Basics of investing from Warren Buffett

The annual letter to the shareholders by Warren Buffett, one of the most successful investors of all time, is an eagerly awaited event in the world of investing. Every word from this "Sage of Omaha" is followed by investors across the world. This time was no different. An excerpt of his annual letter was published by the *Fortune* magazine on its website on 24 February and is being discussed all over the world.

Warren Buffett, according to the *Forbes*, had a net worth of $58.5 billion as on September 2013. Buffett is chairman and chief executive officer of Berkshire Hathaway Inc. The company and its subsidiaries are in diverse businesses including insurance and re-insurance, finance and manufacturing.

The published excerpt is basically an essay on fundamentals of investing, which can be followed by all investors to maximize gains in the long term. The basic essence of the essay is that it does not require a great deal of expertise to be a successful investor. However, it does require a great amount of patience and the ability to ride through business cycles. Buffett this time illustrated examples of his two real estate deals to drive home the point that one needs to identify a good investment idea and then hold on to it for the long term to reap gains.

Here are five key takeaways from his essay that investors can use while putting in their money.

Keep it simple

In order to get reasonably good returns, you don't need to be an expert in the asset class that you are investing in. In order to explain this, Buffett uses the example of a farm that he bought in 1986. He had very little idea about farm operations. But with the help from his son, he did a quick calculation on how much the farm will yield and what will be the operating cost. Around 28 years down the line, the output of the farm has gone up three times and its value has gone up five times. The basic argument is that you need to "keep things simple and don't swing for the fences".

Focus on productivity

Buffett argues that you need to understand the future earning potential of the asset that you are buying. If you are not able to do that, just move on. The idea here is that you must understand the business or the asset that you are buying. Buffet and his partner, Charlie Munger, evaluate businesses in the same way irrespective of whether they are buying a small stake in the business or the entire company.

Avoid predicting price changes

Thinking about price changes is speculation. Also, Buffett argues that something that has appreciated in the recent past should not be your reason for buying. People tend to buy when prices have run up quite a bit and sell when it has already fallen. Investors, in fact, should be doing exactly the opposite. “A climate of fear is your friend when investing; a euphoric world is your enemy,” Buffett wrote.

Avoid constantly tracking stock prices

Buffett’s style of investing is that once you have bought an asset, you should not be worried about its price every day. This is what normally happens in real estate investments. People don’t go out to buy and sell every day. However in the stock market, since prices are available on a real-time basis, there is temptation among investors to do something which should be avoided. Says Buffet: “If you can enjoy Saturdays and Sundays without looking at stock prices, give it a try on weekdays.”

Don’t waste time on macroeconomic and market predictions

Listening to market predictions and macroeconomic opinions, according to Buffett, is of no use in investing. The message is that once you have bought a good asset, you should hold it for the long term. There will be economic and business cycles in between but a good asset, bought at a reasonable valuation, will give you good returns in the long run.

Buffet further says that if you are a non-professional and cannot pick stocks, you still have an option of investing in stocks. All you need is a diversified portfolio of good businesses which you can easily own through index funds. “The goal of the non-professional should not be to pick winners—neither he nor his “helpers” can do that—but should rather be to own a cross-section of businesses that in aggregate are bound to do well,” he argues.

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