
Opinion **Unhedged**

The Buffett premium

And worried Wall Street strategists

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On the (disappearing?) Buffett premium

My colleague Eric Platt [wrote](#) yesterday:

Shares of Warren Buffett's Berkshire Hathaway have underperformed the wider market by one of the biggest margins in decades, as his retirement as chief executive nears . . .

The selling over the past three months has materialised even as Berkshire continued to report healthy operating results . . .

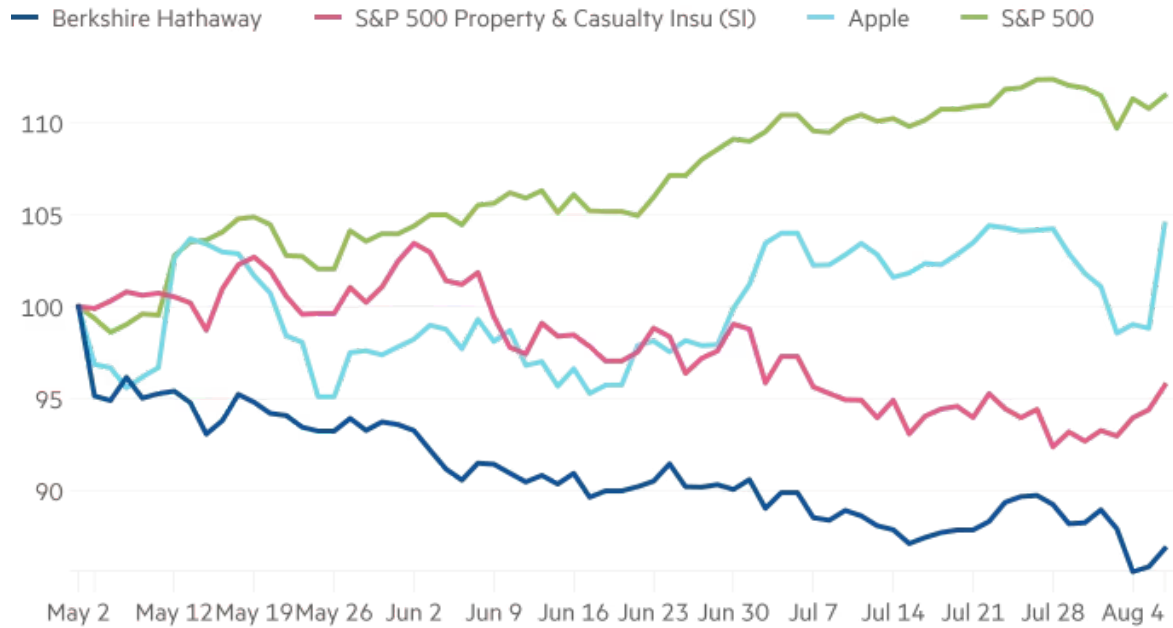
Operating profits across the company were hit by currency moves, but excluding those shifts, Berkshire generated an 8 per cent rise in earnings from a year earlier.

Unhedged [wrote three pieces](#) on Berkshire back in May, after Buffett announced he would be stepping down as CEO at the end of this year, to be replaced by longtime lieutenant Greg Abel. We focused on how Berkshire has achieved what it has under Buffett; we did not go into the question of whether it would be able to sustain the success without him.

Below is Berkshire's price performance since May 2 against the S&P 500 and the S&P 500's property & casualty insurance sub-index (P&C insurance is Berkshire's biggest business unit). I also include Apple, Berkshire's largest stock holding, although a much smaller slice of Berkshire than it once was (Berkshire owns about \$63bn of Apple shares, against Berkshire's total market value of about \$1tn).

