

7/20/61

TO MY PARTNERS:

In the past, partners have commented that a once-a-year letter was "a long time between drinks," and that a semi-annual letter would be a good idea. It really shouldn't be too difficult to find something to say twice a year; at least it isn't this year. Hence, this letter which will be continued in future years.

During the first half of 1961, the overall gain of the Dow-Jones Industrial Average was about 13%, including dividends. Although this is the type of period when we should have the most difficulty in exceeding this standard, all partnerships that operated throughout the six months did moderately better than the Average. Partnerships formed during 1961 either equaled or exceeded results of the Average from the time of formation, depending primarily on how long they were in operation.

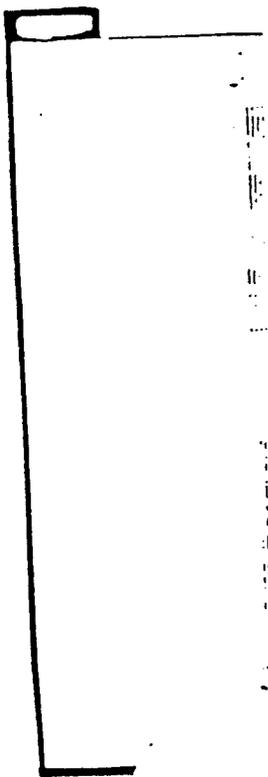
Let me, however, emphasize two points. First, one year is far too short a period to form any kind of an opinion as to investment performance, and measurements based upon six months become even more unreliable. One factor that has caused some reluctance on my part to write semi-annual letters is fear that partners may begin to think in terms of short term performance which can be most misleading. My own thinking is much more geared to five year performance, preferably with tests of relative results in both strong and weak markets.

The second point I want everyone to understand is that if we continue in a market which advances at the pace of the first half of 1961, not only do I doubt that we will continue to exceed the results of the DJIA, but it is very likely that our performance will fall behind the Average.

Our holdings, which I always believe to be on the conservative side compared to general portfolios, tend to be more conservative as the general market level rises. At times, I attempt to have a portion of our portfolio in securities at least partially insulated from the behavior of the market and this portion should increase as the market rises. However, insulation is a two-way street, so as the market boils with appetizing results for even the amateur cook (and perhaps particularly the amateur), we find that more of our portfolio is not on the stove.

We have also begun open market acquisition of a potentially major commitment which I, of course, hope does nothing marketwise for at least a year. Such a commitment may be a deterrent to short range performance, but it gives a strong promise of superior results over a several year period combined with substantial defensive characteristics.

Progress has been made toward combining all partnerships at yearend. I have talked with all partners joining during the past year or so about this goal, and have also gone over the plans with representative partners of all earlier partnerships.



Some of the provisions will be:

(A) A merger of all partnerships, based on market value at yearend, with provisions for proper allocation among partners of future tax liability due to unrealized gains at yearend. The merger itself will be tax-free, and will result in no acceleration of realization of profits;

(B) A division of profits between the limited partner and general partner, with the first 6% per year to partner based upon beginning capital at market, and any excess divided one-fourth to the general partner and three-fourths to all partners proportional to their capital. Any deficiencies in earnings below the 6% would be carried forward against future earnings, but would not be carried back. Presently, there are three profit arrangements which have been optional to incoming partners:

	<u>Interest Provision</u>	<u>Excess to Gen. Partner</u>	<u>Excess to Ltd. Partners</u>
(1)	6%	1/3	2/3
(2)	4%	1/4	3/4
(3)	None	1/6	5/6

In the event of profits, the new division will obviously have to be better for limited partners than the first two arrangements. Regarding the third, the new arrangement will be superior up to 18% per year; but above this rate the limited partners would do better under the present agreement. About 80% of total partnership assets have selected the first two arrangements, and I am hopeful, should we average better than 18% yearly, partners presently under the third arrangement will not feel short-changed under the new agreement;

(C) In the event of losses, there will be no carry against amounts previously credited to me as general partner although there will be a carry-forward against future earnings. However, my wife and I will have the largest, single investment in the new partnership, probably about one-sixth of total partnership assets, and thereby a greater dollar stake in losses than any other partner or family group. I am inserting a provision in the partnership agreement which will prohibit the purchase by me or my family of any marketable securities. In other words, the new partnership will represent my entire investment open in marketable securities, so that my results will have to be directly proportional to yours, subject to the advance I obtain if we do better than 6%;

(D) A provision for monthly payments at the rate of 6% yearly, based on beginning of the year capital value at market. Partners not wishing to withdraw money currently can have this credited back to them automatically as an advance payment, drawing 6%, to purchase an additional equity interest in the partnership at yearend. This will solve one stumbling block that has heretofore existed in the path of consolidation, since many partners desire regular withdrawals and others wish to plow everything

(E) The right to borrow during the year, up to 20% of the value of your partnership interest, at 6%, such loans to be liquidated at yearend or earlier. This will add a degree of liquidity to an investment which can now only be disposed of at yearend. It is not intended that anything but relatively permanent funds be invested in the partnership, and we have no desire to turn it into a bank. Rather, I expect this to be a relatively unused provision, which is available when something unexpected turns up and a wait until yearend to liquidate part or all of a partner's interest would cause hardship;

(F) An arrangement whereby any relatively small tax adjustment, made in later years on the partnership's return will be assessed directly to me. This way, we will not be faced with the problem of asking eighty people, or more, to amend their earlier return over some small matter. As it stands now, a small change, such as a decision that a dividend received by the partnership was 63% a return of capital instead of 68%, could cause a multitude of paper work. To prevent this, any change amounting to less than \$1,000 of tax will be charged directly to me.

We have submitted the proposed agreement to Washington for a ruling that the merger would be tax-free, and that the partnership would be treated as a partnership under the tax law. While all of this is a lot of work, it will make things enormously easier in the future. You might save this letter as a reference to read in conjunction with the agreement which you will receive later in the year.

The minimum investment for new partners is currently \$25,000, but, of course, this does not apply to present partners. Our method of operation will enable the partners to add or withdraw amounts of any size (in round \$100) at yearend. Estimated total assets of the partnership will be in the neighborhood of \$4 million, which enables us to consider investments such as the one mentioned earlier in this letter, which we have had to pass several years ago.

This has turned out to be more of a production than my annual letter. If you have any questions, particularly regarding anything that isn't clear in my discussion of the new partnership agreement, be sure to let me know. If there are a large number of questions, I will write a supplemental letter to all partners giving the questions that arise and the answers to them.

Warren E. Buffett

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July 22, 1961