



## Group Think Robs Investors

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Dear Fellow Investors:

Last week those of us at Smead Capital Management got to listen to the wisdom of Warren Buffett and Hank Paulson. We also read some terrific economic history from Joel Kotkin in a column called “America on the Rise”. I’d like to share some of their thoughts and connect them. In this way we can help folks understand why we think this is one of the best times to own US high quality common stocks by looking for *Hall of Fame Companies* and use long-term holding periods.

Mr. Buffett interviewed Hank Paulson in Omaha at a big Chamber of Commerce gathering. They spent most of their time talking about the tough decisions which Paulson spearheaded in the fall of 2008 as US Treasury Secretary in the Bush administration to avert an economic catastrophe. In the second half of the talk, Hank shared some thoughts which really solidified our feelings about the “group think” which has a tendency to dominate investment decisions in the short run. He said, “Every other economy, including China, has more significant problems than we do.” You might need to read what he said again. Paulson was Treasury Secretary from June of 2006 to January of 2009 and had been the leader of Goldman Sachs in the years just prior. We have just spent the last two years hearing from a wide variety of economic pundits. Almost all of them have told us that the cleansing of 2007 through 2009 and the overhanging debt of the past 15 years is ushering in the decline of American economic glory. Whether it is “seven lean years” or the “new normal”, we’ve heard it and seen most of the people who manage money adopt it as the foundation of what drives their investments and asset allocation.

Kotkin piggybacks Paulson by demystifying China’s future and rebuts George Will’s recent writing about American “declinism”. He does this by sharing some economic history and by sharing key attributes of long-term economic growth.

*“Rarely mentioned in such analyses is China’s own aging problem. The population of the People’s Republic will be considerably older than the U.S. by 2050. It also has far more boys than girls--a rather insidious problem. Among the younger generation there are already an estimated 24 million more men of marrying age than women. This is not going to end well--except perhaps for investors in prostitution and pornography.*

*In the longer term demographic trends actually place the U.S. in a relatively strong position. By the end of the first half of the 21st century, the American population aged 15 to 64--essentially your economically active cohort--are*

*projected to grow by 42%; China's will shrink by 10%. Comparisons with other competitors are even larger, with the E.U. shrinking by 25%, Korea by 30% and Japan by a remarkable 44%."*

Kotkin goes on to remind us how wrong the punditry has been in past cycles. Remember when Japan was eating our lunch in the 1980's?

*"The Japanese experience best illustrates how wrong punditry can be. Back in the 1970s and 1980s it was commonplace for pundits--particularly on the left--to predict Japan's ascendance into world leadership. At the time distinguished commentators like George Lodge, Lester Thurow and Robert Reich all pointed to Europe and Japan as the nations slated to beat the U.S. on the economic battlefield. "Japan is replacing America as the world's strongest economic power," one prominent scholar told a Joint Economic Committee of Congress in 1986. "It is in everyone's interest that the transition goes smoothly."*

He (Kotkin) then reminded all of us what could go wrong with China's economic miracle and then shared his opinion of the future.

*"China's social problems will be further exacerbated by a huge, largely ill-educated restive peasant class still living in poverty. Of course America too has many problems--with stunted upward mobility, the skill levels of its workforce, its fiscal situation. But the U.S., as the Japanese scholar Fuji Kamiya once noted, possesses sokojikara, a self-renewing capacity unmatched by any country."*

*"As we enter the next few decades of the new millennium, I would bet on a more youthful, still resource-rich and democratic America to maintain its preeminence even in a world where economic power continues to shift from its historic home in Europe to Asia."*

Are the pessimistic and dour pundits of today right this time? Should we be congregating our investments in the BRIC countries (Brazil, Russia, India and China) or dialing down our expectations for investment returns in the US investment markets because the inevitable "declinism" of the US economy has set in? This "group think" robs investors of the urge to concentrate on the strong balance sheet, wide moat and powerful brand companies which weather recessions and have more potential to be "Hall of Fame companies". We believe anything that stops us from owning some of the best companies in the world this close to the aftermath of a terrible consumer-led recession is robbing us of future success.

Best Wishes,

***William Smead***

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