



Reclamation or Restoration

December 8, 2009



William Smead
Chief Executive Officer
Chief Investment Officer

Dear Fellow Investors:

Eight years after Mount St. Helens blew up, my wife and I drove from Seattle into the north side of the National Park at St. Helens. We were driving through the thick forest and suddenly popped out into the area that had been devastated by the mountain's massive eruption. While we drove, I noticed that on the left side of the road it looked like the moon. On the right side of the road was a great deal of young greenery and shorter foliage. Why was there such a difference between the two sides of the road?

The park ranger was glad to tell me. The left side of the road had been reclaimed by Weyerhaeuser and other forest product companies to recover whatever useful wood remained. The right side had been untouched by man since the mountain had blown. Where man had meddled it looked like the moon. Where the ashes and decomposed wood were allowed to take nature's course, a bright future among the greenery was quite evident. It was as different as night and day.

The U.S. economy is slowly recovering from the worst recession we've had since 1982 and the worst financial panic since the 1930's. Policy makers have tried many approaches to reclaim the economy and they have had the same results as they had in the park between 1980 and 1988. First, there is loan modification. The Obama administration is putting pressure on lending institutions to find a way to keep people in their homes. You don't cleanse the system of people living outside their means by helping them live outside their means. Let the market clear itself by helping the lending institutions admit their errors as quickly as possible and allowing the foreclosed homes to be placed in the hands of someone who can afford to own them at the price it takes to make that happen. Second, you have the \$750 billion dollar stimulus package. Someone needs to tell Congress and the Senate that public works programs have been completely ineffective in pulling Japan out of their 18-year deflationary funk and are an inefficient way to stimulate business. Even if they succeed, the jobs exist only until the project is done and then you are right back where you started. Huge budget deficits are what you get in trade.

In her book, *The Forgotten Man*, Amity Shlaes argued that all the meddling that the Roosevelt Administration did in the economy from 1932-1938 probably held the economy back and contributed to the recession which started in 1938. What evidence do we have today that the untouched side of the economy is restoring itself? First, in California the residential real estate markets have firmed, inventory has been worked down and in many ways the market is clearing itself at lower prices. California was the epicenter of the subprime crisis and one of the first markets to go in the tank. Government officials got their loan modification projects going too late to stop nature from restoring it

through foreclosures, short sales and the pain of lower prices. There is green foliage in many California residential real estate markets today.

The stimulus plan does little to stimulate small businesses, which do about 75% of the hiring in the U.S. in a typical year. Ultimately, this downturn and its high unemployment levels will trigger a huge number of new small businesses as people choose to get away from being fired by being the one who owns the business. The job summit in Washington, D.C. doesn't have the two largest small business groups in the U.S. even represented there. How many people in Washington have ever owned or run a business? No wonder the employment picture has been as bleak as the moon's landscape.

A number of our companies are doing what it takes to get back into restoration and the government could take a few tips. Starbuck's and Nordstrom's made abrupt expense reductions and found a way to be very profitable at lower sales levels. As their sales pick up, they will be in a position to expand and hire. Comcast is scooping up half of NBC Universal at cyclical low prices and can use their massive free cash flow and entrepreneurial talents to unleash better business instincts than its former non-entertainment conglomerate parent GE could.

We at Smead Capital Management are optimists. We believe that there are very smart and well meaning folks leading our government. They want to help. Individual investors have stayed on the sidelines partially because they got clobbered last year, but also because they have assumed since March that the economy would not naturally restore itself. We believe the economy will give them their confidence back sooner or later, but also believe much like 1982-1987 and 1991-1999 they will enter the U.S. stock market long after the best gains have been seen. . The stock market has historically anticipated the restoration way ahead of the actual results and lower unemployment levels. As usual, it's not different this time.

Best Wishes,

William Smead

The information contained in this missive represents SCM's opinions, and should not be construed as personalized or individualized investment advice. Past performance is no guarantee of future results. The securities identified and described in this missive are a sample of issuers being currently recommended for suitable clients as of the date stated in this missive and do not represent all of the securities purchased or recommended for our clients. It should not be assumed that investing in these securities was or will be profitable. A list of all recommendations made by Smead Capital Management with in the past twelve month period is available upon request.

This Missive and others are available at www.smeadblog.com.