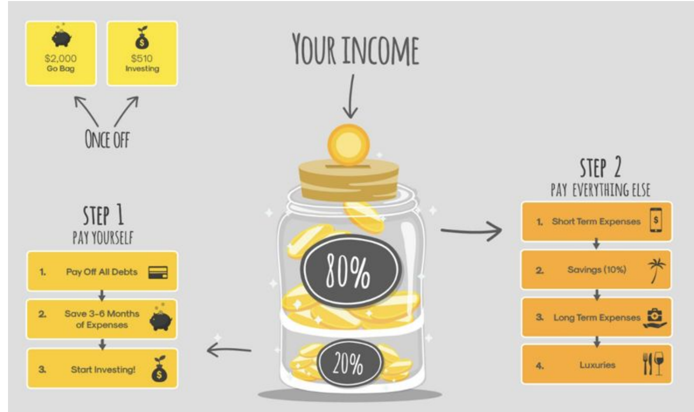
Together with his investing prowess, I think Buffett's first secret to wealth is being *patient*. Not only does he tend to hold investments for many years, he will also take months or years to invest his money. He waits until the time is right.

For example, when the market is rising (when *most* people are buying) he is prepared to sit out and let his cash balance grow. But when the market falls (when most people are selling) and investors' fears run wild -- as it does every few years, on average -- he's got the courage to put his money to work. **Time** is his first secret sauce.

In my opinion, the other Buffett secret is *how he structured his finances.*
Using his businesses, especially his investments in insurance companies, Buffett earns a consistent income which he can use to invest in other companies[14]. There's no-one telling him why, how or when to invest. It's like a personal budget on steroids.

---

[12] The Buffett website, *Valuation,* accessed May 23, 2018
[13] See Berkshire Hathaway Inc, *Owners Manual,* Page 22, "Intrinsic Value"
[14] See "The Market Story - Part 1", presented by *Tom Gayner*, via YouTube: VCFNOW, April 20, 2016



Indeed, Buffett's company structure is similar to a person who has a job and earns a consistent income each week, fortnight or month. If a person has **a rock-solid budget** and an emergency fund set aside, each payday they can become an investor by 'paying themselves' some savings and investing for the long-term -- just like Buffett.

That's why I designed Rask ***Invest's*** budget strategy to produce up to 20% of income as savings for investments. If 20% is out of the question, Rask ***Invest*** members can commit to 1% savings this month, 2% next month and so on.

Summary

I hope this eBook can help more people, just like you and I, to develop and better understand the strategies used by one of the world's best investors.
With a commitment to understanding businesses and investing in the markets, I truly believe these principles can be used by everyday Aussies to improve their investments in private businesses, ASX or international shares.

It's the exact strategy I follow when I'm investing my money for the Rask Invest model portfolio, which offers my best investment ideas to Rask ***Invest*** members.

Keep reading the next page, or click the link below to find out more about how I invest in ASX and global shares.

CLICK HERE TO LEARN MORE ABOUT RASK INVEST

Cheers to our financial future!

Owen Raszkiewicz
Founder & Lead Adviser
Twitter: @owenrask

What is Rask Invest?

Rask Invest is an exclusive website which includes all of my finance and investment research, including my best ASX & global share ideas.

It's divided into bite-sized general advice sections, such as:

- **Everyday finances**, including the simple budgeting strategy and bank accounts I use
- **Superannuation**, including the Super Fund and strategy that emerged from my research
- **Retirement**, including pre-retirement strategies, inside and outside of Super
- **Insurance**, including the names of my preferred health, home and contents insurers, and
- **Investing**, which includes exclusive access to my model portfolio of ASX and international shares. I buy into the share ideas 5 days after Rask Invest members.

The strategies inside Rask Invest took me more than **6 months to research, refine and publish**.

My goal with Rask Invest was to create a strategy that can turn everyday Aussies into investors. Rask Invest is a strategy that I believe can help any Aussie finally escape the rat race by providing the tools and expert knowledge to *make money work for you*.

Complete with my **7-day full money-back guarantee**. You can access all of my research and investing ideas, then decide to get all of your money back in the first 7 days.

How to join

Click the link below to learn more about everything I offer with Rask Invest and how you can get started today.

Click here to learn more about Rask *Invest*.

GENERAL ADVICE WARNING

This document was written by Owen Raszkiewicz and is issued by Rask Group Pty Ltd, which is authorised to provide general financial advice only. That means, the information included in this eBook does not take into account your objectives, financial situation or needs. Because of that, you should consider if the advice is appropriate to you and your needs, before acting on the information. In addition, you should obtain and read the product disclosure statement (PDS) of the financial product before making a decision to acquire the financial product.

Please remember, past performance is not indicative of future performance, as an investment's past performance may not be reflective of its potential future returns. That is, investment returns are not guaranteed.

You should consider obtaining independent financial, legal and taxation advice before acting on the information presented here. Please read our Financial Services Guide.

The Rask Group Pty Ltd (ACN: 622 810 995) is a Corporate Authorised Representative (no. 1264179) of MSC Advisory Pty Ltd (ACN: 607 459 441) (AFSL: 480 649).

At the time of publishing/updating this ebook, Owen Raszkiewicz owns shares of Apple Inc.

Updated: 28 June, 2018.