Miss you already

Share prices and index rebased in \$ terms

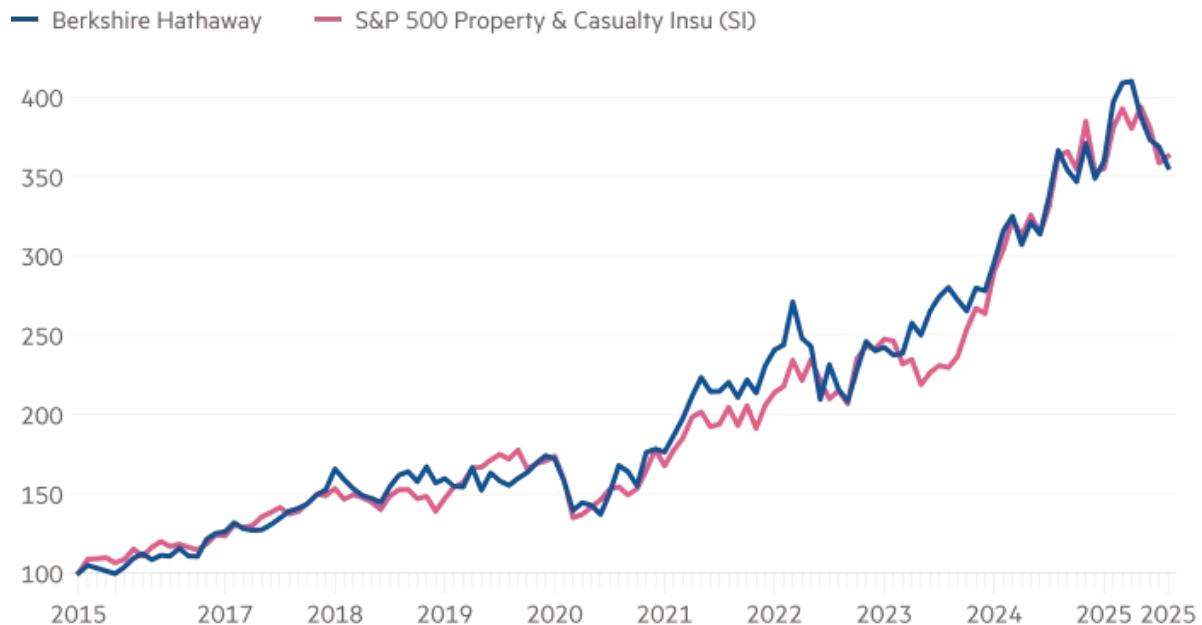


Source: LSEG via markets.ft.com

Two points of context to consider. First, over the past decade Berkshire has traded very closely in line with the property & casualty insurers, and that basic correlation is still in place:

It's a P&C insurance company

Share price and index rebased in \$ terms

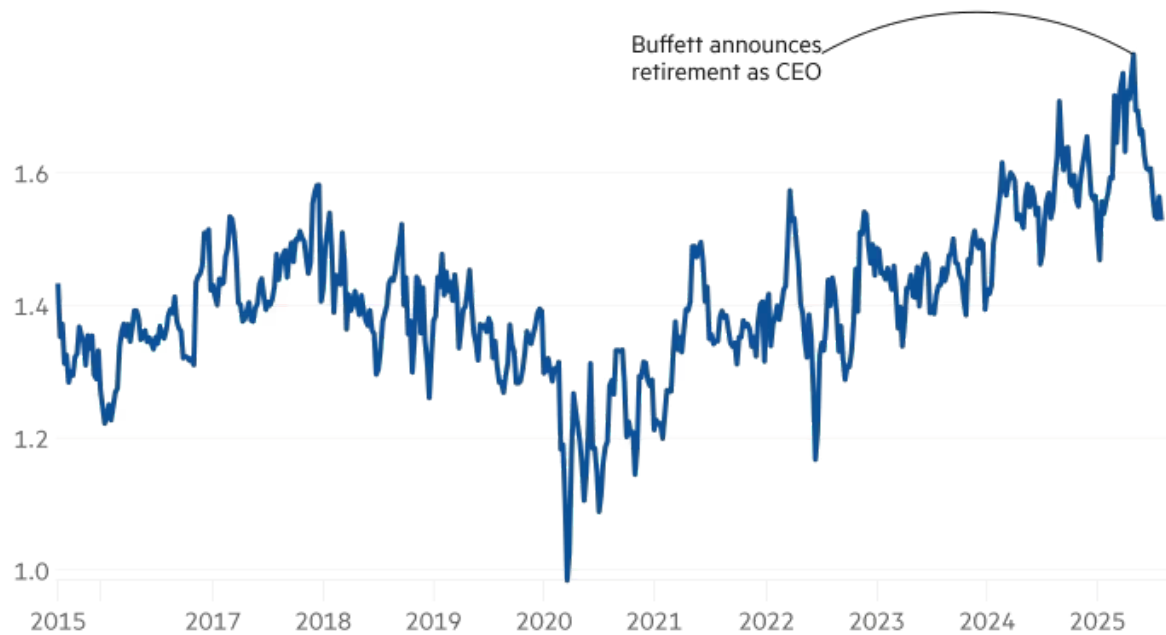


Source: LSEG via markets.ft.com

Next, valuation. Here is Berkshire's price/book value ratio (the ratio of the market capitalisation to the shareholder's equity on the balance sheet):

Mean reversion

Berkshire Hathaway price-to-book ratio



Source: Bloomberg

Buffett happens to have announced his plan to depart just as the stock was hitting a long-term peak in valuation. The decline we have seen since might have happened anyway, driven in part by plain old reversion to the mean.

