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Warren Buffett's Top 10 Pieces of Investment Advice

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Warren Buffett's investment advice is timeless. I have lost track of the number of investing mistakes I have made over the years, but almost all of them fall into one of the 10 buckets of investment tips given by Warren Buffett below.

By keeping Buffett's investment advice in mind, investors can sidestep some of the common traps that damage returns and jeopardize financial goals.

Not surprisingly, Warren Buffett certainly practices what he preaches. Buffett's portfolio of high dividend stocks is perfectly aligned with his guiding principles.

Warren Buffett's Investment Advice

After much deliberation, I settled on my 10 favorite Warren Buffett investing tips in the list below.

Each nugget of wisdom is supported by at least one of Warren Buffett's quotes and is helpful for investors seeking to find safer stocks. Let's dive in.

1. Invest in what you know…and nothing more.

One of the easiest ways to make an avoidable mistake is getting involved in investments that are overly complex.

Many of us have spent our entire careers working in no more than a handful of different industries.

We probably have a reasonably strong grasp on how these particular markets work and who the best companies are in the space.

However, the far majority of publicly-traded companies participate in industries we have little to no direct experience in.

"Never invest in a business you cannot understand." – Warren Buffett

This doesn't mean we can't invest capital in these areas of the market, but we should approach with caution.

In my view, the far majority of companies operate businesses that are too difficult for me to comfortably understand. This is a key point that I follow with my investment philosophy.

I'll be the first one to tell you that I cannot forecast the success of a biotechnology company's drug pipeline, predict the next major fashion trend in teen apparel, or identify the next technological breakthrough that will drive growth in semiconductor chips.

These types of complex issues materially affect the earnings generated by many companies in the market but are arguably unforecastable.

When I come across such a business, my response is simple: "Pass."

There are too many fish in the sea to get hung up on studying a company or industry that is just too hard to understand. That is why Warren Buffett has historically avoided investing in the technology sector (aside from his purchase of IBM).

If I cannot get a reasonable understanding of how a company makes money and the main drivers that impact its industry within 10 minutes, I move on to the next idea.

Of the 10,000+ publicly-traded firms out there, I estimate that no more than a few hundred companies meet my personal standards for business simplicity. Some sectors are better for dividend income than others as well.

Peter Lynch once said, "Never invest in an idea you can't illustrate with a crayon."

Many mistakes can be avoided by staying within our circle of competence and picking up a Crayola.

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2. Never compromise on business quality

While saying "no" to complicated businesses and industries is fairly straightforward, identifying high quality businesses is much more challenging.

Warren Buffett's investment philosophy has evolved over the last 50 years to focus almost exclusively on buying high quality companies with promising long-term opportunities for continued growth.

Some investors might be surprised to learn that the name Berkshire Hathaway comes from one of Buffett's worst investments.

Berkshire was in the textile manufacturing industry, and Buffett was enticed to buy the business because the price looked cheap.

He believed that if you bought a stock at a sufficiently low price, there will usually be some unexpected good news that gives you a chance to unload the position at a decent profit – even if the long-term performance of the business remains terrible.

With more years of experience under his belt, Warren Buffett changed his stance on "cigar butt" investing. He said that unless you are a liquidator, that kind of approach to buying businesses is foolish.

The original "bargain" price probably will not turn out to be such a steal after all. In a difficult business, no sooner is one problem solved than another surfaces. These types of companies also usually earn low returns, further eroding the initial investment's value.

These insights led Buffett to coin the following well-known quote:

"It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price." – Warren Buffett

One of the most important financial ratios that I use to gauge business quality is return on invested capital.

Companies that earn high returns on the capital tied up in their business have the potential to compound their earnings faster than lower-returning businesses. As a result, the intrinsic value of these enterprises rises over time.

"Time is the friend of the wonderful business, the enemy of the mediocre." – Warren Buffett

High returns on capital create value and are often indicative of an economic moat. I prefer to invest in companies that generate high (e.g. 10-20%+) and stable returns on invested capital.

Instead of giving in to the temptation to buy a dividend stock yielding 10% or snap up shares of a company trading for "just" 8x earnings, be sure you are comfortable with company's business quality.

3. When you buy a stock, plan to hold it forever

Once a high quality business has been purchased at a reasonable price, how long should it be held?

