1959 Letter
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The General Stock Market in 1959:

The Dow-Jones Industrial Average, undoubtedly the most widely used index of stock market behavior, presented a somewhat faulty picture in 1959. This index recorded an advance from 583 to 679, or 16.4% for the year. When the dividends which would have been received through ownership of the average are added, an overall gain of 19.9% indicated for 1959.

Despite this indication of a robust market, more stocks declined than advanced on the New York Stock Exchange during the year by a margin of 710 to 628. Both the Dow-Jones Railroad Average and Utility Average registered declines.

Most investment trusts had a difficult time in comparison with the Industrial Average. Tri-Continental Corp. the nation's largest closed-end investment company (total asset $400 million) had an overall gain of about 5.7% for the year. Fred Brown, its President, had this to say about the 1959 marked in a recent speech to the Analysts Society:
"But, even though we like the portfolio, the market performance of Tri-Continental's holdings in 1959 was disappointing to us. Markets in which investor sentiment and enthusiasm play so large a part as those of 1959, are difficult for investment managers trained in values and tuned to investing for the long-term. Perhaps we haven't had our space boots adjusted properly. However, we believe that there is a limit to risks that an investing institution such as Tri-Continental should take with its stockholders' money, and we believe that the portfolio is in shape for the year ahead."

Massachusetts Investors Trust, the country's largest mutual fund with assets of $1.5 billion showed an overall gain of about 9% for the year.

Most of you know I have been very apprehensive about general stock market levels for several years. To date, this caution has been unnecessary. By previous standards, the present level of "blue chip" security prices contains a substantial speculative component with a corresponding risk of loss. Perhaps other standards of valuation are evolving which will permanently replace the old standard. I don't think so. I may very well be wrong; however, I would rather sustain the penalties resulting from over-conservatism than face the consequences of error, perhaps with permanent capital loss, resulting from the adoption of a "New Era" philosophy where trees really do grow to the sky.

Results in 1959:

There has been emphasis in previous letters on a suggested standard of performance involving relatively good results (compared to the general market indices and leading investment trusts) in periods of declining or level prices but relatively unimpressive results in rapidly rising markets.

We were fortunate to achieve reasonably good results in 1959. The six partnerships that operated throughout the year achieved overall net gains ranging from 22.3% to 30.0%, and averaging about 25.9%.

Portfolios of these partnerships are now about 80%comparable, but there is some difference due to securities and cash becoming available at varying times, payments made to partners, etc. Over the past few years, there hasn't been any partnership which has consistently been at the top or bottom of performance from year to year, and the variance is narrowing as the portfolios tend to become comparable.

The overall net gain is determined on the basis of market values at the beginning and end of the year adjusted for payments made to partners or contributions received from them. It is not based on actual realized profits during the year, but is intended to measure the change in liquidating value for the year. It is before interest allowed to partners (where that is specified in the partnership agreement) and before any division of profit to the general partner, but after operating expenses.

The principal operating expense is the Nebraska Intangibles Tax which amounts to .4% of market value on practically all securities. Last year represented the first time that this tax had been effectively enforced and, of course penalized our results to the extent of .4%.

The present portfolio:

Last year, I mentioned a new commitment which involved about 25% of assets of the various partnerships. Presently this investment is about 35% of assets. This is an unusually large percentage, but has been made for strong reasons. In effect, this company is partially an investment trust owing some thirty or forty other securities of high quality. Our investment was made and is carried at a substantial discount from asset value based on market value of their securities and a conservative appraisal of the operating business.

We are the company's largest stockholder by a considerable margin, and the two other large holders agree with our ideas. The probability is extremely high that the performance of this investment will be superior to that of the general market until its disposition, and I am hopeful that this will take place this year.

The remaining 65% of the portfolio is in securities which I consider undervalued and work-out operations. To the extent possible, I continue to attempt to invest in situations at least partially insulated from the behavior of the general market.

This policy should lead to superior results in bear markets and average performance in bull markets. The first prediction may be subject to test this year since, at this writing, the Dow-Jones Industrials have retraced over half of their 1959 advance.

Should you have any questions or if I have not been clear in any respect, I would be very happy to hear from you.

Warren E. Buffett
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