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Beating Buffett Is Hard Enough; Beating Him Tax-Efficiently Is Harder (/blog/beating-buffett-is-hard-enough-beating-him-tax-efficiently-is-harder)

by: Lawrence Hamtil on Wednesday, July 27, 2016

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It goes without saying that Warren Buffett has been extremely difficult to beat as an investor. Few companies can claim to have generated higher returns for their shareholders than Buffett's Berkshire Hathaway, and fewer still investors can claim that their portfolios have generated greater returns than Buffett's. Therefore, I thought it would make for an interesting challenge to try to identify ten or so companies that have generated superior returns to Berkshire over the last quarter-century or so.

It goes without saying that the companies I included in my study had to have data going back to mid-1990, the earliest data for which I have Berkshire A-share returns. In addition, I wanted to exclude from my study any technology and biotech stocks the returns of which I thought might be outliers given the tech bubble of the late 1990s. So, given those

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parameters, I was able to identify several companies that outperformed Berkshire:

Company	Symbol	CAGR	Cumulative	5/29/1990	6/30/2016
Berkshire Hathaway	Brk. A	13.95%	2924.04%	$10,000	$302,404
Altria	MO	18.01%	7436.11%	$10,000	$753,611
Colgate-Palmolive	CL	14.18%	3084.62%	$10,000	$318,462
Sturm Ruger	RGR	14.65%	3449.22%	$10,000	$354,922
Walgreens Boots Alliance	WBA	15.32%	4034.95%	$10,000	$413,495
Church & Dwight	CHD	15.81%	4519.08%	$10,000	$451,908
McCormick	MKC	14.38%	3235.21%	$10,000	$333,521
Home Depot	HD	17.07%	6018.18%	$10,000	$611,618
Lowe's	LOW	17.91%	7279.33%	$10,000	$737,933
Charles Schwab & Co	SCHW	19.08%	9443.29%	$10,000	$954,329
Nike	NKE	16.96%	5877.45%	$10,000	$597,745
TJ Maxx	TJX	20.20%	12094.77%	$10,000	$1,220,000
T. Rowe Price	TROW	17.62%	6822.92%	$10,000	$692,292
Expeditors Int'l	EXPD	18.00%	7430.44%	$10,000	$753,044
Progressive	PGR	15.75%	4454.61%	$10,000	$455,461
Danaher	DHR	18.18%	7727.19%	$10,000	$782,719
General Dynamics	GD	20.84%	13906.31%	$10,000	$1,400,000
Wells Fargo	WFC	14.60%	3406.57%	$10,000	$350,657
US Bank	USB	15.06%	3816.71%	$10,000	$391,671
S&P 500	SPX	9.26%	909.51%	$10,000	$100,951
Wilshire 5000		9.39%	941.67%	$10,000	$104,132
Russell 2000	RUT	9.19%	891.66%	$10,000	$99,274

(data from Morningstar)

In full disclosure, I wasn't able to perform a full filtered search for all stocks that beat Berkshire, so it's possible there were many more that did so. Now, that being said, what's interesting about the list of companies above is how diverse they are as far as sectors and industries, and also how somewhat unique they are within those industries.

For example, Home Depot and Lowe's performed very similarly, so one might reasonably assume that their performance was merely due to trends in housing, particularly in the earlier part of this decade. However, I found their tandem performance exceptional; in other fields, there seemed to be one or two clear winners with many lagging far behind both Berkshire and their peers. For example, while Walgreens delivered >15% annualized total returns to its shareholders, rival CVS delivered only ~10% annualized

returns. Other examples would be the out-sized performance of consumable companies such as Altria and Colgate versus companies like Pepsi and Kimberly Clark, which lagged considerably

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Pepsi and Kimberly Clark, which lagged considerably.

The 1990s were a great time, for asset managers, so I thought that might have been the primary boost for T. Rowe Price. Not so; fellow asset managers Franklin Resources and Legg Mason delivered returns that were about 80% and 45% of Berkshire's returns, respectively. There is a similar result in retail. While several retailers like JC Penney are barely surviving, and others such as Nordstrom are the victims of e-commerce trends, TJX Companies (the parent company of Marshalls and TJ Maxx) has thrived in a challenging brick-and-mortar retail environment.

Now that we've established that these companies delivered superior returns on their own merit and were not necessarily lucky by being the beneficiaries of macro trends, I thought it would be instructive to make the comparison with Berkshire even more challenging. Consider that last December, Philosophical Economics wrote about the impact of taxes on investment returns (http://www.philosophicaleconomics.com/2015/12/taxes/), and compared the pre- and post-tax shareholder returns of Altria, a huge dividend payer, and Berkshire Hathaway, which has never paid a dividend. Jesse Livermore (https://twitter.com/Jesse_Livermore), the blog's author, describes the tax effect on the return differential this way:

> But now let's assume that you were a high net worth individual, living in beautiful Newport Beach, California, holding the position outside of a retirement account (which is where the vast majority of high-end wealth is held). At current marginal rates, neglecting deductions, your dividends would have been taxed at **37.1%**. That's 20% for federal income tax, 13.3% for

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California state income tax, and 3.8% for the new Obamacare tax.

