Buffett: It's Time To Be Optimistic About Our Future

Josh Funk, AP Business Writer

OMAHA, Nebraska (AP) — Billionaire Warren Buffett wants Americans to be optimistic about the country's future but wary about borrowing money and the games public companies play with profit numbers they report.

Buffett said in his annual letter to Berkshire Hathaway shareholders Saturday that he still believes America's best days are ahead.

"Commentators today often talk of 'great uncertainty.' But think back, for example, to December 6, 1941, October 18, 1987 and September 10, 2001," Buffett wrote, referring to the days before the Pearl Harbor attack, a stock market crash and terrorist attacks in the U.S. "No matter how serene today may be, tomorrow is always uncertain. Don't let that reality spook you."

He said a housing recovery will likely begin within the next year, which would help the economy and several Berkshire subsidiaries, including ones that make carpets and bricks.

Buffett's letter detailed how the acquisition of Burlington Northern Santa Fe railroad, better results at Berkshire's other subsidiaries and a $1.9 billion paper gain on investments and derivatives combined to boost the company's net income by 61 percent to $12.97 billion on revenue of $136.2 billion in 2010.

The letter was full of good news for Berkshire investors because nearly all of its businesses, except the ones linked to housing, performed well, said Glenn Tongue, a managing partner at T2Partners investment firm.

"I think his tone in this letter was more optimistic than usual — both about the economy and the business," Tongue said.

Buffett also devoted part of his message to educating investors on key business principles. Buffett said the financial crisis of 2008 confirmed the dangers of investing with borrowed money because even a short absence of credit can ruin a company.

"When leverage works, it magnifies your gains. Your spouse thinks you're clever, and your neighbors get envious. But leverage is addictive," Buffett said. "Once having profited from its wonders, very few people retreat to more conservative practices."

That's part of why Berkshire always keeps at least $20 billion cash on hand for unforeseen events or investment opportunities, he said. At the end of 2010, its cash

reserves totaled $38 billion.

Buffett urged investors not to focus on the net income figures that companies report because they are easily manipulated through accounting tricks or by selling investments. He said Berkshire's net income can be particularly misleading because of the large amount of unrealized investment gains or losses the company holds at any given time.

He said that regardless of Berkshire's performance, it could easily and legally "cause net income in any given period to be almost any number we would like."

Buffett also offered Berkshire shareholders few new details about how the company would function once he is no longer running it.

The 80-year-old chairman and CEO of Berkshire said that investment manager Todd Combs will manage $1 billion to $3 billion of Berkshire's $158 billion investment portfolio. Berkshire hired Combs last fall, and Buffett says Combs has the risk aversion, dedication and track record he wants in an investment manager.

To replace Buffett, Berkshire plans to split his job into three parts — chief executive officer, chairman and several investment managers. Buffett, however, has indicated that he has no plans to retire, and he says he loves his work and remains in good health.

Many people speculate that David Sokol, who is chairman of NetJets and MidAmerican Energy, is the leading candidate to be Berkshire's next CEO. But several other Berkshire managers have been mentioned as possible chief executives, including: Ajit Jain, who runs Berkshire's reinsurance division; Tony Nicely, chief executive of Berkshire subsidiary Geico; and BNSF CEO Matt Rose.

Buffett praised all those managers in his letter Saturday.

Buffett has said previously that the company has three outstanding internal candidates for CEO, but he has refused to name them.

Buffett also reminded investors that Berkshire has little chance of matching its past stellar performance because the company is so large. Buffett's preferred measure of Berkshire's performance is the growth in its book value, which is a calculation of the company's assets minus its liabilities. Buffett said Berkshire's book value grew 13 percent to $95,453 in 2010. The S&P 500, which Berkshire joined last year, gained 15.1 percent last year when dividends are factored in.

But Buffett says he's looking for more big acquisitions and other profitable ways to use the $38 billion cash Berkshire had at year's end.

"We're prepared," Buffett wrote. "Our elephant gun has been reloaded, and my trigger finger is itchy."

Buffett said he expects an end this year to the lucrative deals he made with

Goldman Sachs and General Electric in 2008 during the financial crisis. He said those companies don't want to continue paying steep fees. Berkshire invested $3 billion in preferred GE shares and $5 billion in preferred Goldman shares, and both companies agreed to pay Berkshire a 10 percent dividend.

Buffett said that GE plans to redeem its investment in October and Goldman wants to pay back Berkshire as soon as the Federal Reserve permits it. A similar financing deal with Swiss Re ended earlier this year. Berkshire will receive $1.4 billion in fees from those three companies combined as part of the early repayments, but then it will have even more cash to invest.

Berkshire owns roughly 80 subsidiaries, including clothing, furniture, jewelry and corporate jet firms, but its insurance and utility businesses typically account for more than half of the company's net income. It also has major investments in such companies as Coca-Cola Co. and Wells Fargo & Co. Berkshire has more than 260,000 employees worldwide but only 21 at its headquarters in Omaha.

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