Bi-Polar Sentiment Readings

William Smead
Chief Executive Officer
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Dear Clients and Prospective Clients:

As many of our clients and investors know, we at Smead Capital Management are focused on owning outstanding companies for a long time. In this process, we include attention to the psychological parts of investing because we want to "be fearful when others are greedy and greedy when others are fearful." A strange contradiction has popped up in the psychological world among sentiment polls this last week. We thought we could shed a little light on the subject and trigger some healthy discussion.

Last week's Investor's Intelligence poll showed that bulls were 51% and bears were 19.8% of the newsletter writers. It was the most optimistic that these investment newsletter writers have been since late 2007. The bear number below 20% is a sign for caution and the positive spread of 31% is also a reason to expect a correction in the market in our opinion.

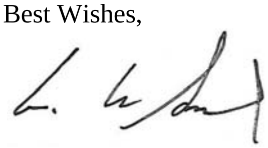
In the same week, the American Association of Individual Investors released their poll which showed that 34% of their members who responded were bullish and 49% were bearish. These kinds of negative attitudes were seen during the bear market decline during 2008. In other words, individuals are as negative after a 50+% rebound in the market as they were after 20% declines during 2008. This has been a bullish signal and a buy indicator in the past. Quite a contradiction in these two sentiment polls.

Why do we believe the newsletter writers are bullish? First, we've had a big run up and they don't want to look foolish. Second, many of them stay invested in the market even when they are negative and adjust the level of investment to represent negative or positive attitudes. The most critical factor among investment professionals, in our opinion, is that most of them kept significant money in the market through the March 2009 lows. Third, they know the history of the markets better than individuals. They know that depressed stock prices, a friendly Federal Reserve Board, extremely negative psychology and massive cash on the sidelines spells what we like to call "Bull Market Stew".

In our opinion, the number one reason that individuals are negative is that they did not have to stay in the market through the bottom in March. Many individuals pulled out of their stocks and stock funds in the last four months of the decline and have not yet come back in. Just as pride stops newsletter writers from staying bearish in an up move, pride stops individuals who got out too late from getting back into the stock market. Second, a great deal of the individual investor money which fled the market in late 2008 and early 2009 went into certificates of deposit (CD's) and can't be accessed until maturity without penalty. The cash in money market funds, savings accounts and CD's still equals a larger percentage of the Wilshire 5000 index today than it did at the bottom of the market in 2003, 1982 and 1974 (despite the 52% move off of the bottom). Who wants to pay a 1% penalty to prove that they made a big mistake by getting out of the stock market somewhere near the bottom? Lastly, individuals buy high and sell low, historically, and have been trained to hold stocks for less than a year by the poor ten-year performance of the S&P 500 Index. Holding periods on the New York Stock Exchange are the lowest since the late 1920's. Scarcity creates value. What is scarce right now are the investors who are willing to participate in quality companies and execute long holding periods.

How do we believe this contradiction in the sentiment polls will get cured? We believe a market breather could do the trick. Time will also move us farther into trusting an economic recovery and away from the point at which those who got out too late, got out. However, none of these short-term oddities should move us away from executing the discipline of maintaining ownership in quality common stocks for long periods of time.

Best Wishes,



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