

In Memoriam: Charlie Munger

December 2023

Dear Investors,

Last week, in a matter of minutes the news of Charlie Munger's passing spread across the entire financial market. Warren Buffett's partner at Berkshire Hathaway, Munger would have turned 100 in just one month. His fame stems not only from the scale of Berkshire, today valued at around USD 800 billion, but from the fact that Warren Buffett and Charlie Munger inspired a legion of investors drawn not just by Berkshire's success, but by the philosophy of life they followed and preached.

While Buffett fits more the stereotype of a businessman — diplomatic in his public statements — Munger was more transparent and direct, not only in making his core values clear, but also in openly criticizing whatever ran counter to them.

This combination of honesty and intellectual generosity meant that Munger, despite not being particularly fond of public appearances, left a vast legacy of knowledge in recordings of the annual shareholder meetings of Berkshire Hathaway and the Daily Journal (the latter led by him), as well as in a series of articles and interviews.

In this letter, we will revisit some of Munger's lessons that, over time, have most shaped both our investment philosophy and our own personal ideals. For those interested in exploring Charlie Munger's life and philosophy more deeply, we recommend reading the book *Poor Charlie's Almanack*.

The Sources of Human Error

Munger used to say that, from an early age, he was struck by how many obvious mistakes people made, even those who were intelligent and should have been capable of recognizing the irrationality of their own actions. This led him to seek to understand what drove such failures, and what he should do to avoid falling victim to the same fate. Over the course of his life, he ended up becoming a “collector of stupidities” — his endearing way of referring to anecdotes about irrational behavior that came to his attention.

The subject is less trivial than it may seem. In the 1970s, the first academic studies on what became known as cognitive biases emerged, carried out by Amos Tversky and Daniel Kahneman. In parallel with the emergence of this academic field — today reasonably well known among investors — Munger had developed his own system for identifying cognitive biases. Several of his principles are condensed in a lecture he gave at Harvard University, titled “The Psychology of Human Misjudgment”.

This knowledge serves a dual purpose. The first is to use the map of cognitive biases to interpret the probabilities of how people may act when faced with investment and business decisions. The second is to understand which of them you yourself are subject to and to learn to avoid them, in order to improve the quality of your own decisions. In our experience, biases affect each person differently, according to their personality. An initial stage of self-analysis is therefore necessary to understand in what types of situations specific biases might influence you, along with perpetual self-discipline to prevent the potential errors that result. The ideal to pursue is to be purely rational in each and every decision.

“People are trying to be smart. All I am trying to do is not be idiotic, but it’s harder than most people think.”

Charlie Munger

Mental Models

Avoiding errors is already a good first step, but Munger argued that it is possible to greatly expand our cognitive capacity by cultivating a series of mental models that serve as a toolkit for interpreting reality.

The concept of mental models is inevitably abstract: they are archetypal ideas that function as shortcuts to facilitate the understanding of certain situations, as if they were pre-processed chains of reasoning that can be quickly retrieved to form more complex lines of thought. In economics, for example, the notion that large-scale industrial operations tend to have lower unit costs is a mental model that can be immediately retrieved without having to work through the entire chain of reasoning that explains why this effect occurs.

The central point of Munger's philosophy is that having only a few mental models is not enough. Reality is complex and multiple angles of analysis are generally needed to understand, for example, how a business may develop over time. Furthermore, reality does not respect the divisions between fields of knowledge created by academics, so the mental models required to understand a business are often rooted not only in economic theory, but in many other disciplines as well (psychology, politics, physics, chemistry, biology, etc.). An investor must therefore be willing to study whatever is necessary to understand the subject of analysis, regardless of which academic field that knowledge belongs to.

The risk of being too specialized is losing breadth of vision. With his characteristic humor, Munger illustrated this risk by saying that “to the man with only a hammer, everything looks like a nail.”

“What you need is a latticework of mental models in your head. And, with that system, things gradually fit together in a way that expands cognition.”

