Warren Buffett vs. Real Cash

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Recently, the super investor Warren Buffett again expressed his opinion on gold. Here's his view from the 2011 Berkshire Hathaway annual report:

"Today the world's gold stock is about 170,000 metric tons. If all of this gold were melded together, it would form a cube of about 68 feet per side. (Picture it fitting comfortably within a baseball infield.) At $1,750 per ounce – gold's price as I write this – its value would be $9.6 trillion. Call this cube pile A.

Let's now create a pile B costing an equal amount. For that, we could buy all U.S. cropland (400 million acres with output of about $200 billion annually), plus 16 Exxon Mobils (the world's most profitable company, one earning more than $40 billion annually). After these purchases, we would have about $1 trillion left over for walking-around money (no sense feeling strapped after this buying binge). Can you imagine an investor with $9.6 trillion selecting pile A over pile B?

[...]

A century from now the 400 million acres of farmland will have produced staggering amounts of corn, wheat, cotton, and other crops – and will continue to produce that valuable bounty, whatever the currency may be. Exxon Mobil will probably have delivered trillions of dollars in dividends to its owners and will also hold assets worth many more trillions (and, remember, you get 16 Exxons). The 170,000 tons of gold will be unchanged in size and still incapable of producing anything. You can fondle the cube, but it will not respond.

Admittedly, when people a century from now are fearful, it's likely many will still rush to gold. I'm confident, however, that the $9.6 trillion current valuation of pile A will compound over the century at a rate far inferior to that achieved by pile B."

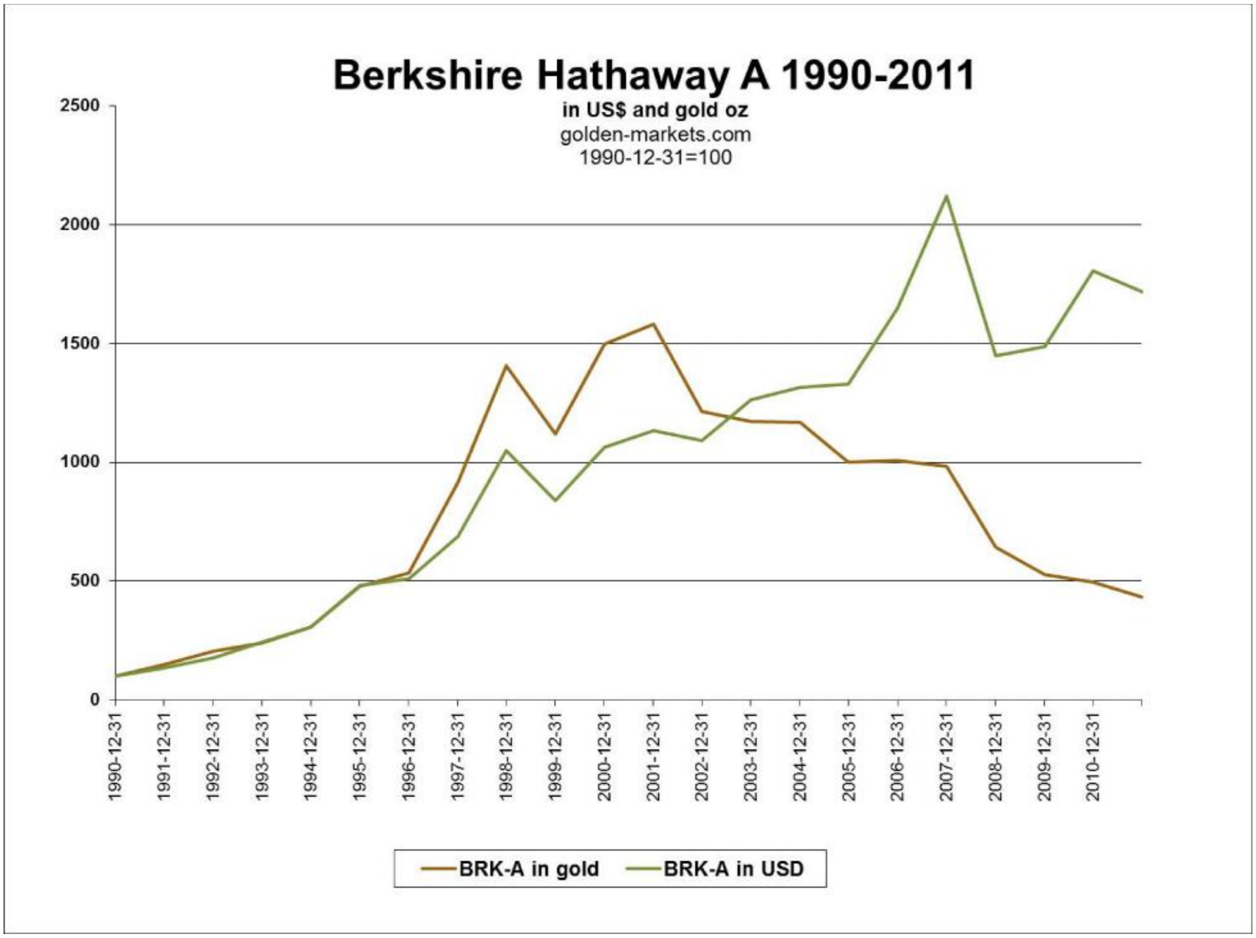
He clearly wants to show how utterly silly it is to own gold.

