A WYATT INVESTMENT RESEARCH SPECIAL REPORT

WARREN BUFFETT'S TOP 5 STOCK PICKS

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After 50 years at the helm of **Berkshire Hathaway (NYSE: BRK-B)**, it's no accident that Warren Buffett has reached legendary status in the investing community.

Critics mock his folksy style and refusal to invest in anything he doesn't completely understand. Frankly, I think Warren Buffett's style is a breath of fresh air that flies in the face of the high-stress, high-speed and high-turnover world of Wall Street.

I imagine Warren Buffett spends very little energy worrying about what his critics think of his personality and investing style. And why would he? His record speaks for itself.

Buffett's latest annual letter to shareholders includes the 50-year increase in the company's stock price – an incredible 1,826,163% gain. And in case you're thinking I replaced a decimal with a comma, I'll spell it out so there can be no question.

This translates into a compound annual share price increase of 21.6%.

Compare that to the overall gain and annual gain of the S&P 500 (including dividends) during this period: 11,196% and 9.9%, respectively.

Don't think that this success has gone to Warren Buffett's head. Carol Loomis – a financial journalist, longtime friend of Buffett and editor of Buffett's annual letter to shareholders – noted that Buffett didn't include either of these incredible statistics when he submitted the first draft of the "Golden Anniversary" edition of his annual letter to shareholders.

While it was soon inserted into its usual spot on the first page of the annual letter, Buffett still modestly referred to 2014 as merely "a good year." Mind you, 2014 was a year in which Berkshire Hathaway stock rose 27% versus the S&P 500's gain of 13.7%.

A good year indeed!

Buffett's philosophy is often summarized through a series of quotes, such as his simple assertion that "our favorite holding period is forever."

Buffett's annual letter discloses the criteria the company uses to evaluate potential acquisition targets. Notably, Buffett and Berkshire Hathaway seek "simple businesses" that earn "good returns on equity while employing little or no debt. As Buffett notes in the letter, "If there's lots of technology, we won't understand it."

To better understand Buffett's successful investment philosophy, it's important to consider how this philosophy came to be.

Warren bought his first stock at the age of 11. After he sold it for a small profit, the stock soon surged 500%.

As he got older, Buffett began adding more and more routes to his newspaper delivery job until he was earning as much as $175 per month.

He had a breakthrough during his senior year of high school, after he and a friend bought a pinball machine for $25. They reinvested the earnings from the machine to buy others, compounding the amount of money they could earn from their investments in pinball machines.

After earning his undergraduate business degree in just three years, Buffett attended the Columbia Business School, where he met teachers Benjamin Graham and David Dodd, regarded as the fathers of value investing on the strength of their book "Security Analysis." Buffett studied under the pair and picked up where they left off as champions of value investing.

While you may safely assume that any stock owned by Berkshire Hathaway is worth owning, the pick of the litter from this collection of top stocks represents some of the best investment opportunities that can be found.

Our investment research team has dug into the entire portfolio of stocks owned by Buffett's Berkshire Hathaway. Based on a variety of criteria including valuation, growth prospects, and recent financial results, we've selected just five stocks that we think every investor should buy today.

Some of these stocks are longtime holdings by Berkshire Hathaway. And others are recent purchases in his investment portfolio.

Buffett owns nearly 50 stocks. But we know that most investors don't want to own *every* one of Buffett's stocks. Instead, they want to own just a select few. This report reveals our top picks.

Costco Wholesale Corp. (NASDAQ: COST)

Costco is more than just a wholesale superstore. It's also a super stock. That's why Warren Buffett has owned it for 13 years.

Known for a carefully curated selection of bulk offerings and brand-name items – as well as those produced for Costco's own private-label Kirkland brand – the store has inspired a massive and loyal consumer following. Buffett also noted in his 2007 letter to shareholders that – like Berkshire's insurance subsidiary Geico – Costco is a "low-cost producer" which is a "formidable barrier" against competition.

Buffett first bought shares of Costco during the first half of 2002. Though he paid only $40 to $46 per share, the stock now trades for over $140 per share.

As if share price appreciation weren't enough, Costco has been raising its dividend annually since issuing its first dividend payment in 2004. Its annual dividend growth rate is a portfolio-pleasing 13.4%.

The best part is that Costco maintains a relatively low payout ratio that has never risen above 30%. This means the company has a lot of room for boosting its dividend in the future while continuing to invest in its growth.

