Consistency
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Chief Executive Officer
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Dear Fellow Investors:

As we open the year 2010 (sounds like a big number), you are going to hear us at Smead Capital Management talk a great deal about Hall of Fame Companies. One of the hallmarks of a Hall of Fame Company is consistency. Why are we so interested in recession-resistant companies with strong brands and repeat customers?

First, companies with relatively unbroken strings of earnings and dividend growth can be held for long periods of time. Since the holding period on the New York Stock Exchange is the lowest in 70 years, nothing could be more contrary to the prevailing wisdom. Long-term holding periods reduce trading costs and make capital gain tax rates lower and payments rare. Long holding periods put folks in position to collect dividends and enjoy dividend increases from shareholder friendly companies (another Hall of Fame characteristic). Much of the statistical advantage common stocks have over other investment categories (bonds, gold, real estate, etc.) comes from dividend payments.

Second, consistent companies aren't as likely to have big earnings misses because their success isn't built around short-term business excitement. It amazes me how much money, thought and time are invested in trying to figure out which businesses will do the best this year or next. Today (January 4th) investors are excited about Oil and Basic Materials companies not only because of the prospect of a rebound in our economy, but also the growth in China and other Emerging Markets. Unfortunately, you'll also have to figure out when to get out because of the inevitability of the next economic slowdown in either of those places. Apple Computer Company is a terrific company, but they must constantly come up with the next great consumer electronic mousetrap or risk terribly disappointing the massive fan club of investors they have developed. I used two Q-Tips this morning after showering and I think there is much less pressure on the product development team at Unilever (who makes Q-Tips) than there is at Apple (We own neither company).

Lastly and probably most importantly, consistent companies (and mutual funds owning them) make for a better ownership experience and are more likely to be owned for long holding periods. According to Morningstar, Kenneth Heebner has one of the best ten-year track records among mutual fund managers. I admire him as an investing genius, but we don't envy him because he trades constantly and works way outside our own circle of competency. His Focused Fund (CGMFX) has returned a phenomenal 17.89% per year on average in the ten years ended 12/31/09. However, Morningstar also reports that the average investor who participated in his Focused Fund lost 10.83% per year in that same time period! How could there be such a chasm? One, Heebner goes from the outhouse to the penthouse and back constantly with spectacular penthouse results. Two, investors get really excited about what he is doing right after his hot streaks (pouring in new money). They lose faith during extended cold stretches (withdrawing capital) including his recent cold stretch from July of 2008 through the end of 2009. The taxation of his fund must be horrendous because his good years and high turnover produce massive short-term capital gains. The Dodge & Cox Stock Fund (DODGX) earned 6.05% in those same years. The average investor in that fund returned 3.05% per year. Heebner won the investing battle and Dodge & Cox investors won the war.

Human beings are much more likely to survive as long-term holders with less volatility and more consistent results. Unfortunately, we are very close to the year 2008 which was a total torture chamber for even the buy and hold investors who wanted to own consistent companies (SCM included). Holding larger cash positions was the easiest way to improve performance that year, but that doesn't help marry investors with the consistent companies in the market. We believe that 2008 was a watershed year and marked the end of the horrific decade for owners of US common stocks. Since scarcity creates value and consistent companies are the most likely to be held long term, we believe we are starting another particularly good era for ownership of recession-resistant companies with strong brands and repeat customers.

Happy New Year,

William Smead

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