This has stirred up some comments with gold bugs and they have been quick at comparing the performance of gold to Berkshire Hathaway or Coca-Cola (where Berkshire Hathaway owns a big chunk), as priced in USD. See for example Jim Grant in an excellent Bloomberg interview here. Mr. Grant noted that:

"It's humiliating to the people who own [Coca-Cola] common. This is why valuation is so important. This is why price and the margin of safety is so important. In 1996 Coke was whatever 39 times earnings or something and gold was known to be the refuge of not the fearful but of the idiots. And to be sure I don't fault Mr. Buffett as an investor it would hardly behoove me to do so, but I do observe that over these past not so prosperous dozen or so or more years, the commodities have done better than even the best quality equities."

However, since I happen to believe in measuring things in gold instead of inflated fiat currencies, especially in the longer run, we have produced our own tables and graphs on how Mr. Buffett has performed in relation to holding real cash, i.e. gold.

First of all, we can have a look at the Berkshire Hathaway A share as measured in gold:



Looking at things this way, we see that although Mr. Buffett might be a super investor in terms of US dollar, in in terms of real cash (gold), the track record looks less impressive. It seems to be mostly dollar inflation behind it all.

Secondly, we can have a look at the development for each year during the period at hand, as well as the accumulative returns.

Year	BRK-A in USD		BRK-A in gold oz	
	Yearly return	Acc. return	Yearly return	Acc. return
1991	36%	36%	48%	48%
1992	30%	76%	38%	104%
1993	39%	145%	18%	141%
1994	25%	206%	28%	208%
1995	57%	381%	56%	380%
1996	6%	411%	11%	434%
1997	35%	589%	72%	817%
1998	52%	949%	53%	1307%
1999	-20%	740%	-21%	1018%
2000	27%	964%	34%	1397%
2001	6%	1033%	6%	1482%
2002	-4%	990%	-23%	1112%
2003	16%	1162%	-3%	1071%
2004	4%	1217%	0%	1068%
2005	1%	1228%	-14%	899%
2006	24%	1548%	1%	907%
2007	29%	2021%	-2%	883%
2008	-32%	1347%	-35%	543%
2009	3%	1386%	-18%	428%
2010	21%	1704%	-6%	396%
2011	-5%	1619%	-13%	334%
www.golden-markets.com				

Once again, the 20-year track record in gold doesn't look as impressive. For example, we see have:

- ✓ 9 years with negative returns, instead of 3
- ✓ Total return of 334% instead of 1,619%
- ✓ Average annual return of 5.9% instead of 14.2%

I am a big fan of Ben Graham and value investing, and to some extent Mr. Buffett as well. He's good, no doubt about it. But we must also point out that it doesn't necessarily help much to have more and more of something that is itself vanishing. The US dollar is vanishing, and as such, is a very poor unit-of-account.

Investing in even such a good share as Berkshire Hathaway, with yearly drawdowns of as much as 35%, with negative returns almost every other year, all for a meager return of 5,9% on average, is it really worth it? Would Mr. Buffett himself do that?

"Whatever the currency may be", Mr. Buffett wrote. Is that really so? Or is it rather "whatever the fiat currency may be"? Maybe real cash is king, or at least not all that bad? What do you think, Mr. Buffet?

I find it hard to see how Mr. Buffett can make the claims he makes about gold. However, there's one thing we clearly agree with Mr. Buffet. He noted that "if you own one ounce of gold for an eternity, you will still own one ounce at its end." Indeed, I also think so.

This is one major reason why I think gold is the premium cash, or real cash.