Costco paid out the second special dividend in the company's history at the start of 2015, a $5 per share dividend that was separate from its regular dividend. Along with the $7 per share special dividend the company paid out in 2012, this latest special dividend is an additional example of Costco's shareholder friendly practices.

Another of the Costco's shareholder friendly policies is its stock repurchase program. The company has reduced its share count from 492 million shares in 2005 to fewer than 440 million today, a reduction of more than 10% in 10 years. Costco's board of directors reauthorized the repurchase program in early 2015, approving up to $4 billion in additional share repurchases through 2018.

Between the company's surging profits, rising dividends and huge stock repurchases, it should come as no surprise that Costco stock is up more than 250% since Warren Buffett first purchased shares of the company.

Even as Costco ramps up its plans for international expansion, the next phase of growth may very well come from a relationship established with **Visa (NYSE: V)** and **Citigroup (NYSE: C)** in early 2015. The deal will end the longstanding relationship between Costco and **American Express (NYSE: AXP)**, in which American Express had served as Costco's exclusive payment processor.

The market has seen the move as hugely positive for Costco but negative for American Express. Co-branded Citibank Costco credit cards will be loaded with rewards that will keep loyal customers coming back. What's more, Visa's strong international payment network is an asset to Costco's growth.

Though Costco stock typically trades at an above-average valuation, it also produces above-average returns.

And when you consider Costco's superior annual earnings growth – forecasted to be 11.5% through 2020 – it emerges as the clear choice within the mega retail group.

With double-digit earnings growth forecasted through 2020 and a fresh round of stock buybacks and dividend increases driving shares higher, the stock looks like it will reward shareholders handsomely for years to come.

DaVita HealthCare Partners (NYSE: DVA)

Besides having an eye for a great deal, Buffett also has a keen eye for talented investment managers. Two of Berkshire Hathaway's investment managers who fit this description are Todd Combs and Ted Weschler. Buffett praised their performance in his 2013 letter to investors, noting that their picks had significantly outperformed his own for the year.

One of those picks is DaVita HealthCare Partners, a favorite of Weschler's.

Prior to joining Berkshire Hathaway in 2011, Weschler ran his own hedge fund where DaVita was one of his favorite holdings. It took only months for him to establish a position in the stock for his new employer, as the stock was added to the Berkshire Hathaway portfolio in the fourth quarter of 2011. The position was aggressively built up over the next several quarters.

DaVita has the distinction of being one of the only health care stocks held by Berkshire Hathaway, and it accounts for nearly 3% of the total portfolio. The position has been a real winner for Berkshire Hathaway, and the winning streak is almost certain to continue.

DaVita operates a pretty simple business – a trait that we know Buffett loves. The company also benefits from inelastic demand, as its customers literally need the company's services for their own survival. The vast majority of the company's earnings – typically around three-quarters – are generated through its network of dialysis centers located around the country.

Dialysis treatments are an essential part of life for Americans suffering from end-stage renal disease, or ESRD, which is typically caused by diabetes and/or high blood pressure. Patients with ESRD require dialysis treatments three times per week for the rest of their lives, unless they're able to secure an expensive and hard-to-find kidney transplant.

Kidney failure is on the rise, a byproduct of both the aging U.S. population and the obesity epidemic that is now spreading to other developed nations. Buffett and Weschler clearly recognize these trends and know that DaVita is a great way to profit from an aging population and the obesity epidemic that shows no sign of slowing.

Despite a somewhat rich valuation, Buffett has continued adding to his DaVita stake in recent quarters. The stock has certainly rewarded shareholders who have looked past its valuation. DaVita shares rose 45% in 2012 as Buffett was quickly growing his stake, more than 15% in 2013 and nearly 20% in 2014.

With a forecasted annual growth rate of 12% through 2020, it's no wonder that the stock is a favorite of Berkshire Hathaway investment managers.

The growing importance of DaVita's dialysis services is a sad reality in a world filled with obesity, poor nutrition and sedentary lifestyles. But it is a reality nonetheless, one that will continue to drive patients to DaVita and deliver profits to its shareholders.

MasterCard (NYSE: MA)

Electronic payments are taking off as cash becomes more and more removed from people's daily lives. Today's consumers have gotten so used to pulling out their credit card to pay for just about everything with a price tag that they hardly even notice parting with their money.

Making these electronic transactions possible is a group of traditional credit card companies that have adapted to the times to dominate the market for electronic payment processing. These

companies which collect small fees on millions of transactions per day are essentially toll booths on our modern commercial system.

The big three payment processors are MasterCard, Visa and American Express. It probably won't surprise you that Warren Buffett owns shares of all three companies.