Chris Bloomstran of Semper Augustus Investments, a longtime Berkshire watcher and shareholder, told me that early May was the first time in several decades the shares had traded at a premium to his [estimate](#) of the intrinsic value of the business. The shares have since returned to a discount (if that's right, expect Berkshire to start buying its own shares again; it hasn't done so in more than a year).

Still, the recent underperformance — worse than the weak showing of the P&C insurers — is notable. One has to ask if Buffett brought something to the table that Abel cannot. I think Berkshire's carefully designed conglomerate still makes sense, and I see no reason to doubt that Abel can run it well. The tricky issue, however, is what it means for the company to lose Buffett's incredible personal brand and charisma. His absence could change the business along at least three dimensions:

Friendly deals: when the owners of a large private business wants to sell to a good steward, Buffett is the natural call to make. The purchase of the Pilot truck stop chain for something over \$11bn is one recent example. Will business owners want to do handshake deals with Abel in quite the same way? (Bloomstran argues that this is less relevant today, given that there are very few private business left big enough to make a difference to Berkshire).

Symbolic solidity: One key to Berkshire's share performance is that the stock outperforms in moments of crisis. This, I would argue, has as much to do with the fact that Buffett is a living symbol of prudence as with any economic fact about the business itself. Will scared investors flock to shelter in Abel's arms in quite the same way?

A pass from regulators and the press: Berkshire's disclosures provide limited details about many parts of the business. But no regulator so much as clears their throat, because everyone trusts Buffett. The company's relationship with the financial press is similarly gentle, as demonstrated most recently when Berkshire took a \$4bn [writedown](#) on its Kraft Heinz investment and no one, as far as I can tell, had a nasty word to say about it. Will Abel get the kid glove treatment, too?

The next few years are going to be interesting for Berkshire.

(Armstrong)

Is a correction coming?

A flurry of Wall Street strategists have come out in recent days saying they expect a market correction, probably a modest one, in the next few months. At Unhedged, our bias is that the shorter the timeframe, the harder it is to predict returns. Over 10 years you can make a decent ballpark prediction; over a few months, good luck. So we thought we'd kick the tires on a few of the strategists' arguments.

Julian Emanuel of Evercore ISI writes that the base case is for a correction between 7 per cent and 15 per cent heading into the autumn, "catalysed by tariffs, soft jobs data while the Fed holds on rates, and otherwise respectable tech earnings colliding with a higher bar and valuations".

This chimes with Mike Wilson of Morgan Stanley's take that last week's downturn is the start of a modest pullback . . .

... driven by the lagged impacts of tariffs on growth data (both macro and micro), while fears of inflation keep the Fed on hold perhaps longer than markets desire ... Friday's weaker labour report combined with a Fed on hold could be the beginning of the 3Q consolidation we've been expecting.

Alexandra Wilson-Elizondo of Goldman Sachs warned that labour market weakness could spark a correction even before last Friday's bad jobs numbers landed. Around a week beforehand, she said on [CNBC](#) that the market was due for a near-term hit:

The amount of buying coming from retail is coming in at much higher levels than it has in the past. Over the past month, we've seen about \$50bn in buying from retail. It's about 40 per cent of the market share. In our minds, that's very vulnerable to changes in the labour market. There's a very high correlation between the labour market and the ability to want and be invested in risky assets.

Parag Thatte at Deutsche Bank is a more modest prognosticator: he thinks a small pullback wouldn't be surprising simply because we haven't had one in a while:

The S&P 500 has seen small pullbacks (over 3 per cent) every 1.5 to 2 months on average. It's been well over 3 months since the last one in April. Somewhat larger pullbacks of 5 per cent or more have occurred every 3 to 4 months on average historically. The S&P 500 is down about 2.5 per cent from the highs earlier this week, and it will not be a surprise if it pulls back a little more.

Thatte also thinks positioning could play a role; he noted to Unhedged that fundamental investors are already modestly underweight US equities, while trend-following quants have raised their exposure, but could cut and run in the face of rising volatility.

Tariffs; a job slowdown; inflation; excessive retail exuberance; rising volatility; over-extended positioning. All legitimate worries, and all worth keeping in mind as you decide whether risk asset prices are fair. But as tools for predicting a near-term correction? Probably useless. The best reason to expect a correction is that of Thatte: because they happen once in a while.

(Kim)

One good read

[Beaches in a sand-less world.](#)

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