Why Did Buffett Sell Taiwan Semiconductor?

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Warren Buffett is the famously successful investor who has said that his favorite timespan for owning a stock is forever. He only buys a stock when he understands how the company makes money and how it will continue to make money in the future. He is a disciple of Benjamin Graham, the father of the concept of **intrinsic stock value**. Something that surprised the market recently was when Buffett first disclosed that his company, Berkshire Hathaway, had purchased a large amount of stock (American Depositary Receipts) in Taiwan Semiconductor, the world's leading computer chip designer and manufacturer.

When Buffett subsequently sold most of his **Taiwan Semiconductor shares**, it spooked the market. If this is the guy whose favorite holding period for stock is forever, why did he sell so abruptly? We do not pretend to see into the mind of Mr. Buffett but offer our thoughts on why he sold Taiwan Semiconductor. We think that it is a useful exercise for investors to consider why someone like Buffett departs from his normal routine.

Warren Buffett Cigar Butt Investing

When Buffett started out investing his favorite strategy was to find ailing companies, buy them for a bargain price, make a few strategic changes, and quickly sell for a significant profit. This was the **cigar butt approach**. Buffett's explanation was that "If you buy a stock at a sufficiently low price, there will usually be some hiccup in the fortunes of the business that gives you a chance to unload at a decent profit, even though the long-term performance of the business may be terrible."

Although that cigar-butt-in-the-street stock only has "one puff" left, that "puff" is pure profit because of the extremely low purchase price. The formula that applies to this approach is this:

Net Value = (Current Assets – Inventory – Total Liabilities – Preferred Stock) / Outstanding Shares

The point of this little history lesson is that Buffett, the famed long term investor, will still sell a stock when he sees the opportunity for short term profit and that opportunity outweighs the likelihood of long term gains. We noted in an article recently that **Intel is in trouble** and that trouble extends across the entire chip industry to include Taiwan Semiconductor as the economy slows.

Buffett Spooks the Market

Upon news of Buffett selling 86% of his American Depositary Receipts of Taiwan Semiconductor, the stock fell by 6.5%. What does Buffett know that the rest of the market does not know? What Buffett knows is that semiconductor stocks tend to be volatile with their share prices waxing and waning with the economy and demand for electronic devices that use their chips. When Buffett bought Taiwan Semiconductor last November it was bottoming out before a brief recovery. What we expect is that the stock will not return to its previous highs very soon and will probably fall some more as the economy weakens. While Taiwan Semiconductor is not "cigar butt" stock but rather a world leader in semiconductors, it offered a significant quick profit which the "Oracle of Omaha" took.

Inflation Is Not Over and Neither Are Federal Reserve Rate Increases

2022 saw the highest inflation in four decades which prompted the US Federal Reserve as well as other central banks to raise interest rates and cut back on their balance sheets. The point is to slow the economy and reduce the surges in both wages and prices that drive inflation. It is rare for the Fed to successfully reduce inflation without **causing a recession** and driving unemployment up. Higher rates have driven the stock market down and started to slow the economy. Lower demand for computers and all the other electronic devices that use semiconductor chips is just part of the constellation of effects of the Fed's rate-raising efforts. No matter how bad recessions are, they do come to an end and stock prices go back up. However, the new investing environment will not include the historically low interest rates seen for years after the Financial Crisis. As such **big tech stocks**, including semiconductors, are not likely to fly as high as they did in recent years.

For us the take home lesson is that when an investor uses intrinsic value as a guide it is not just to buy a stock and hold forever but also to decide whether or not to sell it. It just turns out in the case of Taiwan Semiconductor that economic forces created both buying and selling opportunities in this case.

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