Mohnish Pabrai's Webcast and Q&A with students at the London Business School on May 14, 2019

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Speaker 1: Good evening, everyone. First of all, thank you very much for taking time out for today's event. Our speaker for today, Mr. Mohnish. Pabrai needs no introduction, but I'll just say a couple of words about him. He's the founder and managing partner of Pabrai Investment Fund and CEO of Dhandho Investor. He's also the author of two investing books, I would say, two great investing books "The Dhandho Investor and Mosaic Perspective on Investing". He's also known in the Value Investing Circle for paying about 650 K US dollars for a dinner with Mr. Buffett which changed his life. He's known in the student community for being generous with his time to share his investing, investing wisdom and learning. He runs his blog Chai with Pabrai, which is regularly updated with all his content and all his investment thoughts. That's about him. Before we start the event, small heads up, let's respect this event discussing just an investment philosophy research process and how Mohnish has as an investor over a period. Let's not ask stock specific questions. It's an educational event, and let's continue that event in that spirit. With that out of our way with a, without further ado, please join me in welcoming Mr. Mohnish Pabrai.

Mohnish: Thank you. It's a pleasure and honor to be with you. It's wonderful. LBS is one of the best business schools on the continent, which is great. What I'll do is, I'll just go through a very quick slideshow and then we'll go through a Q and A, and pretty much any question is fine, other than asking me what I'm buying right now and what we hold right now, I think anything else is fair game. I don't know if maybe I'll ask for a show of hands. I had a talk with the students at Boston College. I talk with them every year, I'd done a talk with them, I think November or December last year. That talk was about the 10 Commandments of Investment Management. How many of you, if you just raised your hand, have seen that YouTube video?

Okay. We have some enlightened souls, which is pretty good. I'm not going to go through what's in that talk. I think for the rest of you, you can go through the talk, but just I think a couple of days back, someone sent me a nice note where he took my 10 commandments, and he said it in verse. He said that if you give things in verse to humans, they have an easier time kind of remembering it, and it gets much easier to etch into your psyche if it's in verse. I'm just going to quickly go through the 10 Commandments. The first one is commandment

One, “thou shall not skim off the top”. This one refers to not having management fees, having all the fees, being performance fees.

I won't explain these. I'd say these are well explained in the Boston College video. For those of you who haven't seen it, you can go through that video. But I'll just go through Johnny's take on these. Johnny Bonner is the one who sent me the revised commandment set in verse. His commandment, one, the quantity of assets under your belt does not entitle big fees to be dealt. Then we go to slide number five, which is commandment two. Thou shall not have an investing team and Johnny's take on outsourcing investment understanding will result in a hard landing. Then we go to slide six, which is commandment three. Thou shall accept that thou shall be wrong at least one-third of the time. Johnny had two of these for this one. He said, an investment record winning two of three, a rich man or woman, you soon will be.

Also, as long as you're right a bit more than wrong, your lifelong return will likely be strong. I think the second is truer. I think that's correct. If you're even slightly more right than wrong, things will go very well for you. Then commandment four thou shall look for hidden P/E one stocks, you know, and I think Johnny does it better than I could. He says a company selling what it will earn in a single year if uncovered will prove to be dear. Then we go to slide 10. Thou shall never use Excel. Of course, no one in this room ever uses Excel, so we don't even need commandment Five. Good investment decisions do not need Excel's precision. Then commandment six, thou shall always have a rope to climb out of the deepest well.

Johnny's take, you must prepare for times of despair, for when hope is rare. Then commandment seven, thou shall be singularly focused like Arjuna. Maybe some of you are familiar with the Mahabharat. Johnny's take a man with focus will see through the hocus. Then commandment eight, thou shall never short a stock. Here Johnny goes wild and crazy, knowing a company would fail, he placed a short sale, but what was under the veil was not the failure, but the time scale. This is what the Tesla shorts forgot. Then commandment nine, thou shall not be leveraged, neither a lender nor a borrower be. I'm paraphrasing Polonius and Hamlet. We go to Johnny's Take, using debt to leverage a bet will make you sweat because of the threat that one day your obligations will not be met.

I think that will sear it a little bit better. Then the last commandment, which I think is the most important one, thou shall be a shameless cloner and Commandment 10, which I tweaked a little bit to make it a little bit better. Don't be ashamed to copy the best. After all, it is the road to Success. I think we whip through those commandments fast, but as I said, if you want to get a full perspective on them, then you can just check out that Boston College video on YouTube. With that let’s go to your questions. If you could tell me your name and kind of where you're at in your LBS journey, and then your question, that'd be great. Thank you.

Student1: Okay. I'll start with the first question. Before we get into the investing related question, it would be super helpful to understand how you structure your day in terms of reading. What do you read? Who do you get your recommendation from, and how do you structure your reading material?

Mohnish: Yeah, so that's a great question. It is quite opportunistic. There's no game plan. To take a step back, one of the things I copied from Warren Buffett was the power of having an empty calendar. Buffett used to have more than 80 CEOs reporting to him, managing more and more than a $200 billion portfolio, et cetera. If you see his calendar, it's almost completely empty. I mean, he has more bridge games scheduled on his calendar than anything else in the evening than weekends. But during the day, he has almost nothing on his calendar. Charlie Munger is the same way. These two guys basically built one of the largest enterprises on the planet without being scheduled by the minute or any of that.

