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First Half Performance:

During the first half of 1965, the Dow Jones Industrial Average (hereinafter called the "Dow") declined from 874.13 to 868.03. This minor change was accomplished in a decidedly non-Euclidian manner. The Dow instead took the scenic route, reaching a high of 939.62 on May 14th. Adding back dividends on the Dow of 13.49 gives an overall gain through ownership of the Dow for the first half of 7.39 or 0.8%.

9.6% advantage over the Dow

We had one of our better periods with an overall gain, before allocation to the general partner, of 10.4% or a 9.6 percentage point advantage over the Dow. To bring the record up to date, the following summarizes the year-by-year performance of the Dow, the performance of the Partnership before allocation to the general partner, and the limited partners' results:

Year	Overall Results From Dow (1)	Partnership Results (2)	Limited Partners' Results (3)
1957	- 8.4%	+10.4%	+ 9.3%
1958	+38.5	+40.9	+32.2
1959	+20.0	+25.9	+20.9
1960	- 6.2	+22.8	+18.6
1961	+22.4	+45.9	+35.9
1962	- 7.6	+13.9	+11.9
1963	+20.6	+38.7	+30.5
1964	+18.7	+27.8	+22.3
1st half 1965	+ 0.8	+10.4	+ 9.3
Cumulative results	+133.2	+682.4	+449.7
Annual compounded rate	10.5	27.4	22.2

(1) Based on yearly changes in the value of the Dow plus dividends that would have been received through ownership of the Dow during that year. The table includes all complete years of partnership activity.

(2) For 1957-61 consists of combined results of all predecessor limited partnerships operating throughout the entire year after all expenses but before distributions to partners or allocations to the general partner.

(3) For 1957-61 computed on the basis of the preceding column of partnership results allowing for allocation to the general partner based upon the

present partnership agreement, but before monthly withdrawals by limited partners.

<3 years results don't mean much, especially in control situations

Our constant admonitions have been: (1) that short-term results (less than three years) have little meaning, particularly in reference to an investment operation such as ours that may devote a portion of resources to control situations; and, (2) that our results, relative to the Dow and other common-stock-form media usually will be better in declining markets and may well have a difficult time just matching such media in very strong markets.

With the latter point in mind, it might be imagined that we struggled during the first four months of the half to stay even with the Dow and then opened up our margin as it declined in May and June. Just the opposite occurred. We actually achieved a wide margin during the upswing and then fell at a rate fully equal to the Dow during the market decline.

1) general partner responsibility to be honest

2) results can deviate substantially

I don't mention this because I am proud of such performance — on the contrary, I would prefer it if we had achieved our gain in the hypothesized manner. Rather, I mention it for two reasons: (1) you are always entitled to know when I am wrong as well as right; and, (2) it demonstrates that although we deal with probabilities and expectations, the actual results can deviate substantially from such expectations, particularly on a short-term basis. As mentioned in the most recent annual letter, our long-term goal is to achieve a ten percentage point per annum advantage over the Dow. Our advantage of 9.6 points achieved during the first six months must be regarded as substantially above average. The fortitude demonstrated by our partners in tolerating such favorable variations is commendable. We shall most certainly encounter periods when the variations are in the other direction.

requires fortitude to tolerate the variations

controlling interest - value determined by assets + earning power

During the first half, a series of purchases resulted in the acquisition of a controlling interest in one of the situations described in the "General-Private Owner" section of the last annual letter. When such a controlling interest is acquired, the assets and earning power of the business become the immediate predominant factors in value. When a small minority interest in a company is held, earning power and assets are, of course, very important, but they represent an indirect influence on value which, in the short run, may or may not dominate the factors bearing on supply and demand which result in price.

small interest - value is based on supply + demand (weighing v. voting)

When a controlling interest is held, we own a business rather than a stock and a business valuation is appropriate. We have carried our controlling position at a conservative valuation at midyear and will reevaluate it in terms of assets and earning power at yearend. The annual letter, issued in January, 1966, will carry a full story on this current control situation. At this time it is enough to say that we are delighted with both the acquisi cost and the business operation, and even happier about the people we have managing the business.

Investment Companies:

coming back to the yardstick

We regularly compare our results with the two largest open-end investment companies (mutual funds) that follow a policy of being, typically, 95-100% invested in common stocks, and the two largest diversified closed-end investment companies. These four companies, Massachusetts Investors Trus Investors Stock Fund, Tri-Continental Corp., and Lehman Corp., manage over $4 billion and are probably typical of most of the $30 billion investment company industry. Their results are shown in the following table. My opinion is that this performance roughly parallels that of the overwhelming majority of other investment advisory organizations which handle, in aggregate, vastly greater sums.

