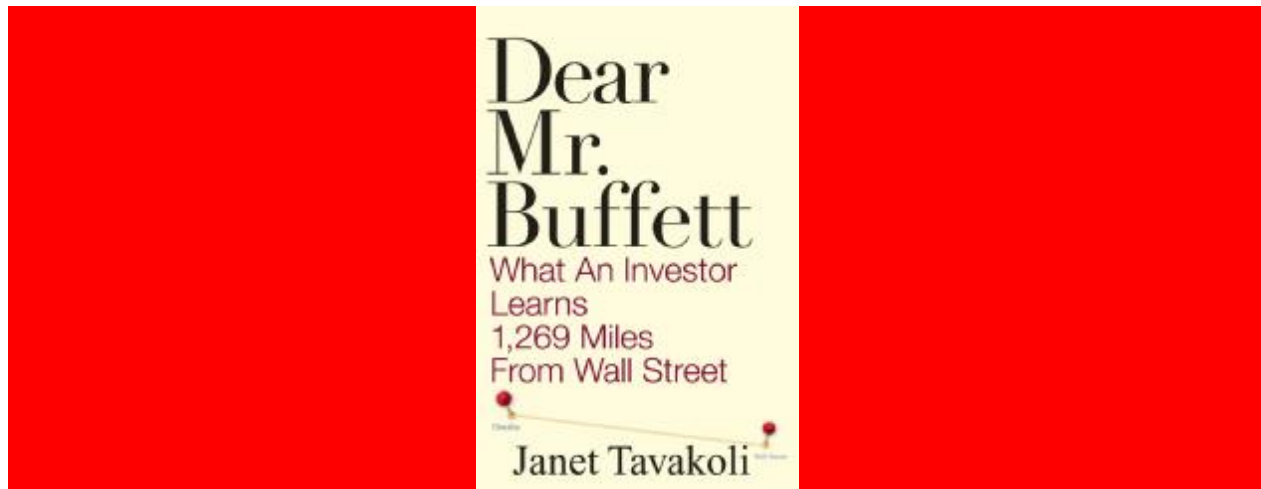


## BOOK REVIEW



### DRINKING KOOL-AID?

BY K. GRAHAM

Warren Buffett, the legendary “Oracle of Omaha,” started communicating in 2005 with Janet Tavakoli, author of the book *Structured Finance & Collateralized Debt Obligations* (yes, that book was the subject of the featured review article in the last edition of *HQ Financial Views*). The gist of those conversations as they relate to the financial and world events unfolding through 2008 are intermingled with Tavakoli’s insights in a thought-provoking easy to read narrative in this just released book, *Dear Mr. Buffett: What An Investor Learns 1,269 Miles from Wall Street*. Of course as usual, the different topics covered probably will appeal relative to each reader’s perspective, which is fine because once again Tavakoli has written a book that offers much to ponder. “Drinking the Kool-Aid,” human nature, and marketing are the subjects reading *Dear Mr. Buffett* made me contemplate.

According to Wikipedia, “drinking the Kool-Aid” is a term first used by *The Washington Post* in 1987 in a quote about former Washington, D.C. mayor Marion Barry. That usage was derived from the 1978 slaying of over 800 people in Guyana by cult leader Jim Jones who put potassium cyanide in his followers’ Kool-Aid. These individuals knew that the sweetened water contained poison but they drank it anyway because Jones ordered them to do so. Tavakoli provides a phenomenal amount of evidence and quotes from the regulators, financial leaders, and other individuals directly involved in the current global financial meltdown. The comments and actions given as examples lead me to think that if these people were not stupid, ignorant, or gaining some sort of payoff, they must have been

drinking the Kool-Aid that either trapped them in an increasingly onerous situation or blinded them to reality.

For example, Tavakoli quotes SEC Chair Cox about a week before Bear Stearns blew up. He assured the public that all the major investment banks including Bear Stearns had plenty of capital so there was nothing to be concerned about. Now if I sitting here in Chicago knew at that time that those banks were likely to falter, how could someone in Cox’s position not know, especially if he had reviewed their books? If ignorance, stupidity, or a payoff are not the culprit for his blunder, could belonging to a culture that would penalize him personally for doing his job and reward him for accepting the prevailing dogma been enough of a trap to bind him? Could being part of the “in crowd” play a role in blinding him to reality?

