



## **Buffett's Gold**

By Emilio Vargas

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Warren Buffett's valuation of Burlington Northern and his use of arguably cheap Berkshire Hathaway stock to purchase it have created a bit of a cacophony among analysts. It seems to some very un-Buffett-like to pay top dollar for an asset and to use precious equity currency to get a deal done. What does Buffett see that others do not? Oddly, the argument made by gold bugs for their asset of choice may hold the answer.

People buy gold because it is a currency that no central bank that can create more of, thereby diminishing its value. Monetarists tell us that inflation is always and everywhere the result of creating too much money, so the argument goes that the extraordinary growth of central bank balance sheets in the United States and around the globe will eventually cause massive inflation. Even some well known and successful value managers have bought the inert metal despite its lack of income, perhaps rationalizing their investment as a "guilty pleasure."

Having no yield, gold has an infinite duration, which makes it unappealing to a true value investor, even one with the long-term investment time horizon of Buffett.

Is it possible that Buffett saw the inflation threat and merely chose a different asset to protect the huge pile of cash in his company's coffers? Stocks, after all, are a claim on the assets of a corporation and are in that respect as real an asset as gold. The logic behind the decision to buy the railway and the decision to buy the shiny metal may be same.

The question Buffett may have been asked and answered is "What tangible asset can and will (1) allow me to put a very large amount of money to work, (2) have a durable competitive advantage, and (3) will over the long haul have a return that will be indexed?" Burlington Northern's right of way is such an asset. While others see the economic sensitivity of the company's earnings that affect the near-term pricing of the stock, the underlying asset value may be key here. It is a gold mine that cannot be depleted. Absent the invention of Star Trek transporters, the railroad's right of way is likely to create wealth over a very long time horizon. Buyers of precious metals that are getting no income are effectively paying an infinite P/E for their inflation hedge. By comparison, the P/E Buffett



paid for the railroad's right of way is cheap.

The last time Buffett used Berkshire Hathaway's stock to consummate a deal was in the purchase of General Re in 1999. That was a very clever way to reduce Berkshire Hathaway's exposure to the equity market near the peak of that bubble without paying taxes or roiling the market for his publicly traded holdings. The large holdings of bonds in General Re rebalanced his portfolio. It was not a complete success, as Buffett readily admits, because of the derivative exposure in General Re, but the use of stock to get that deal done may have been worth it to accomplish a strategic goal.

Is it possible that we are looking at another portfolio rebalancing?

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