Visa controls around 60.5% of the global market for payment processing, while MasterCard and American Express control around 27% and 4%, respectively. Together, the three companies control around 91.5% of the market.

Though Buffett is extremely picky when it comes to his investments, he doesn't necessarily have to pick one company out of an industry if he likes an entire industry. He can – and in some cases does – simply choose to buy all of the stocks that he likes in a particular industry.

Of course, you're welcome to do this as well. But for most investors looking to profit from the brilliant business model established by the payment processing companies, it makes sense to choose only one.

MasterCard is the one to buy. The stock is up nearly 2,000% since its 2006 IPO and shows no signs of slowing.

The company has an iconic and globally recognized brand in an industry that is well entrenched – both of which are traits that Warren Buffett loves. The industry dodged a major bullet when **Apple (NASDAQ: AAPL)** launched Apple Pay, which has made its mark as the first mobile payments solution to gain massive traction.

Rather than try to cut the payment processors out of the transactions, Apple further entrenched its role in electronic payments by requiring users to register and pay with a credit card as part of the Apple Pay process.

Though competitors like **eBay's (NASDAQ: EBAY)** PayPal still represent a threat to the big payment processors, Apple's decision to include these payment processors in Apple Pay essentially guarantees that companies like MasterCard will have a starring role as mobile payments take off like a rocket.

Like many of the companies you find Warren Buffett buying, MasterCard is extremely shareholder friendly. The company spent nearly $1 billion buying back shares in the first quarter of 2015 alone and has around $3 billion left in its current share repurchase program.

The company also pays a dividend. While this dividend isn't all that juicy yet – typically yielding around 0.75% – it has grown incredibly fast. MasterCard's original dividend of 9 cents per share has already risen to a split-adjusted $1.60 per share since 2006, and has increased by an average of 57.6% over the past five years.

MasterCard also has room for growth, as a new consumer class is emerging in developing markets all over the world. This includes Africa and the Middle East, where the company saw its average transaction size grow by 20% in the first few months of 2015. The opportunity in China is also huge for MasterCard.

Meanwhile, the company is growing operating margins and executing double-digit earnings growth, while the stock is handily beating the market. MasterCard's dividend growth shows no signs of slowing – an indication that its shares will continue to pump up your portfolio for years to come.

Goldman Sachs (NYSE: GS)

Despite the criticism and public scrutiny faced by Goldman Sachs in the wake of the 2008 financial crisis, there's a very good reason why the firm manages money for families like the Waltons of **Wal-Mart (NYSE: WMT)** fame, and why it was chosen to be the lead underwriter on the red-hot **Twitter (NYSE: TWTR)** initial public offering.

Simply put, Goldman is regarded as the best.

The 146-year-old financial institution has risen from the ashes of Wall Street boom-and-bust time and time again. Many storied firms – Solomon Brothers, Lehman Brothers and Bear Stearns, to name a few– have fallen casualty to these crises. But Goldman seems to always emerge leaner, stronger and better than ever.

It's for this reason that Warren Buffett invested $5 billion in the bank at the height of the financial crisis, giving Goldman the jolt of investor confidence it needed. A financial vote of confidence from the "Oracle of Omaha" is the best way to boost investor sentiment that I know of, especially when it comes at a time as dark as September 2008.

In exchange for the $5 billion Buffett injected into Goldman's coffers, Berkshire Hathaway received Goldman Sachs preferred stock with a 10% yield. It also received $5 billion worth of warrants to purchase the stock at $115 per share.

As The Wall Street Journal wrote of the deal on Sept. 28, 2008, "With Mr. Buffett saying that a preferred investment in Goldman is safe, Goldman's lenders and those with whom it trades are apt to be reassured."

Reassured indeed.

Buffett and Goldman would eventually revise the deal, allowing Goldman to buy back its preferred stock but giving Buffett a stake in the company without him having to inject any more cash. The deal left Berkshire Hathaway with a 12.6 million share stake that was worth around $2.1 billion at the time – roughly 2.1% of Buffett's U.S. equity portfolio.

Since then, Buffett has left the stake unchanged, a further vote of confidence in the bank some say he helped save. In that time the dividend has more than doubled and the stock has risen nearly 300% off of its 2008 lows.

Buffett's interest in large banks is well-known.