Year	Mass. Inv. Trust (1)	Investors Stock (1)	Lehman (2)	Tri-Cont. (2)	Dow	Lim Part
1957	-11.4%	-12.4%	-11.4%	- 2.4%	- 8.4%	+
1958	+42.7	+47.5	+40.8	+33.2	+38.5	+3
1959	+ 9.0	+10.3	+ 8.1	+ 8.4	+20.0	+2
1960	- 1.0	- 0.6	+ 2.5	+ 2.8	- 6.2	+1
1961	+25.6	+24.9	+23.6	+22.5	+22.4	+3
1962	- 9.8	-13.4	-14.4	-10.0	- 7.6	+1
1963	+20.0	+16.5	+23.7	+18.7	+20.6	+3
1964	+15.9	+14.3	+14.0	+13.6	+18.7	+2
1st half 1965	0.0	- 0.6	+ 2.7	0.0	+ 0.8	+
Cumulative results	+114.9	Bleh... +102.8	+111.7	+115.4	+133.2	+44
Annual compounded rate	9.4	8.7	9.2	9.5	10.5	2

(1) Computed from changes in asset value plus any distributions to holders of rec during year.

(2) From 1965 Moody's Bank & Finance Manual for 1957-64. Estimated for first 1965.

Last year I mentioned that the performance of these companies in some ways resembles the activity of a duck sitting on a pond. When the water (the market) rises, the duck rises; when it falls, back goes the duck. The water level was virtually unchanged during the first half of 1965. The duc as you can see from the table, are still sitting on the pond.

As I mentioned earlier in the letter, the ebb of the tide in May and June a substantially affected us. Nevertheless, the fact we had flapped our wing mutual fund performance similar to random selection

a few times in the preceding four months enabled us to gain a little altitude on the rest of the flock. Utilizing a somewhat more restrained lexicon, James H. Lorie, director of the University of Chicago's Center for Researc in Security Prices was quoted in the May 25, 1965, WALL STREET JOURN/ as saying: "There is no evidence that mutual funds select stocks better than by the random method."

Of course, the beauty of the American economic scene has been that random results have been pretty darned good results. The water level has been rising. In our opinion, the probabilities are that over a long period of time it will continue to rise, though, certainly not without important interruption. It will be our policy, however, to endeavor to swim strongly, with or agains the tide. If our performance declines to a level you can achieve by floating on your back, we will turn in our suits.

If performance just matches the Dow, you should withdraw your money?

Advance Payments and Advance Withdrawals:

We accept advance payments from partners and prospective partners at 6% interest from date of receipt until the end of the year. While there is no obligation to convert such advance payments to a partnership interest at the end of the year, this should be the intent at the time it is paid to us.

Similarly, we allow partners to withdraw up to 20% of their partnership account prior to yearend and charge them 6% from date of withdrawal until yearend when it is charged against their capital account. Again, it is not intended that partners use us like a bank, but that they use the withdrawal right for a truly unexpected need for funds. Predictable needs for funds such as quarterly federal tax payments should be handled by a beginning-of the-year reduction in capital rather than through advance withdrawals from B.P.L. during the year. The withdrawal privilege is to provide for the unanticipated.

The willingness to borrow (through advance payments) and lend (through advance withdrawals) at the same 6% rate may sound downright "un-Buffett like." (You can be sure it doesn't start my adrenaline flowing.) Certainly such a no-spread arbitrage is devoid of the commercial overtones an observer might impute to the preponderance of our transactions. Nevertheless, we think it makes sense and is in the best interest of all partners.

The partner who has a large investment in indirect ownership of a group of liquid assets should have some liquidity present in his partnership interest other than at yearend. As a practical matter, we are reasonably cert that advance withdrawals will be far more than covered by advance payme For example, on June 30, 1965, we had $98,861 of advance withdrawals a $652,931 of advance payments.

Why then the willingness to pay 6% for the net of advance payments over advance withdrawals when we can borrow from commercial banks at substantially lower rates? The answer is that we expect on a long-term basis to earn better than 6% (the general partner's allocation is zero unless we do) although it is largely a matter of chance whether we achieve the 6% figure in any short period. Moreover, I can adopt a different attitude regarding the investment of money that can be expected to soon be a part of our equity capital than I can on short-term borrowed money. The advance payments have the added advantage to us of spreading the investment of new money over the year, rather than having it hit us all at once in January. On the other hand, 6% is more than can be obtained in short-term dollar secure investments by our partners, so I consider it mutually profitable.

Miscellaneous:

The bold expansion program to 909 1/4 square feet described in the annual letter was carried off without a hitch (the Pepsi's never even got warm).

John Harding joined us in April and is continuing the record whereby all the actions in the personnel field have been winning ones.

As in past years, we will have a letter out about November 1st (to partners and those who have indicated an interest to me by that time in becoming partners) with the commitment letter for 1966, estimate of the 1965 tax situation, etc.

Cordially,

Warren E. Buffett

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Jamie Retherford

WEB:bf