Good Nutrition in the New Year!

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William Smead
Chief Executive Officer
Chief Investment Officer

Dear Fellow Investors:

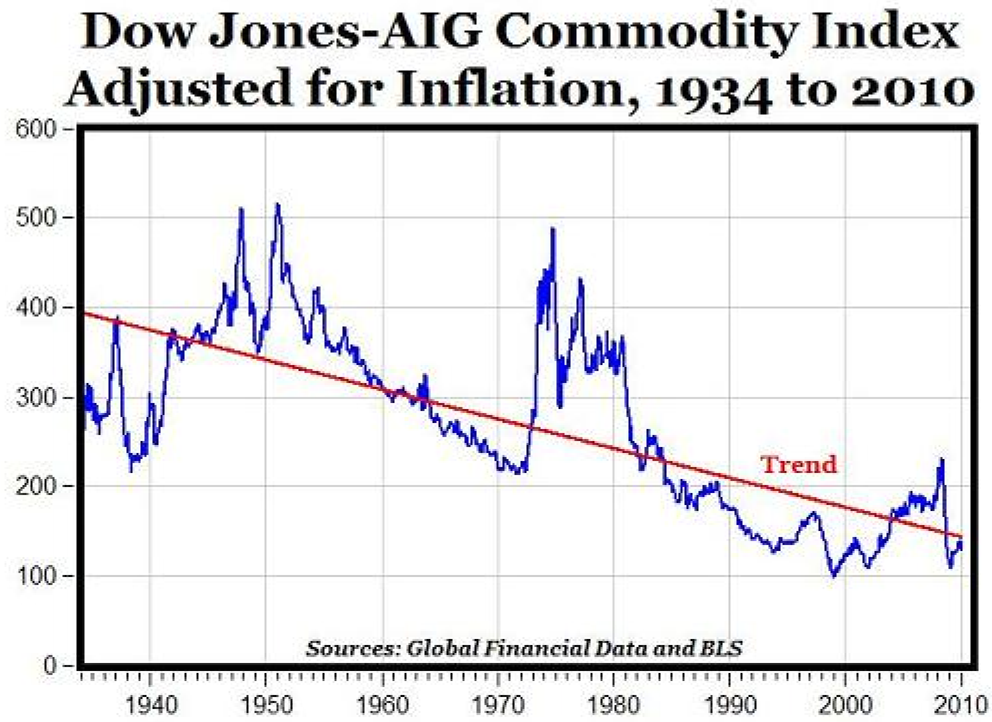
Heart disease has been prevalent in our family. About three months ago we started to develop better eating habits. We are trying to avoid many of my favorite foods (chocolates, hamburgers, fries, pizza, etc.) by replacing them with fruits and vegetables. We are bringing down our cholesterol in the process and a positive side affect is that I've lost some weight as well.

As Frank the Tank said in the movie, *Old School*, "It tastes so good when it hits your lips". I miss the wonderful flavors of dark chocolate Mounds bars or the blending of the tastes in a Burgermaster cheeseburger with a big slice of Walla Walla sweet onions. They give me a big boost of energy, but years of eating these favorites can layer my arteries in plaque. This is the main cause of heart attacks and strokes.

It is amazing how similar long duration investing is to long duration living. At any given time, there are tasty and exciting industries, sectors and countries which can give you short-term delight. Imagine the pleasure of folks who bought gold three years ago or commodities like copper or cotton or sugar. This burst of price appreciation has raised investor confidence the way my blood sugar level goes up right after Thanksgiving Day dinner! The benefits are in the short run and the problems come much farther down the road.

Investors were excited about gold in 1980 when I started in the investment business. It peaked above $700 per ounce in 1981 as investors were sure that the double-digit inflation would be a fixture of the future. Today, investors are excited about it at $1400 per ounce as an alternative to paper currencies. These currencies have multiplied in the deep recession through the remedies governments are using to prevent deflation. Gold has doubled in price in 29 years. This means that despite all of the recent excitement you have received about a 2.5 percent average annual return during those years, even though it has been on fire for five to seven years. The Dow Jones Industrial Average rose from 800 to over 11,000 in that same time period. Those who used gold as a long duration investment had hardening of their financial arteries.

How about commodities like copper, cotton and sugar? The most widely followed commodity indexes, like the Dow Jones-AIG Commodity Index, show that commodities have dropped in price on an inflation adjusted basis fairly significantly over the last 70 years (see chart below). Therefore, their only use is for the kind of short-term highs that I get from the fresh cooked chocolate chip cookies or the barbecued ribs lathered in sweet sauce. Better technology and human productivity are a curse to commodity investing! Compare that to all the wealth creation which long duration companies like Disney or McDonald's or Nordstrom or Merck produce from those same factors. As an investor, do you want better technology and human productivity to be your friend or your foe?



The current investment landscape is loaded with sugar highs. All things China and BRIC trade are smoking hot including the commodities we've mentioned. The blood sugar level has taken heavy industrial stocks like Caterpillar, Joy Global and Cummins off the charts. The taste of mining basic materials in Australia and putting them on a boat to China is mouth watering. The GDP growth numbers in China are as exhilarating as drinking a couple of craft beers while washing down hot wings.

Our bodies are subject to heart disease and those events usually come in shocking fashion. In the investment world there are business cycles with recessions and depressions mixed into history. When these negative events follow a boom, markets collapse and can lead to paralysis and permanent damage. Cyclical and commodity oriented common stocks trade at historical discounts for this very reason. **Our current circumstance is that cyclical stocks and more economically sensitive small cap stocks trade at big premiums to recession resistant large cap non-cyclicals!** History shows that investors in the cyclical stocks get crushed and profits many times turn to losses in the down cycles. Holding for the long-term is not an option which human investors have been able to handle.

As disciplined long-term value investors, we at Smead Capital Management are patiently waiting for time to put things back into order. We believe long term financial health goes to those who defy short-term flavor gratification. Much like the fable of the Tortoise and the Hare, you only make the long-term success in investing if you avoid the busts that follow the adrenaline of today's excitement. We wish you all health and wealth in the upcoming New Year!

Best Wishes,

William Smead

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