The reason they did that was that they wanted a lot of flexibility and time to read and think and to have control over their schedules. I think one of the most important things that money cannot buy is time. The first thing is that the empty calendar is a side effect of being really good at saying no. If you never get anything else on this talk, I think the thing that I hope you get is being great at saying no. Saying no isn't easy. I'll get emails from people saying, "Mohnish, big fan of yours. I'm coming to LA for a week from Australia or New Zealand, but I meet you for coffee". Of course, the request is perfectly fine because the guy's flying halfway around the world.

But I don't do any meetings with any humans other than Warren and Charlie without extremely compelling agendas. In that email, there's no compelling agenda. Usually, my assistant has all the emails, and he then else responds when these things show up. She does not even check with me. She sends the response that, "Mohnish is happy to meet with you at 5:30 AM at the south entrance just before the Berkshire halfway meeting on Saturday, May 4th. Other than that, he's not available. Warm regards". A few people show up at 5:30 AM at the south entrance. We concentrate all our meetings with humanity at that single point in plays in time. That works out well. The first thing is to clean out the calendar. I mean, if I look at my schedule this week, I think this is the only thing I have on my calendar, this LBS talk.

Once the calendar is cleaned out, then everything else becomes straightforward. The priority with reading is, if there is something I am actively researching or drilling down on, then obviously I will set aside a kind of general reading and zoom in on that. I read three newspapers a day, and that happens no matter what. The FT, the Wall Street Journal, and the New York Times and I read the physical copies of those papers. All my reading is physical stuff on paper. I do not read on screens. I also don't have many emails coming to me. Almost all the emails go to my assistant and she's able to handle most of them without any input from me and a sliver of them that she thinks I should see, et cetera.

I mean, I get a folder on my desk at 11:00 AM usually, and that folder has all emails or anything business related to have to deal with. Usually, some of you might have seen that my responses are handwritten and by 11:15 I'm done with that folder. Emails are 900 seconds a day. My reading is just a function of if I'm into investment research or some company, which is what I'm doing right now, then I put that on priority. I mean, the three newspapers a day are still happening. Beyond that, usually all the magazines I catch up with on airplanes and books, I have a large number of books that I have in my library that I have not read. I know which ones I want to go to next. Sometimes I'll change my mind. I'll say, okay, let's go read completely different subjects. When I'm looking for reading, I'm quite open, it could be a business biography. It could be some kind of philosophical book. It could be a kind of wide range of stuff, just depending on what is of interest to me at the time. That's how we take it from there. But I think the important thing, (I think from all of you because I think you have the ability you are like wet clay; you can adapt yourselves), is "get freedom from the devices". The beautiful thing is someone like Charlie Munger has yet to use a mobile phone, forget a computer.

He has never made a phone call on a cell phone or received one for that matter or owned one for that matter. He doesn't have a computer. What that does for someone like Charlie is, most of us humans cannot do it, he's blasting into 20 books a week, a thousand books a year. If you just remove the devices from your life and other humans from your life, maybe you can get up to five or 10 books a week. Humans are a big waste of time. All right, next question

Pradeep: I am Pradeep, I'm doing Masters in the International Programming in LBS. My question to you is, what comes to your mind when you first see a stock? The gut that comes for at first or the numbers that comes first to you.

Mohnish: Can you just repeat what you said after first seeing a stock, what did you say after that?

Pradeep: I'm saying, is it that gut feeling that comes first or are the numbers that come first?

Mohnish: Is it what that comes I'm sorry, I can't hear. Is it what that comes first that,

Pradeep: Gut feeling or intuition?

Mohnish: Okay, I didn't fully get that, but I'll give it a shot of what happens after I see a stock. My objective whenever I encounter any stock is to, as quickly as possible, reject the idea so I can get back to general reading. The model is not to find investments. The model is to find the flimsiest reason to say no. As soon as I get to the first reason, I'm done, and I move on. Usually, two things work well for getting rid of stocks really fast. The first is the circle of competence. If I look at some pharma company or something, it's gone. I mean, I don't even need to look beyond the name. It's gone. The second is that I think I if have some understanding of the business, then the second is I look at very quickly, the market cap earnings, just some metrics on valuation.

I'm talking about less than 60 seconds. Once I see that it's not at a PE of one, it's gone as well. Basically, I want to get rid of investment ideas for the flimsiest reasons as quickly as possible. Let's say some stock is cheap. It appears to be within my circle of competence. Then from one minute, I'll go to five minutes, I'll give it five minutes to find something where I can just get rid of it. If I cannot get rid of it in five minutes, then I'll give it 15 minutes. All these exercises are designed to get rid of the stock as soon as possible. The inversion of that is that I'm only looking for if I can find two or three ideas in a year, I'm done.

