Bear market mauls Buffett too

'Many shall be restored that now are fallen and many shall fall that now are in honor'
Horace–Ars Poetica

Ben Graham began his seminal piece on value investing with that quote, and several of his disciples built impressive records over many decades using it as their guiding principal. Buy established businesses when their share prices have fallen substantially and are out of favour, the theory goes, and sell them when the world comes to its senses. It worked for the best part of 70 years. Then, in 2008, it stopped working.

US fund manager Bill Miller outperformed the S&P 500 every single year from 1991 to 2005, building himself a record of outperformance that made him one of the highest profile value investors in the world. He bought stocks like American Express and Freddie Mac when no one liked them (usually during recessions) and sold them when the boom times returned.

When financial stocks plummeted towards the end of 2007, Miller began loading up on them again, buying the stocks he knew and in many cases the ones he had owned before. This time, however, low stock prices were not simply a function of investor irrationality. This crisis was different and Miller's purchases became the who's who of corporate failures: Merrill Lynch, Washington Mutual, Wachovia, Freddie Mac, Bear Stearns and AIG to name a few. In the space of 12 months, Miller undid 15 years of outperformance (see Bill Miller's defeat in *The Wall Street Journal*).

Value investors around the world have suffered a similar fate. We bought stocks we thought were cheap, only to see them plummet from there and, in many cases, permanently destroy our capital through share issues or insolvency. Even Warren Buffett has admitted to Berkshire Hathaway shareholders that he lost them substantial amounts of money in 2008. His investments in two (unnamed) Irish banks have declined more than 90% since his purchase last year and, by his own admission, the losses are permanent, not temporary.

While minuscule relative to Berkshire’s capital, the investments are Buffett's worst ever in percentage terms (of those we know of, at least). Even the great man has been fooled by the great value illusion: what seems to be there one day isn't there the next.

Edward Chancellor, author of *Devil Take the Hindmost* and columnist with breakingviews.com, has called it the Death of value investing (you need to sign up for a free trial). I wouldn't go that far but it's clear this financial and economic crisis is different to anything Warren Buffett has experienced. Unless you're an octogenarian, that makes it different to anything you or I have seen either. It's time to tread extremely carefully.

Note: Greg Hoffman published his [analysis of Buffett's letter] on [The Intelligent Investor], or you can read it yourself at [berkshirehathaway.com]. If there’s anything you'd like to add, post it in the comments box below.