There’s a lot of Kool-Aid drinking in the world and it’s not all poisonous. For instance, as a retained executive search recruiter, the most important quality my candidates must have outside of the requisite skill sets is that they “fit” the corporate culture. In other words, they naturally like the flavor of the Kool-Aid of that organization’s culture. One of the key ingredients for being promoted is a person’s personal commitment to the values that the firm’s upper management holds. Can you imagine someone working for Buffett who doesn’t conduct independent fundamental analysis, doesn’t evaluate the underlying collateral’s probability of default and recovery worth, and loves leverage? There are many successful financiers and business owners with

such non-Buffett approaches but if they're not drinking Buffett's Kool-Aid, they shouldn't be a Berkshire Hathaway investor or employee. These value distinctions expressed in different corporate approaches create the profit and loss opportunities in open financial markets. These value disparities are what create the opportunities for Buffett to repeatedly profit from others' practices, which Tavakoli provides numerous accounts of in *Dear Mr. Buffett*.

How does one individual, such as Warren Buffett, continually keep producing such positive returns? In *Structured Finance & Collateralized Debt Obligations*, Tavakoli explains the unusually large number of purported financial geniuses present in the modern world using probabilities of a coin toss: "If you have 64 people in a room, each tossing a coin,...the law of probabilities being what it is, one person will flip heads six times in a row. This person will be dubbed a genius. What genius? What cockamamie twaddle! The next thing you know, another firm has signed the lucky person to a two-year contract at a minimum of \$1 million per year." In *Dear Mr. Buffett*, Tavakoli focuses on the outlier, the person who truly is a genius. Reading this book, reviewing the volumes of material written on Buffett, watching Buffett's interview with Charlie Rose from October 2008, and thinking of other true geniuses, I realized that these outliers share at least three common characteristics.

The first two are a profound comprehension of their subject matter and a deep understanding of human nature. Buffett attended Wharton for several years before transferring to the University of Nebraska where he earned his BS in Economics followed by a MS in Economics from Columbia University where he studied under the famous Benjamin Graham. Graham gave Buffett an A in his classes, which was something very uncommon for Graham to do according to Tavakoli's book. At 24 years old, Buffett started working at Graham's firm, Graham-Newman, as a securities analyst. Two years later he had amassed personal savings of over \$140,000, which was a lot of money in 1956. Obviously, from early on, Buffett demonstrated great investing comprehension, a talent that he refined into a philosophy of investing that Tavakoli explains with frequent stories in *Dear Mr. Buffett*.

As for a deep understanding of human nature, Tavakoli begins in her preface by saying that Buffett "has a genuine affection for the human race, and a generous desire for everyone to get as much from life as he does." This regard and knowledge of how people work is also clearly displayed in Charlie Rose's interview of Buffett. When asked about who created the current financial fiasco, some of Buffett's comments were:

- "Everyone behaved foolishly."
- "People should always know better."

- "You're not going to change human nature...It's the basics of greed...you see others making money and you want to do the same...it pays off for awhile."

His three market phases were also very illuminating: Buffett calls them "the three I's": Innovators followed by Imitators followed by Idiots. The comment he made that most embedded in my musings, however, was when Buffett said, "It's a big mistake to mislead people."

The third characteristic that true geniuses have is their innate knack for marketing, themselves as well as their companies. There are over one million Google entries regarding Buffett and his marketing genius. There's a whole section at each of the major bookstores dedicated just to books written about Buffett. That's a lot of free advertising Buffett is gaining. So what is Buffett doing different than other investors who have to pay for their brand marketing? What has he done different than Wall Street?

In Tavakoli's book she mentions that: Buffett is top tier school educated; he's a "highly intelligent polymath;" Buffett uses derivatives to make money; he takes directional bets; he hedges his portfolio in multiple ways including buying only assets at bargain prices and eschewing debt; and although an advocate of transparency, much of his firm's earnings are hidden because Buffett's company "prefers to purchase companies that generate earnings that do not have to be reported."

The Wall Street "Black Barts" that Tavakoli mentions by name and quote in *Dear Mr. Buffett* are also generally top tier school educated; highly intelligent polymaths or geeks; use derivatives; take directional bets; hedge their portfolios although not using all of Buffett's methods; and prefer a lack of transparency. Outside of the facts that their use of derivatives, their directional bets, and their hedging portfolio techniques of using leverage and buying pricey assets have not resulted in the success that Buffett's approach has garnered, is there any other difference between Buffett and some of the Wall Street crowd?

"It's a big mistake to mislead people." Hmmmm.

Reading *Dear Mr. Buffett: What An Investor Learns 1,269 Miles From Wall Street* provided me with some great insights. Other reviewers of this book focused on other aspects. What I and all of her other reviewers to date have agreed on is that Janet Tavakoli's newest book is yet another "must read." After reading *Dear Mr. Buffett*, why don't you visit HQ Script's blog at [www.hqsearch.com/blog](http://www.hqsearch.com/blog) to read the other reviewers' insights, watch the Charlie Rose interview of Warren Buffett, and add your own perspective?