Justin, I think in daily emails, which I get in my folder, I think on a typical day there are like at least three or four stock tips in that folder. Within the 900 seconds of processing the folder, is those four stock tips. Each of them gets 15 seconds because I just look at the company, I look at the price, and I very quickly try to see, okay, what is this guy saying is the money we're going to make on it? A lot of times the stocks I get, it's trading at 10 and it's worth 13, and then there's a 40 page write up explaining why it's 13. Well, once I see it's worth 10, I say, Okay, I'm going to give this human full benefit of doubt. I'll accept that it's worth 13. He didn't say it's worth 60 with trading at 10, so we're done, move on.

Basically, be a very harsh grader on stocks. The second thing about this business is, you guys don't play baseball, but I think maybe you're familiar enough with the game that Buffett says, in investing there are no called strikes. In baseball, three strikes you are out. In investing you can let a thousand balls go by, 10,000 balls go by, you can let 95% of great investment ideas go by and it doesn't matter. There are always more balls being pitched at you. If, in a year, you can find three of them and even after finding three of them you're wrong on one of them, like one of the commandments says that's just par for the course, it doesn't matter. You're right, two or three times you'll be quite wealthy.

Student 3: The question was basically related to your due diligence process.

Mohnish: Yeah.

Student 3: When you look at a particular company and when you conduct your due diligence, what resources do you use? Is it just the annual filing or do you also hire third party consultants to conduct research or expert networks like GLG?

Mohnish: Here's one of the commandments. Thou shall not have a team. There are no humans who needed to find three ideas to invest in. I have never paid anyone anything to do any research of any kind or hired any third parties or any of that. All of those are Buffett violations. He doesn't do it. The guru doesn't do it, I'm not going to do it. The scuttlebutt or the amount of time it takes or the due diligence to get comfortable with the investment varies quite widely. I mean, it's been as short as three hours from the time I first ever heard about a company to the time I started buying it to three months, like I think when we made the investment in Fiat Chrysler in 2012, I hated that industry so much.

I kept trying to find reasons not to invest. After three months of digging, I capitulated and bought it. It's been 8x since then. Basically, the thing is, it varies. It just depends on the business. The good thing is that if you run a concentrated portfolio, and if you're going to make two or three investments in a year, you have more than enough time, especially if you're quick to say no, and you don't spend time with other humans, you have more than enough time to basically do all the research you want, even kick the tires as you want to, and so on. That's the Buffett model. I think many of the things you'll hear, or you'll see with the way I operate. First, all of these were copied from Warren, I didn't come up with any of these, but it is not the way the industry operates. In my opinion, the industry operates stupidly. Many things, no team, no management fees, doing all your own work, concentrated portfolios, all of these, this is the pattern nirvana, and that's what you want to be getting to and that's what you want to be doing. Next question. Yeah.

Student4: Buffett often talks about using a common yard stick in terms of a discount rate. What do you think about that?

Mohnish: Yeah, the discount rate is, I think if we had a perfect crystal ball which told us what the risk-free rate of returns going to be for the next 20 years then that would give you a basis to come up with a discount rate. That would be the right way to do it. But we don't have crystal balls that tell us that Charlie Munger also says that he's never, ever seen Warren do a discounted cash flow. I already told you thou shall not use Excel. I know that in your time at LBS, you have never turned on the Excel, and I'm so proud of you. The thing is that we are not going to fixate on stupid things like discount rates.

What we want is obvious no brainers hitting us over the head with, in the US, what we would call a two by four, something you'd buy at Home Depot. Basically, when I was looking at Fiat Chrysler in 2012, I've never run a DCF. I mean, I think DCFS is for birds. I mean, the market cap of the company was 5 billion, and I thought in maybe five, six years they'd make 5 billion a year. I said, “Okay, why don't we just buy the company and hold it for five years, and let's see what Mr. Market will price this business at when it's making 5 billion a year. I'd really like to see it being priced at 5 billion then and be the cheapest stock on the planet”. That was the extent of the DCF that was done. Basically, what we are looking for is, we are looking for obvious no brainers wildly mispriced severely undervalued opportunities. That's what we are looking for. We want to be harsh graders and then say no to everything else.

Sujeet: Yeah. I'm Sujeet from India, and I'm doing my full time MBA 2019 here. You talked about your investment process and how you analyze the company and all that. Can you shed a little bit of light on how you do your exit process?

Mohnish: Exits are a lot more complicated than entrances. In fact, I have a chapter in my book, how many of you have read The Dhandho Investor? Just raise your hands. We have a few people. That's good. There's a chapter in the book that talks about exits, and you might enjoy that chapter. But exits are complicated. I don't do exits well. In fact, if I go back and look at my track record on exits, it's terrible. Usually, I'm leaving a lot of money on the table. Part of the reason that happens is that the business looks, I mean, it's gone up a few times. It looks fully priced or whatever else, and then something else shows up on the radar.