Charlie Munger

Circle of Competence

Since knowing everything is a utopian ideal, despite one's willingness to cross any artificial barrier erected between academic departments, it is important to be realistic about one's own ability to analyze a given case — that is, to always begin by judging whether your current knowledge is sufficient to analyze a specific investment thesis. This boundary of how far your own knowledge reaches is what Buffett and Munger called the circle of competence.

For investors, the first recommendation is never to stray outside your circle of competence. Rather than seeking to form opinions on everything, it is safer to select only those investment opportunities about which you have a sufficiently deep understanding and to form more assertive views on them. The remaining opportunities, which fall outside your circle of competence, should be avoided, due to the risk of mistaken interpretations caused by your own lack of knowledge about the specifics of the case.

Defining one's own circle of competence is an exercise in humility, but not in complacency. The boundaries of your knowledge are not fixed and can be continuously expanded as you dedicate more and more time to studying new subjects. Munger used to say that Buffett's secret to being so successful is that he never stopped learning new things — even after becoming extremely wealthy and at a very advanced age, he continued to study and learn.

“Knowing what you don’t know is more useful than being brilliant.”

Slow Distillation

On one occasion, Munger criticized the modern tendency toward ever-shorter attention spans. Going in the diametrically opposite direction, he attributed much of his success to the ability to maintain focus on a subject of interest for long periods — however long was needed to understand it deeply and fully absorb each new piece of knowledge.

Despite the apparent lack of agility this approach might suggest, investing the necessary time to fully master new concepts allows one to react faster to situations that continuously arise. Buffett once said: “Charlie can analyze and evaluate any kind of business faster and more accurately than any person alive. He sees any possible weakness in sixty seconds.” This account illustrates the result of a life devoted to the patient and constant distillation of countless mental models.

Munger also used to say, “Take a simple idea and take it seriously,” emphasizing that simplicity is sometimes the result of long, hard work to understand the deep truths of the world and condense them into a format suitable for memory. People generally dismiss the effect of simple concepts, assuming they are too trivial to explain high-impact situations, yet widely known factors are often the most decisive variables in business scenarios.

The philosophy of *value investing* itself is quite simple: seek out predictable and resilient businesses, wait until you have the opportunity to buy them cheaply, and have the patience to wait until the investment delivers its results. Yet, even though this straightforward and widely proven method exists, a large portion of the investing public continues to search for miraculous new investment methods.

“I did not succeed in life by being smart. I succeeded by having long attention spans.”

Charlie Munger

Independent Thinking

Seeking to personally understand the principles and logic behind each opinion, rather than simply accepting that the most popular view is correct, is a general concept valid in any field, but especially important in investing. Inevitably, the greatest investment opportunities will be tied to cases in which an investor is simultaneously right and contrary to the general market consensus. This inevitability stems from the fact that, if the market held the same view, the price of the asset in question would already reflect those expectations and would no longer offer exceptional returns. An investor who aspires to above-average returns must therefore be willing to maintain convictions that are at odds with the majority of their peers.

It is worth noting, however, that simply going against the market is not a recommendable strategy. In most cases, the community of analysts and investors is correct, and as a default, always acting in the opposite direction tends to produce poor results. The goal should be to identify the few situations you are capable of understanding better than average and to act with conviction when the market runs contrary to your own well-grounded view.

“Everybody is wrong but Charlie.”

Discipline and Patience

Finally, we emphasize that none of the lessons revisited here are tricks or shortcuts that make investing easy. Despite the simplicity of the recommendations, their execution demands constant effort over long periods. This is yet another mental model that can be readily incorporated: true human excellence is achieved through decades of dedication to self-development, not through magical methods that promise quick results. Developing broad knowledge depends on thousands of hours invested in accumulating information in memory, and human intelligence requires a degree of methodical refinement to be used to its full potential.

The best investors will therefore naturally be those who adopt sound methods and devote their lives to constant study and self-development.

“To get what you want, you have to deserve what you want. The world is not yet a crazy enough place to reward a whole bunch of undeserving people.”

Charlie Munger

We are deeply grateful to Charlie Munger for the knowledge he shared and the example he set. May his memory and philosophy live on for generations and generations of investors to come.