"If you aren't thinking about owning a stock for ten years, don't even think about owning it for ten minutes." – Warren Buffett

"Our favorite holding period is forever." – Warren Buffett

"If the job has been correctly done when a common stock is purchased, the time to sell is almost never." – Phil Fisher

Warren Buffett clearly embraces a buy-and-hold mentality. He has held some of his positions for a number of decades.

Why? For one thing, it's hard to find excellent businesses that continue to have a bright long-term future (Buffett runs a concentrated portfolio for this reason).

Furthermore, quality businesses earn high returns and increase in value over time. Just like Warren Buffett said, time is the friend of the wonderful business. Fundamentals can take years to impact a stock's price, and only patient investors are rewarded.

Finally, trading activity is the enemy of investment returns. Constantly buying and selling stocks eats away at returns in the form of taxes and trading commissions. Instead, we are generally better off to "buy right and sit tight."

"The stock market is designed to transfer money from the active to the patient." – Warren Buffett

For investors seeking more information, I wrote an article covering the sell criteria I use to manage our dividend portfolios: When Should I Sell My Stocks?

4. Diversification can be dangerous

I previously wrote a piece about how to build a dividend portfolio and touched on the topic of diversification. In my view, individual investors gain most of the benefits of diversification when they own between 20 and 40 stocks across a number of different industries.

However, many mutual funds own hundreds of stocks in a portfolio. Warren Buffett is the exact opposite. Back in 1960, Buffett's largest position was a whopping 35% of his entire portfolio!

Simply put, Warren Buffett invests with conviction behind his best ideas and realizes that the market rarely offers up great companies at reasonable prices.

"You will notice that our major equity holdings are relatively few. We select such investments on a long-term basis, weighing the same factors as would be involved in the purchase of 100% of an operating business: (1) favorable long-term economic characteristics; (2) competent and honest management; (3) purchase price attractive when measured against the yardstick of value to a private owner; and (4) an industry with which we are familiar and whose long-term business characteristics we feel competent to judge. It is difficult to find investments meeting such a test, and that is one reason for our concentration of holdings. We simply can't find one hundred different

securities that conform to our investment requirements. However, we feel quite comfortable concentrating our holdings in the much smaller number that we do identify as attractive." – Warren Buffett

When such an opportunity arises, he pounces.

"Opportunities come infrequently. When it rains gold, put out the buck, not the thimble." – Warren Buffett

On the other end of the spectrum, some investors excessively diversify their portfolios out of fear and/or ignorance. Owning 100 stocks makes it virtually impossible for an investor to keep tabs on current events impacting their companies.

Excessive diversification also means that a portfolio is likely invested in a number of mediocre businesses, diluting the impact from its high quality holdings.

"Diversification is a protection against ignorance. It makes very little sense for those who know what they're doing." – Warren Buffett

Perhaps Charlie Munger summed it up best:

"The idea of excessive diversification is madness." – Charlie Munger

How many stocks do you own? If the answer is more than 50-60, you might seriously consider slimming down your portfolio to focus on your highest quality holdings.

5. Most news is noise, not news

There is no shortage of financial news hitting my inbox each day. While I am a notorious headline reader, I brush off almost all of the information pushed my way.

The 80-20 rule claims that around 80% of outcomes can be attributed to 20% of the causes for an event.

When it comes to financial news, I would argue it's more like the 99-1 rule – 99% of the investment actions we take *should* be attributed to just 1% of the financial news we consume.

Most of the news headlines and conversations on TV are there to generate buzz and trigger our emotions to do something – anything!

"Owners of stocks, however, too often let the capricious and often irrational behavior of their fellow owners cause them to behave irrationally as well. Because there is so much chatter about markets, the economy, interest rates, price behavior of stocks, etc., some investors believe it is important to

listen to pundits – and, worse yet, important to consider acting upon their comments." – Warren Buffett

The companies I focus on investing in have thus far withstood the test of time. Many have been in business for more than 100 years and faced virtually every unexpected challenge imaginable.

Imagine how many pieces of gloom-and-doom "news" originated over their corporate lives. However, they are still standing.

Does it really matter if Coke missed quarterly earnings estimates by 4%?