Usually, I've not been very good at exits. I'm trying to get better at it. But I think the simple way to approach it is, whenever you're buying a business, you, by definition, must know what it's worth, what the intrinsic value of that business is. Typically, when it's getting to maybe 90% of that value or something like that, that's probably a good time to look at exit. Now if it's a great investment, that intrinsic value will move up over time, and that's really what you are trying to do, you're trying to find these great businesses. Rather than buying discounted pies, it's a far better idea to buy growing pies. Growing pies are usually a lot better than discounted pies, even if you buy them at a lower discount. In fact, you usually will be forced to buy them at a lower discount. If they're growing pies, then typically intrinsic value is kind of increasing every year or every few years. Hopefully it always stays somewhat above where the stock price is, which means you can hold it for a long time. That's utopia if you can get there. But I am not a shining example of being spectacular at exits. I still want to get better at it, and I'm trying to get better at it.

Sujeet: My question is, you have been in the industry for a substantial number of years, and you are seeing how the technology has arrived, and we want to know, is it possible going in the future to take widely mispriced stocks as you're talking with the arrival of machine learning algorithms utilizing all the possibilities in the planet to identify all the mispricing? Is it going to be harder in the future? What is your viewpoint on this? Thank you.

Mohnish: I think that humans vacillate between fear and greed, and that trait of humans is not going to change. As long as humans are involved in equity markets, even if you have various algorithms or whatever else involved, you're going to see vacillations between here and greed. There's a book you guys might enjoy a lot. It's called Trend Watching. It's actually written by TV anchor. Normally TV anchors are useless authors. It's written by a TV anchor called Ron Insana. But in this case, Ron did a good job, and he chronicles like a very wide range of bubbles. We are aware of bubbles. I've probably seen more bubbles than you have, but bubbles are around us all the time in different asset classes and different geographies.

Different things are getting inflated and deflated all the time simply because that's how humans operate. We are always gone. The other thing is that the valuation or getting to intrinsic value of a business is part art, part science. It's not pure science. I'm deeply skeptical about the ability of automated AI algorithms to do better or replace humans. I mean already we have a situation where we have index funds, and for most humans, index fund is a great way to go. It'll beat 90% of human managers and so on and so forth, maybe 95% after fees. We already have a way to invest which doesn't particularly need much technology or AI or anything and gives you decent returns. But I think that stock picking will go through, its ebbs and flows. Markets get euphoric and stock picking becomes hard and they become depressed, and stock picking becomes easy. I mean, that's just the nature of markets. I think that will continue.

Even if you have automatic things going on, if humans are involved. So, humans basically have 17 year memories, and once you get past the 17 year memories, their memories start getting kind of faded and distorted. We see some of that. For example, if you look at the Dow, the Dow Jones Industrial average from 1965 to 1981 is absolutely flat. I think it was around 873 in 1965, and it's 873 in 1981. In that period from 65 to 81, the United States grew a lot. There was a lot of growth in the economy, and there was a lot of inflation in the economy.

In spite of all that, those two endpoints were identical. Then from 82 to 99, the Dow goes from less than 900 to around 12,000. We had the first 17-year period, which is absolutely flat. We had a second 17-year period where we were doing, I don't know, 16, 17% a year great return. In fact, Maggie Mahar wrote a great book called Bull, which chronicles this. You see this in all markets around the world. I gave a talk at Trinity College in Dublin, and I think that'll go online in a few weeks. The talk is about these long periods where markets do nothing, and then short periods or long periods where they just go crazy. Then if you look at it from 2000 to 2016, the next 17-year period what I knew, and actually when I was starting Pabrai Investment funds in 99, is I was going into a period with a lot of headwinds where markets were unlikely to do well.

That actually turned out to be the case. It still was fine. I mean my network is a lot higher than it was in 2000. That didn't even with the head winded workout, just fine. I think that we are going to always have vacillations in asset prices, and we have underpricing, overpricing fair pricing, all of the above, way into the future. It's just the nature of the beast. We are going to see it across the board. Like you've seen pricing on Bitcoin, for example. I mean, you can look at asset class after asset class, and you go to Ron Insana's book, you'll see that these bubbles are just, I never thought bubbles were that common. They're extremely common. They're just happening all the time.

Akshay: My name is Akshay and I'm doing the Master of Financial Analysis here at LBS. My question revolves around management. What do you think, how do you look at management buying stock, especially for growing companies in terms of market share or earnings where there's no sign of management purchasing stock? Do you still view this as a bad sign? Because I've read all the time that one of the key things to look for in a company is management buying stock. How do you view that?

Mohnish: Yeah, share buybacks are like any other investment. The management team should buy back stock if their stock is undervalued. When the stock is overvalued, it's a very dumb thing to do. There are companies that it's like clockwork. They do buybacks every year. They don't really care what the price is, whatever. I mean, if you look at a company like Coca-Cola it's formulaic. They're going to take a certain percentage portion of the cash flow and buyback stock. It doesn't matter to them whether the copay is 10, 20, 30, 50, 100, 500 or 1000. Any of those numbers make no difference to them. Those humans who are making those decisions are extremely stupid. They're extremely good at running the business, and they're very stupid about capital allocation, especially in terms of buybacks. We see that also, for example, a company like MasterCard, these are businesses that are the best of the best.