His stake in **Wells Fargo (NYSE: WFC)** is by far Berkshire Hathaway's largest U.S. equity position, making up nearly 24% of the portfolio. He also owns a stake in **U.S. Bancorp (NYSE: USB)** that is larger than his stake in Goldman, plus smaller stakes in **M&T Bank (NYSE: MTB)** and **The Bank of New York Mellon Corp. (NYSE: BK)**.

Buffett didn't just invest in Goldman because it was paying him well to express confidence in the company. Rather, Buffett has confidence in the company.

We want to own Goldman Sachs for the same reasons that Buffett executed one of the gutsiest deals of his career and hasn't looked back. As Buffett said of Goldman, "It has an unrivaled global franchise, a proven and deep management team and the intellectual and financial capital to continue its track record of outperformance."

It also has strong earnings and revenue momentum, a rising dividend and a culture of winning that has guided the bank through thick and thin. Goldman is exactly the kind of stock Warren Buffett likes to buy: a stock to buy and hold forever.

Deere & Company (NYSE: DE)

I've saved Deere & Company for last because it may very well be Warren Buffett's favorite stock to buy right now.

The company behind the famous green and yellow tractors is exactly the kind of company Buffett loves to own. It has an iconic American brand that is known around the world, it has strong competitive barriers and it operates in the agricultural industry, which obviously isn't going anywhere.

Buffett bought his first shares of Deere in the third quarter of 2012, but the stake remained small – roughly 4 million shares. Buffett used a type of confidential treatment granted by the SEC to quietly acquire significantly more shares, which the public found out about in February 2015.

It was then that we learned Buffett had increased his position in Deere by around 90% in Q3 2014 and another 125% in Q4 2014.

It appears as if he will continue adding to this position, as recent purchases bring his stake to around 5% of the business, or roughly 1.4% of Berkshire Hathaway's U.S. stock portfolio.

Unlike many of the other stocks in the Berkshire Hathaway portfolio, the broader investment community seems pretty ambivalent when it comes to Deere. The stock has essentially traded sideways for the last few years, rising only 6.7% during 2013 and 2014 while the S&P 500 rose more than 45%.

Why Deere?

Buffett's interest in Deere appears to be a long-term bet on American agriculture. And this makes complete sense.

His interest in big banks and his outright purchase of the Burlington Northern Santa Fe Railway appear to be long-term bets on the American economy. Meanwhile, his interest in H.J. Heinz, **Johnson & Johnson (NYSE: JNJ)**, **Kraft Foods Group (NASDAQ: KRFT)**, **Mondelez International (NASDAQ: MDLZ)**, **Proctor & Gamble (NYSE: PG)** and many other consumer staples stocks appears to be a long-term bet on the American consumer.

Deere's agriculture and turf division generates nearly 80% of the company's sales. Certainly a bet on Deere is a bet on the future of agriculture.

The move seems to fit well with Buffett's contrarian investment philosophy. In the current strong dollar environment, Deere's overseas profits have slipped. Couple that with low crop prices and expectations of rising interest rates in the near future, and it appears that Deere is facing some major headwinds.

Surely Buffett knows this too, but he also knows that the market for agricultural equipment isn't going away. It sure seems as if he is using the stock's poor near-term outlook as a chance to buy for the long term.

The stock trades at a discount to the market at just over 16 times 2015 earnings. Meanwhile, it is expected to grow earnings at 8.6% over the next five years, while the market appears to be expecting just 2% growth based on its valuation. Based on the same kind of Graham-Dodd valuation that we know Buffett believes in, Deere is clearly undervalued.

Adding Deere to the Berkshire Hathaway portfolio – and doing so under a veil of secrecy – tells us that this is Buffett's latest great long-term value investment. It's a long-term bet on everything he believes about the American economy and the American consumer.

Invest with Warren Buffett

The reality is that any individual investor could simply buy shares of Berkshire Hathaway and call it a day. Our Chief Investment Strategist – Ian Wyatt – recommends Berkshire Hathaway stock and owns it in his personal investment portfolio.

Buffett's track record speaks for itself, and he has assembled a management team that is constantly demonstrating that they are ready to take the reins when Buffett can no longer run the company.

Just like Buffett picks the best companies and best values to beat the market, we can hand select from Buffett's best stocks based upon their current valuations and future prospects. For example, why own Visa, MasterCard and American Express if you expect MasterCard to be the top performer of the group?

Here's where the size of Buffett's portfolio serves to limit his opportunity. It requires him to spread out his bets beyond simply purchasing the best payment processing stock or shares of the best financial institution. We don't have those limitations.

That's why these five stocks – Buffett's top stock picks – could beat the market and even Buffett's own portfolio over time.

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