



Dumb Money?

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Dear Fellow Investors:

The folks at Smead Capital Management (SCM) are admirers of the journalists who follow our industry. We'd like to expand on a piece written by Kelly Evans titled "'Dumb Money' Returns to Stocks". The thesis put forward was that a recent tiny trickle of buying interest from US equity mutual fund investors and evident optimism in recent investment sentiment poles might be an indication that the dumb money is back, in the opinion of the Wall Street Journal headline editor. The conclusion was beware.

Our problem with the article is it lacks historical precedent. John Maynard Keynes was a very successful money manager in the 1920s until the late 1940s. He said investing "...is the one sphere of life and activity where victory, security and success is always to the minority and never to the majority." Therefore, Keynes would argue that in the long run the majority is dumb and the minority is smart.

For the last 19 months it has been "dumb" to be out of US stocks. The minority bought and the majority sold. Individual investors in the majority bought bonds and net liquidated stocks. How can the first positive flows after years of net liquidation qualify as a majority? The only enthusiasm for equity funds from US investors has come through net inflows into emerging market and commodity related funds. They are in the majority also.

We at SCM do not market time. If you are a long-term timer, you want to get out when individuals and institutional investors are falling all over each other to buy US equity mutual funds. This would mean multi-year, massive net inflows. We are a long way away from there. We believe the finest US companies are the minority investment and we have eight criteria for selecting them.

John Paulson was an unheralded hedge fund manager in 2007. He was in the minority thinking that the mortgage market would meltdown. Institutional and wealthy individual investors invested with him to hedge their long positions in mortgage-backed securities and over-exposed financial stocks. We believe that US large-cap recession-resistant quality is a good hedge for the majority of gun-shy individual investors who have chased bonds. They are also a good hedge for over-diversified institutions who think

BRIC-trade related investments aren't in the majority. Andy Grove, former Intel CEO, was asked in a Fortune magazine article what was the best business advice he'd ever received. He replied, "My professor at the City College of New York said, 'When everybody knows that something is so, it means that nobody knows nothin'." What people know is how strong the emerging market economies have been. What they don't know is how much better the minority is going to do over the next five years as compared to the majority. We believe that over the long haul the minority will look smart.

Best Wishes,

William Smead

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