I mean, these are very wide moat businesses almost indestructible and such, and so they hardly need any money to run the business. In fact, Coke can run with no capital. MasterCard can run with no capital, and they gush cash. There are basically only two things they can do with that cash. They can issue dividends, which in the case of MasterCard and Coke would be a smart thing to do, or they can do buybacks which at present prices, I think, especially for MasterCard, is very stupid. But the thing with public company CEOs, the number one skill that public company CEOs must get to the position that they got in is their great sales guys. If they weren't good at sales, they wouldn't have been able to rise to those levels and convince all those people that they were the best things since life spread.

They've got great sales skills. They've got great leadership skills, they've got great management skills, all of those things, and they understand the domain of their businesses and such. These are the skill sets that get you to be CEOs of large businesses. Very little of getting to the top has to do with capital allocation. Typically, we accidentally run into some CEOs who are greater capital allocation, and mostly we went end up with lousy capital allocators. The lack of great capital allocation skills manifests itself in two ways in companies. One is dumb acquisitions, they see some fit with some business and whatever, and that may or may not be the case, but when they look at those fits, they ignore price, and the price is an important variable.

The reality is most acquisitions won't work. A lot of money gets wasted in acquisitions might be the right acquisition, it's the wrong price, and a lot of money gets wasted in buybacks. We should be buying back stock very heavily when the business is severely undervalued. A lot of these CEOs, if you ask them, “hey, what do you have in your investment portfolio?” They'll say, “Oh, I don't do any of that. I've outsourced it to XYZ”. On the personal side, they don't think they have the skills to pick stocks, and on the professional side, they're pumping billions into buybacks. That's just the way the world is. All right. Next question.

Student 4: Hi, Mr. Pabrai. You recommend all of us to be cloners and use platforms like Data Roma to see what the smartest guys are doing, but could you give an example of how being a cloner and using Data Roma to see what the smartest guys are doing could go terribly wrong?

Mohnish: Oh, yeah. Well, things go terribly wrong all the time. That's just normal. Well, I think when we do clone, cloning is simply a starting point of beginning research. Cloning is not that you go to Data Roma and five minutes later put in your buy order. You would get your head handed to you in that scenario, more likely than not. From my vantage point, you would deserve to have your head handed to you. That's fine. Yeah, cloning is a very powerful model because what happens is that some investment and this is especially the top two or three ideas of very smart investors if some very good investor has a high conviction, it's already gone through one pretty significant filter where it's gone through their filter, and they've put their money where their mouth is if you will.

I think for us if that is the universe in which we are picking stocks, that is kind of like shooting fish in a barrel, it's a great hunting ground. I already said that one in three times is going to be wrong. It is not etched in stone that if I clone an investment made by Warren Buffett, I won't be wrong. You know, a lot of people cloned Mr. Buffett on IBM and they didn't do so well. So, that is not I mean, I think what you can do with a company like IBM is if Warren buys it, you could use it as a basis to start research and see if you come to some perspectives on what the intrinsic value IBM is and whether it's significantly different from what the stock price is. Then see if that's the best opportunity in front of you. Yeah, absolutely mistakes will happen whether you clone or not. But I think if you clone without doing your research, I think that's a very bad idea and it's probably going to have a lot of negative consequences with an increased rate of errors. Next question,

Student 5: Mohnish, thanks for your time today. You changed your portfolio construction process in the middle of the credit crunch. How do you feel about that now in hindsight? Do you think it was the right thing to do mid-crisis, and what do you think would've happened if you stuck to your original portfolio construction process? Not just financially, but personally and emotionally? Thank you.

Mohnish: Yeah, that's a good question. I haven't done the numbers of what would've happened if I had made no changes. Basically, what was happening during the financial crisis was that I was drinking from a fire hydrant. While my portfolio was crashing and burning, I think we were down like 70%. There were a lot of incredible ideas, very cheap ideas to buy into. I mean, whole sectors had been decimated. For example, when I was looking at commodity stocks, one looked cheaper than the other. I mean, these are just clobbered valuations. They were coming at me so fast that I was drowning in ideas. It was quite an orgasmic time. Now, the thing is that it was orgasmic, but, my own portfolio crashing and burning, I lucked out in the sense that I had one stock which was Fairfax Financial which had large put positions on equity markets, and they had large CDS's, et cetera, that they had they had shorted. Their stock was just doing well while everything else was burning. I took the opportunity to sell Fairfax which had gone up in price and moved that money. Many times, I sold businesses that were at three times earnings in my portfolio to buy stuff at three times earnings.

In the financial crisis, I think it made sense for me to have a basket approach because I was going so fast. Like in the commodity space, for example, we made a number of bets, and we made them all 2% bets. Not even one of those bets lost money. I can't recall any stocks we bought in 2009 that ended up being losers. Many of those ended up being multi baggers, 5,5x or more. It was a great time. The portfolio recovered pretty quickly after that. I think that if I encounter those times again, I will take a similar approach. It would just make sense to do that because I couldn't tell which of these picks would do better than the other.