Should I sell my position in Johnson & Johnson because the stock has slid by 10% since my initial purchase?

With falling oil prices reducing demand for some of GE's products, should I sell my shares?

The answer to these questions is almost always a resounding "no," but stock prices can move significantly as these matters arise. Financial news outlets also need to blow up these issues to remain in business.

"Remember that the stock market is a manic depressive." – Warren Buffett

As investors, we need to ask ourselves if a news item truly impacts our company's long-term earnings power.

If the answer is no, we should probably do the opposite of whatever the market is doing (e.g. Coke falls by 4% on a disappointing earnings report caused by temporary factors – consider buying the stock).

The stock market is an unpredictable, dynamic force. We need to be very selective with the news we choose to listen to, much less act on. In my opinion, this is one of the most important pieces of investment advice.

6. Investing isn't rocket science, but there is no "Easy Button"

Perhaps one of the greatest misconceptions about investing is that only sophisticated people can successfully pick stocks.

However, raw intelligence is arguably one of the *least* predictive factors of investment success.

"You don't need to be a rocket scientist. Investing is not a game where the guy with the 160 IQ beats the guy with the 130 IQ." – Warren Buffett

It doesn't take a genius to follow after Warren Buffett's investment philosophy, but it is remarkably difficult for anyone to consistently beat the market and sidestep behavioral mistakes.

Equally important, investors must remain aware that there is no such thing as a magical set of rules, a formula, or an "Easy Button" that can generate market-beating results. It doesn't exist and never will.

"Investors should be skeptical of history-based models. Constructed by a nerdy-sounding priesthood…these models tend to look impressive. Too often, though, investors forget to examine the assumptions behind the models. Beware of geeks bearing formulas." – Warren Buffett

Anyone proclaiming to possess such a system for the sake of drumming up business is either very naive or no better than a snake oil salesman in my book. Beware of self-proclaimed "gurus" selling you a hands-off, rules-based system to investing. If such a system actually existed, the owner certainly wouldn't have a need to sell books or subscriptions.

"It's easier to fool people than to convince them that they have been fooled." – Mark Twain

Adhering to an overarching set of investment principles is fine, but investing is still a difficult art that requires thinking and shouldn't feel easy.

"It's not supposed to be easy. Anyone who finds it easy is stupid." – Charlie Munger

7. Know the difference between price and value

Stock prices are pushed at us nonstop. For some reason, investors love to fixate on ticker quotes running across the screen.

"The stock market is filled with individuals who know the price of everything but the value of nothing." – Phil Fisher

However, stock prices are inherently more volatile than underlying business fundamentals (in most cases).

In other words, there can be periods of time in the market where stock prices have zero correlation with the longer term outlook for a company.

Many bargains were available during the financial crisis because investors were quick to sell off all companies – regardless of their business quality and long-term earnings potential.

Many firms continued to strengthen their competitive advantages during the downturn and emerged from the crisis with even brighter futures.

In other words, a company's stock price was (temporarily) separated from its underlying business value.

"During the extraordinary financial panic that occurred late in 2008, I never gave a thought to selling my farm or New York real estate, even though a severe recession was clearly brewing. And, if I had owned 100% of a solid business with good long-term prospects, it would have been foolish for me to even consider dumping it. So why would I have sold my stocks that were small participations in wonderful businesses? True, any one of them might eventually disappoint, but as a group they were certain to do well." – Warren Buffett

As long-term investors, we need to heed Warren Buffett's investment advice to buy quality when it is marked down in price.

"Price is what you pay. Value is what you get." – Warren Buffett

Stock prices will swing with investor emotions, but that doesn't mean a company's future stream of cash flow has changed.

While there is always some debate surrounding a company's future earnings stream, the margin of disagreement is usually far lower than the stock's price volatility.

Investors need to distinguish between price and value, concentrating their efforts on high quality companies trading at the most reasonable prices today.

8. The best moves are usually boring

Investing in the stock market is not a path to get rich quickly.

If anything, I believe the stock market is best meant to moderately grow our existing capital over long periods of time.

Investing is not meant to be exciting, and dividend growth investing in particular is a conservative strategy.

Rather than try to find the next major winner in an emerging industry, it is often better to invest in companies that have already proven their worth.

