



3 Investments That Fit Warren Buffett's Most Important Investing Rules

Description

Little needs to be said about the success of Warren Buffett. The Oracle of Omaha has been the most successful investor of all time, growing his fortune to more than \$50 billion before he started giving it away to charity. Seemingly every stock he's invested in has become a winner, and his annual letters to the shareholders of his company, **Berkshire Hathaway** (NYSE:BRK.A, BRK.B), are filled with tidbits of information both informative and entertaining to investors everywhere.

While it's impossible to boil down all of Buffett's wisdom into a single article, his success is based on identifying just a few factors, zeroing in on what's most important. Most of his stock purchases follow these same three different rules. Keep them in mind when choosing your next stock.

Pricing power

Let's take a look at Buffett's 1988 and 1998 purchase of **Coca-Cola** ([NYSE:KO](#)) shares. The company wasn't particularly cheap, since in 1988 it had largely recovered from the New Coke fiasco. The price/earnings ratio was pretty much where it is now, close to 20. There were essentially two things going for Coca-Cola, and that was the potential for international growth and the strength of the brand.

Fellow value investors often talk about a company's moat — the likelihood (or lack thereof) of a competitor coming in and stealing significant market share. A company like Coca-Cola has a wide moat. There are many people around the world whose first choice is a Coke, especially as developing nations get richer.

This means that Coca-Cola has pricing power. It can maintain their margins throughout challenging times because people are willing to pay a premium for the product. Don't underestimate the importance of a company's ability to continue to raise prices. One Canadian stock with terrific pricing power is **Tim Hortons** (TSX:THI). It doesn't matter how much it raises coffee prices, people will keep going through the drive-thru for their morning cup of joe.

Timing

Many of Buffett's greatest stock picking successes were bought at times when the market was severely

beaten up.

In the crisis of 2008-09, Buffett was active, getting sweetheart deals from such powerhouses as **General Electric** ([NYSE:GE](#)) and **Goldman Sachs** ([NYSE:GS](#)) in exchange for a few billion dollars and, perhaps more importantly, attaching his name and reputation to a deal. Both those investments netted Buffett billions in profit.

Even when Buffett wasn't as wealthy as he is now, he was still taking advantage of special opportunities. He purchased more than 10% of **American Express** ([NYSE:AMX](#)) in 1964 after it fell more than 50% due to the famous "salad oil" scandal. He recognized the potential for credit cards and the company's solid financial footing were far greater than the negatives surrounding the scandal, and the rest is highly profitable history.

Barrick Gold ([TSX:ABX](#))(NYSE:ABX) is down more than 50% for its recent high. Buffett would be far more likely to look at a company like Barrick than a company trading at new highs.

Easy-to-understand businesses

Buffett famously doesn't invest in technology because he feels his understanding of the sector just isn't good enough. This is an important lesson for every investor.

Just about every stock Buffett invests in is an easy to understand business. You won't see any of his capital going into complicated hedging strategies or companies with many different types of business. Buffett keeps it simple, investing in stalwarts like food, energy, financials, or railroads. He understands those businesses, and limits himself to the sectors he knows best.

One Canadian company with an easy to understand business is **Rogers Sugar** ([TSX:RSI](#)). It sells one thing and it does it well. Fewer moving parts means there's less that can go wrong.

Foolish bottom line

While I'd recommend every investor goes back and takes a look at Buffett's annual chairman letters over at Berkshire Hathaway's website, Buffett's investing philosophy can really be boiled down to three simple rules. The difference between Buffett and the rest of us is how good he is at identifying companies that fit his criteria.

CATEGORY

1. Investing

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2. NYSE:BRKA (Berkshire Hathaway Inc.)
3. TSX:ABX (Barrick Mining)
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