There wasn't that much time to research them as thoroughly as I wanted to because the volume of work for me to sift through 10 commodity stocks carefully to pick the one that I thought was the best, would've taken me months. I said, I'm just putting 2% into all of them because I can't see anything that tells me that any of these have a problem. That worked in the environment that we are in right now, I think that we very rarely are not making 10% bets because I think that we are not able to find that much until, so when we do find stuff, what is happening now is I have enough time available to drill down as much as I want to. We want to go to the max exposure once we uncover what we think are great opportunities. 10% of the max for us, and that's what I'm trying to do now. It's just a matter of being flexible based on what the world is throwing at you. Next question,

Speaker 2: Hi Mohnish. My question is behavioral bias. I just wonder what your advice would be to incorporate steps in our research process to identify and counterbalance our behavioral biases. Thank you.

Mohnish: I have to say that is probably the all-time greatest question I've ever received. What an incredible question? LBS hits it out of the park. The problem we have as humans, we have a lot of problems. But one of the problems we have as humans is our brains are a mishmash of ancient and modern. The brain doesn't even understand what era we live in. Like my body believes that if I eat a meal, it believes that we don't know when or where the next meal is coming from. It doesn't understand that there is refrigeration and unlimited resources and supermarkets and everything else. Listen, don't make me store the food because trust me, my next meal will come in a few hours. You can take that to the bank, but the body doesn't understand that it's terrible.

I don't know when it will understand that. Might never understand that. We live in bodies, and we live in brains. We live with brains that are not adapted to the circumstances that we are trying to deal with. They were never designed to do equity research or to pick stocks. That is not the evolutionary trajectory that our brains have gone through. The ancient brain with the amygdala and all that, and then we have the prefrontal cortex, and all this is more recent. I think Charlie Munger spent his entire life studying quirks in our brains. I mean, that's the number one thing he's got the most interest in. When I meet him, he's always extremely curious about the nuances of specific humans. These humans are nobody, like it'll be some relative of mine I'm talking to him about. He'll drill down because he's very curious about the screwed-up brains of all these humans. How many of you have read Poor Charlie's Almanack? Raise your hand.

Okay, we have a few enlightened souls. That's good. If you do nothing else, please read Poor Charlie's Almanack. I would say that Poor Charlie's Almanack, and I hope you excuse me for saying this, is 10 LBS degrees. If you just read and study that book, you will get more wisdom than, I don't know how many college degrees at any place can give you. I try to reread Poor Charlie's Almanack every year and every year when I reread it I could swear to you I find stuff that I've never seen before. I say, hey, this is the first time I'm seeing this stuff. It has many lifetimes of wisdom in that book. A lot of that wisdom has to do with misjudgments in our brains. Charlie did us a huge favor.

The last talk in that book, which is the Psychology of Human misjudgment, goes from page 440 to page 498. Those 48 pages are probably the most brilliant pages ever. Those pages are like a guide to how to navigate the world and how to deal with all the screws in our brains. The human misjudgment and the way we are kind of quirky about different things. It is important to understand that because it'll give you a huge advantage in life, massive advantage in life, and it'll give you a huge advantage in investing. I'll give you an example. There's a guy, Robert Cialdini, who wrote a book called Influence. Some of you might have read the book, but that's, I think, another book, that I think is up there dealing with all the human misjudgment.

Just to give you one example of how our brains are screwed up. If you go back, maybe 10,000 years or something, humans are living in kind of small groups, and some guy has extreme success at hunting, brings down a big beast and brings it to his community, and he knows that there's no refrigeration and he cannot eat that big beast. He knows that he must store it in the bellies of his neighbors. He calls the community, he said, “look what I got for you”. Everyone has a big feast. Everyone eats, everyone's happy, and he freely shares with the others in the community. Then a few days later, when someone else brings down a big beast, they invite this guy in, and this is going back thousands of years.

Humans have a reciprocation tendency. That reciprocation tendency is hard coded in our ancient brain going back thousands of years because of this dynamic of people being forced to share whether they want to do or not. But there's a quirk in the wiring, the quirk in the wiring is that I will remember that John did me a favor by inviting me to eat when I was hungry. I'll remember that, but I will not be able to calibrate the degree of the favor, how good was the meal? How big was the meal? How well did it taste? All of that sort of thing. All I can remember is John did me a favor, and I owe John a favor, okay? The human brain understands when someone does it a favor and it understands and it has hard coded in the brain, reciprocation tendency.

What it does not have hard coded is the calibration of the degree of the favor. You can take advantage of that. A lot of slimy sales guys take advantage of that. I take advantage of that. For example, Pabrai Investment funds is mostly closed, but when someone asks, "Hey, I would like to get information about Pabrai Investment funds, most other funds deal with stuff digitally, they'll send out email and here's the documents and whatever else you need and et cetera". What we do is we send a physical package out, and the physical package we send out is high end in the sense that just the box costs more than $20. It's nicely designed in the package is a very nice cross pen, probably a, I don't know, 25, $30 cross pen with our logo on it.

It has my book and a few other things in the package. What happens is that when people get that package, they feel good. Someone gave them a nice pen, a book to read, it looks good, everything's fine. They have now taken meat from me, okay? They've been fed and they feel good about Mohnish, and they know that they owe Mohnish a favor. The way the favor works is I give you a $30 pen, you wire me 2 million. It might be like something like what happens is, I'd like to study how humans react. Probably one in 200 humans will send the entire package back. Here Mr. Pabrai, thank you for sending the package. I looked at it and it's not of interest. Warm regards, send the package back with the pen, because they are concerned that it's creating an obligation and they don't want the obligation.