How would these taxes have impacted your returns? Instead of compounding at **21.0%**, the Altria investment would have compounded at **19.0%**. The final value of the investment would have been reduced by almost half, to $50.6MM. With Berkshire, however, the final investment value wouldn't have changed at all. It would still be $77.0MM, because Berkshire didn't pay any dividends. Of course, you would still owe taxes on the $77.0MM, but you would be able to pay them on your own schedule, whenever you wanted to use the money. And bear in mind that you would *also* have to pay taxes on the $50.6MM held in Altria.

We all recognize that taxes have a significant impact on long-term returns, especially when expected nominal returns are high. But we normally assume that the impact is limited to cases of excessive short-term trading, where capital gains that could have otherwise been deferred are prematurely incurred at punitive short-term rates. The truth, however, is that the detrimental impact of taxes extends beyond the space of capital gains, into the space of dividend income. As the example illustrates, owning a portfolio heavy on dividend-paying stocks like Altria and light on cashflow recyclers like Berkshire can impose a substantial drag on returns over time.

Considering the huge tax impact on dividends over the very long run, I wanted to see how these companies would have performed ex-dividend; that is, I wanted to compare their returns with Berkshire's without reinvested dividends* just to see how the performance would have been altered. Interestingly, only ten of the above companies (emboldened) managed excess returns without the benefit of dividend reinvestment:

			CAGR ex-Div	Investment	Ending Value
Berkshire Hathaway	Brk. A		13.95%	$10,000	$302,404
Altria	MO		12.37%	$10,000	$210,231
Colgate-Palmolive	CL		11.84%	$10,000	$185,533
Sturm Ruger	RGR		9.67%	$10,000	$111,322

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Walgreens Boots Alliance	WBA		13.87%	$10,000	$296,895
Church & Dwight	**CHD**		**14.29%**	**$10,000**	**$327,071**
McCormick	MKC		11.98%	$10,000	$191,766
Home Depot	**HD**		**15.54%**	**$10,000**	**$434,630**
Lowe's	**LOW**		**16.74%**	**$10,000**	**$569,282**
Charles Schwab & Co	**SCHW**		**17.87%**	**$10,000**	**$731,926**
Nike	**NKE**		**15.52%**	**$10,000**	**$432,128**
TJ Maxx	**TJX**		**18.56%**	**$10,000**	**$852,146**
T. Rowe Price	**TROW**		**15.28%**	**$10,000**	**$409,645**
Expeditors Int'l	**EXPD**		**17.23%**	**$10,000**	**$634,001**
Danaher	**DHR**		**17.94%**	**$10,000**	**$742,983**
General Dynamics	**GD**		**15.67%**	**$10,000**	**$446,884**
Wells Fargo	WFC		11.54%	$10,000	$173,091
US Bank	USB		11.67%	$10,000	$178,451
(data from Morningstar; author's calculations)					

It is pretty stunning to consider the difference in returns. It would require another post altogether to dig into the reasons why these companies blew away the competition, *and Warren Buffett*, even excluding dividends, but that will be a future project.

It is interesting to note that of the examined Berkshire holdings, only Wells Fargo and US Bank generated higher returns (with dividends) than Berkshire itself, while long-time holdings Coca Cola, P&G, and American Express all lagged. Furthermore, at some point in the period examined, Berkshire owned Home Depot, Lowe's, and General Dynamics, but sold out of them years ago (http://finance.yahoo.com/news/seven-stocks-warren-buffett-never-113013526.html). That just goes to show you that even if you are history's most renowned investor, you are still fallible.

Now here are some other articles which may be of interest to you:

Finance/Investing

The cost of capital and future return expectations (https://thepfengineer.com/2016/07/27/cost-of-capital/). - Daniel Sotiroff

What drives momentum performance (http://economicdata.blogspot.com/2016/07/what-drives-momentum-performance.html)? - EconomPic (Jake)

[Being comfortable with being uncomfortable (http://blog.cordantwealth.com/getting-comfortable-with-being-uncomfortable?utm_content=33708478&utm_medium=social&utm_source=twitter)](http://blog.cordantwealth.com/getting-comfortable-with-being-uncomfortable?utm_content=33708478&utm_medium=social&utm_source=twitter). - Isaac Presley, Cordant Wealth

History

[What if Germany had won the Great War (https://www.theguardian.com/commentisfree/2013/dec/25/if-germans-won-first-world-war)](https://www.theguardian.com/commentisfree/2013/dec/25/if-germans-won-first-world-war)? - Martin Kettle, via The Guardian

Miscellaneous

[The weird history of clear soda (http://www.livescience.com/55354-crystal-pepsi-weird-history-of-clear-soda.html)](http://www.livescience.com/55354-crystal-pepsi-weird-history-of-clear-soda.html). - Stephanie Pappas, via livescience.com

*Yes, I am aware that the returns would be different if these companies had retained earnings and not paid them out, and that investors could have taken their after-tax dividend proceeds and reinvested them in other

ventures, etc.

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Lawrence Hamtil is a fourteen-year veteran of the financial services industry, having served clients in all aspects of the business during his career, which started in 2002. In 2005, he joined Dennis Wallace of Fortune Financial Services, LLC, becoming, at the time, one of Multi-Financial Securities, Inc's youngest registered representatives. In 2008, Dennis and Lawrence made the decision to become fully independent by founding their own Registered Investment Advisory (RIA), Fortune Financial Advisors, LLC. He serves clients in the United States and Europe. His financial commentary has been referenced in Barron’s online edition.

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