Warren Buffett to heirs: Put my estate in index funds

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By Mitch Tuchman

Farmer Buffett says invest in stocks like you would a farm — and watch your garden grow.
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the succession chatter of late.

After all, Buffet is 83 now. Sooner or later, someone will take the reins at his firm, Berkshire Hathaway, and that person will pick up the mantle of his amazing performance over the years.

They will be tough shoes to fill. Buffett racked up nearly a 20% annualized return through 2012 from 1965, turning a foundering textile mill into a holding company for ventures that span the globe and run the gamut from consumer goods and newspapers to industrial giants and railroads.

That compares to a 9.4% return on the Standard & Poor's 500 Index **SPX, +0.19%** — quite a run. And while investors have long made the pilgrimage to Berkshire headquarters in Omaha to hear Buffett and his managers speak, they probably weren't prepared for his latest remarks on investing. He flatly endorsed a simple portfolio of inexpensive index funds for his own survivors.

Put your money in index funds and move on, he told them. Seriously, you'll do better. In fact, he said, that's what I plan to do with my own money once I am gone.

Here's the quote, from page 20 of his most recent annual letter to Berkshire shareholders, dated Feb. 28. After all of his Berkshire shares are distributed to charity, take the cash, Buffett says, and just buy index funds:

My advice to the trustee couldn't be more simple: Put 10% of the cash in short-term government bonds and 90% in a very low-cost S&P 500 index fund. (I suggest Vanguard's.) I believe the trust's long-term results from this policy will be superior to those attained by most investors — whether pension funds, institutions or individuals — who employ high-fee managers.

What's fascinating about this letter isn't that he favors passive investments. That much we already knew. Nor that he believes in stocks, as a 90/10 split clearly implies.

Ignore the chatter

What's fascinating is that he doesn't want his executor to keep the money in Berkshire, where presumably his influence would continue on for at least a few years. Nor does he want his surviving family to bother with Wall Street and active money managers.

Again, from the letter:

Both individuals and institutions will constantly be urged to be active by those who profit from giving advice or effecting transactions. The resulting frictional costs can be huge and, for investors in aggregate, devoid of benefit. So ignore the chatter, keep your costs minimal, and invest in stocks as you would in a farm.

It's an interesting notion, considering that Buffett himself owns a 400-acre farm. He admits up front he knows nothing about farming, but as investments go it isn't among the most sophisticated he's ever had to analyze.

The farming comparison, however, is right in line with how long-term portfolio investing really works to ensure that your retirement happens. You have to presume from the start that planting seed means, in time, a crop will grow.

There might be bad weather. There could be a crop failure one year or the next. There are certain costs of doing business, mostly predictable and best kept low.

And, largely, there's nothing to do. Like crops in the field, a long-term, mostly stock investment cannot help but produce a reasonable return — assuming you don't overthink it and don't spend willy-nilly in a vain attempt to make it grow faster.

Some will argue that Buffett's advice is a case of "do as I say and not as I do," and that's a fair criticism. For instance, on Berkshire's behalf he holds a small number of stocks in a limited number of sectors. One academic analysis of his Berkshire investments found a median holding period of one year.

investors in aggregate, devoid of benefit. He really is saying "do as I say, not as I do" because you and I aren't Warren Buffett.

The researchers put it this way:

Warren Buffett's record by the start of our sample period strongly suggests he is a gifted trader. His success in subsequent years in generating abnormal returns doesn't in itself imply market inefficiency. Rather such returns can be construed as compensation for his extraordinary talent and acquisition of private information.

Do you have access to the same private information as Warren Buffett? Do you have his level of investing skill? Does your financial adviser?

If the answer to these questions is "no," just buy a portfolio of index funds and be a farmer about it. You'll do better than most, avoid losing money pointlessly to high-cost active managers and certainly do well enough over time to retire with more.

It's what Buffett is doing for his own family.

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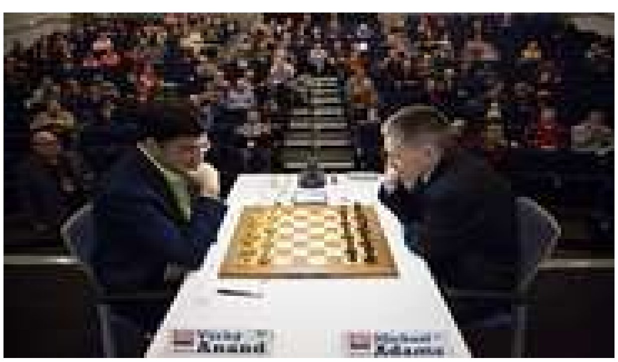

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