But to send the package back is a lot of frictional effort. You go to the post office and all this nonsense. It's too much effort. Most humans, even if they have a desire to send it back, will not send it back. Once you don't send it back, you feel good about Mohnish, okay? You feel like he did something for you, you got to do something for him. That's how the world works. For example, that's an example of reciprocation tendency applied in the real world. There are dozens of these quirks in humans and Cialdini highlights how these quirks can be used or have been used by different humans. I think that it would give you a huge advantage in life. It would give you a huge advantage in marriage, huge advantage with all your human relationships if you understood the way we are wired.

For example, I have relatives and whenever I have some disagreement with one of these relatives, I cannot rationally present why I was right and they were wrong, and my rational arguments were correct, trust me, okay? But I never made any headway because that is not how humans process. Humans are not designed where if I tell you, hey, listen, X leads to Y leads to Z and therefore we have these irrefutable truths that mean nothing. Ben Franklin said, if you would convince focus on interest, not on reason. I changed my tactic. I was using reason; reason is dumbass and stupid, humans are not going to listen to reason if it's not in their interest. I switched the conversation to interest, and I was shocked at the way I can just break breakthrough. You must understand that if you have a disagreement with a human and you are going through logical steps and arguments, good luck.

That is not going nowhere. But if you get to interest, I mean you see that in the US-China trade war, the US-China trade war will not be sorted out with reason. Neither party will accept reason, they will accept interest, they will not accept reason. You have to switch that, and you have to think about it from that lens. The same thing with the North Korean. He's all about interest. He's zero interest in reason, and on and on. Basically, I think the thing is that if you understand Poor Charlie Almanack, you have to reread a lot, but the last essay which actually wasn't a talk he gave, he actually spent a lot of time rewriting that. Psychology, human misjudgment, that is a dense almost 50 pages. I would like to read it a 50 times, just to make sure and probably read it with some gaps because there are many lifetimes of wisdom there and if you can switch your mental models of how you approach humans, once you understand how their wiring works, it'll give you a huge advantage in life.

Sohit: Hi Mohnish. I'm Sudeep, thank you so much for this. My question for you is, for someone who would like to start his own fund, when does one feel that they're competent enough? Also, just in terms of the investor demographics, who should we be essentially approaching for that?

Mohnish: Sure. Sat sri akal ji Sohit.

Mohnish: Okay, someone asked Charlie Munger, you gave your money to Li Lu to manage, and that's the only outside manager you ever hired in your 95 years on Planet Earth. Why'd you do that? How could you say that this guy was the right guy to give your money to? Munger's response is that his approach to the selection of an investment manager is simple. His first criteria is the investment manager needs to already be rich. Munger says, “Look, if you are a guy who is going to deliver above average returns, you should have been doing above average returns in the past. If you're doing above average returns in the past, then the power of compounding with even small amounts of capital will make it into significant amounts of capital. How many of you have heard of Li Lu?”

A few people have heard of Li Lu. Alright, Li Lu was a kind of an activist in Tiananmen Square, he's a good friend of mine. The Chinese government basically wanted to just put him away and he somehow escaped to Hong Kong. Then with the help of some Chinese distance in Hong Kong, he made it to New York, and he joined Columbia University, and he did the three simultaneous degrees. He did a law degree, undergraduate degree, and an MBA all simultaneously. He's the only guy in Columbia had who finished three degrees in four years. He had no money; it was all student loans. He had about, as Charlie would describe it, about $20,000 of float of the student loan because money that came to him before he had to give it to the school or whatever else, housing, et cetera.

By the time he graduated, just investing the temporary float that he had on these student loans, he had $950,000. The 20,000 got converted to 950. Then the 950, once he graduated, became several million. Then he started managing money. I mean, it's a phenomenal record. I think he's compounded in probably in the north of 20% analyze rate for, for a while maybe 20 years or more. When Charlie met him, this track record is already there and Charlie said, Okay, it's a no brainer. Let's go. If you are starting an, or thinking of starting an investment partnership, the first question you need to answer for yourself is, are you a good investor? The only definitive way to answer that question is your track record.

I always tell people that whenever they get going, they should set up a separate brokerage account, a discount brokerage account, don't write your grocery checks from there but just keep it separate so later it could be audited if someone wanted to audit it. Do your investing in that account and see what the track record is and see how it compares to the indices, et cetera. I think that's the very first thing, because even later, when you go to manage money, when you're looking to get investors to manage money, you follow what I call the three F's. You go to friends, family, and fools. The most important is the fools because you want to have a lifelong relationship with friends and family. You'll go to the friend's family in Fools, but before you go to the Friends family in Fools you need to have convinced yourself that you are the best things in Slice bread on managing money and hitting it out of the park.