"We make no attempt to pick the few winners that will emerge from an ocean of unproven enterprises. We're not smart enough to do that, and we know it." – Warren Buffett

After all, the goal is to find quality businesses that will compound in value over the course of many years. If we get this right, our portfolio's return will take care of itself.

Many companies that boast long and successful corporate lives provide basic products and services – snacks, beverages, toothpaste, medicine, convenience stores, etc.

While not the most exciting businesses, a slow pace of industry change often protects industry leaders. Many companies in the Dividend Aristocrats Index and Dividend Kings list have benefited from this phenomenon.

"Beware the investment activity that produces applause; the great moves are usually greeted by yawns." – Warren Buffett

There is no need to try and be a hero or impress anyone with our investments. Boring can be beautiful.

9. Low-cost index funds are sensible for almost everyone

Did you know that most investors fail to beat the market – and often by a wide margin?

We hurt our performance in many different ways – trying to time the market, taking excessive risks, trading on emotions, venturing outside our circle of competence, and more.

Even worse, many actively managed investment funds charge excessive fees that eat away returns and dividend income.

Despite his status as arguably the most prolific stock picker of all-time, Warren Buffett advocates for passive index funds in his 2013 shareholder letter.

Once Buffett passes away and his Berkshire Hathaway shares are given to charity, Buffett's trustee has clear instructions to follow:

"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." – Warren Buffett

Low-cost, passive indexing is a great strategy for many investors to consider. Most stock pickers fail to generate performance that justifies their higher fees.

Investors interested in learning more about the pros and cons of investing in dividend ETFs versus individual stocks will find the following articles worth reading:

Dividend ETFs: Is Investing in Dividend Funds Worth It?
Best Dividend ETFs: Top 10 Dividend Funds for Income

10. Only listen to those you know and trust

Throughout his shareholder letters and occasional interviews, Warren Buffett emphasizes the importance of only investing in trustworthy, competent management teams.

Simply put, Warren Buffett is very careful when it comes to selecting his business partners and managers. Their actions can make or break an investment for many years to come.

"Once management shows itself insensitive to the interests of owners, shareholders will suffer a long time from the price/value ratio afforded their stock (relative to other stocks), no matter what assurances management gives that the value-diluting action taken was a one-of-a-kind event." – Warren Buffett

Warren Buffett is obviously far more connected than any of us, which certainly helps him learn who the best and most trustworthy management teams are in a particular industry.

While we lack the resources to really evaluate the character and skill of a public company's CEO for investing purposes, we can certainly control who we listen to when it comes to selecting our investments and managing our portfolios.

The financial world is filled with many characters – good and bad. Unfortunately, a number of folks realize they can prey on investors' unrealistic expectations and feelings of fear and greed to make a quick buck.

Many finance "gurus" and talking heads are in the business of getting eyeballs to sell more advertisements, making sensationalist claims to gain new subscribers, or convincing investors to place trades in order to gain a commission.

None of these activities benefit individual investors, and self-proclaimed "experts" are generally no better than we are at predicting the future. They simply must play the role of Mr. Confident to benefit their own self-interests.

"We've long felt that the only value of stock forecasters is to make fortune tellers look good." – Warren Buffett

In fact, most of the "experts" issuing "advice" are very average using everyday standards.

"Wall Street is the only place that people ride to in a Rolls Royce to get advice from those who take the subway." – Warren Buffett

One of my missions with Simply Safe Dividends is to cut through the noise and gimmicks that have infiltrated the finance world.

I urge investors to stay focused on the facts, recognize the amount of randomness involved in investing, set realistic expectations, and stay the course.

No one cares about your nest egg more than you do, and investors living off dividends in retirement do not get a second chance.

"Management changes, like marital changes, are painful, time-consuming, and chancy." – Warren Buffett

Be careful who you trust!

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Closing Thoughts on Warren Buffett's Investment Advice

We often make investing harder than it needs to be. Warren Buffett follows a simple approach rooted in common sense. I can certainly relate to his investing tips from my experience working as an equity research analyst, but that doesn't mean they are always easy to follow!

By embracing some of Warren Buffett's investment advice – focusing on the longer term, sticking to blue chip dividend stocks, remaining within our circle of competence – we can better manage our portfolios to reduce the number of costly errors we make and continuously move closer to achieving our goals.

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