I think in my case I had sold a portion of my business in 94, which was just when I was hearing about Buffett. I had a million dollars for the first time ever. I was, for the first time ever. I didn't have credit cards and debt and all that. I did this million, which was completely extra money, and I just was figuring out the Buffett model. I said, let's take the million and see what we can do with it. Let's start investing in it. I think from 94 to 99, that million became north of 11 million. Well done, Mohnish. Then there were a bunch of people who came to me because I should just give my friends stock tips. I bought a stock, I'd say, hey, listen, go buy this company.

Let's look good. They would make money, but they would sometimes not see me for a while, whatever else. They came to me and said, listen, all this stock tip business is random. Like some guy would say, Listen, I'm worth 10 million. You give me a stock tip, I put 10,000 in it, it doubles, but so what, he says, these guys came and said, "we want more structure, so we want you to manage the money instead of giving us stock tips". I just thought, okay, you can't really have an investment operation with 1 or $2 million. They were like eight or nine investors that collectively gave me a million dollars. These were good friends of mine. I didn't want to lose the money for them. I made sure I followed all the Buffett rules, and I thought it was a hobby. I didn't think this was going to become a business.

But then I think a year in, I really liked the idea, and I always enjoyed the investing process, but I said, Hey, it's interesting. I have this little bit of investor capital and I think it'd be fun to build this into a real business. Treating it like a hobby or a stepchild. About 15 months after Pabrai Investment Fund started, I said, “Okay, let's actually start trying to get more investors and those sorts of things. That was a very fun journey because I had to work within the limitation, the SEC rules where you can't advertise or solicit or any of that. You have to actually rely on people, and so on.”

But the bottom line is that if you deliver above average returns like Buffett says, they will swim to you in shark infested waters in the middle of the Atlantic and give you money to manage. You can be a leper and you will get assets if you deliver the bacon. That's what I would suggest, do it on your own, prove it to yourself, and after you've convinced yourself with enough years that you are actually good at it, then we go to the three F's and then we go from there.

Swathi: Hi, Mohnish Swathi here from the MBA program, just out of what's a central theme of your discussions with Charlie and Warren at the AGMs of Berkshire.

Mohnish: Well, there are no discussions at the AGM of Berkshire because they're super busy. They have too many humans around them. I think Warren, I used to see once during the AGM, but now I think I don't get to see him because he doesn't come for that event. Charlie, I get to see a couple of times briefly, but I played Bridge with Charlie every few weeks in LA which is a blast. It starts with lunch and then bridge, and I'll always have some questions or something, which I've been thinking about, which I'll start with. I remember like one time I was going through the old annual meeting videos. Another great resource is if you go to buffet.cnbc.com, it has the archives of all the Berkshire annual meetings video archives all the way back to 94.

Those are an incredible treasure trove, and they're annotated and so on. What I've been doing for the last year is, while I'm getting ready, shaving or showering, et cetera, I listen to about 30 minutes a day. I have to say that the 30 minutes is sometimes the most exciting, biggest learning part of the day. I usually find that's, that's great. I think I heard in 98, Buffett was saying that in his personal portfolio, everything was in one stock. I'll meet Munger for lunch before Bridge, et cetera. I'll say, hey, Charlie, in 98, Warren was saying everything was one stock. You know what stock was that? His language is a lot saltier one on one then at the Berkshire meeting.

Basically, I got to answer, I have no idea, but then, he'll take that discussion to a tangent and I think he was saying that, Warren had less than 10 or 20 million in 1970 when he shut down to partnerships outside of Berkshire Hathaway in cash. That money has always stayed outside. That money now is over 2 billion. This is just the side bet, that Warren was not doing the Berkshire bet. Charlie said that throughout that period, it was always concentrated, mostly in two or three stocks. Sometimes options, sometimes leverage, but great returns. Anyway, different subjects come up during these sessions and it's a blessed life

Student 6: Personally, I am aiming to start career in investment. What advice would you give us, like people to work for, structure our career?

Mohnish: Well, I think that that's tough because I think that most places you would look at, they're violating all the core principles, that's unfortunate. But I would say the next best thing, once you accept that you're violating principles is what Buffett says, which is you go to work for people who you like, admire and trust. I think one of the mistakes a lot of people in your situation make, people finishing business school and so on, is there's a lot of prestige with certain name brands. Usually, people are making decisions based on name brands or they're making decisions based on comp, and both are very stupid. The job you want to take is the job you would do if you weren't getting paid. That is the ideal job.

I mean, I would say if I looked at my situation, currently I'm at home, but my setup at home and my setup at work are identical. In fact, it doesn't make any difference to me when I'm working where I'm at. If there were no outside funds, I would still have an outside office, just have a little bit of change, if you will. There'd be almost no changes to my life, whether I'm managing outside money. It would all, almost everything would be the same. The investment process would be the same. Almost everything would be the same. That is where you want to get to. I think the most important thing is to go to work for people who like, admire and trust. Look very carefully at the individual who's going to be your boss and the individuals who are going to be your peers. Both should be individuals that you highly respect and look up to. That's important. Then the compensation of the name brands, those are irrelevant.

Wish you all the best and it was a pleasure. The good news of the video is we can edit a lot of this, so we'll look a lot better than with the way it went through, but I really enjoyed the session, so thank you.