Hall of Fame Companies: Making the Liquid Illiquid
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Dear Fellow Investors:

Why do most people make money owning their home? Why do folks make money on company stock and ten-year options? The answer is they hold these investments for a long time. If you hold a sound investment for ten to twenty years you typically get rewarded quite well. However, most human beings never participate in an investment for twenty years in anything other than their home or a piece of investment property. Why do investors hold most investments for short time periods when all the evidence is that you get the greatest rewards for long holding periods?

Historically, homes have appreciated at around 5% in the U.S. and common stocks have gained around 10% from a combination of appreciation and dividends. Why do US households have most of their capital tied up in real estate? We believe the biggest factor is liquidity. The only investments folks hold for twenty years are relatively illiquid. The cost and hassle of buying and selling property causes people to hang on. The hassle of moving your residence and the added monthly payments of buying a new one preclude activity. The fact that the price is not printed in the newspaper every day and there isn't a willing buyer every day causes longer holding periods. We at Smead Capital Management think people are better off for having invested in real estate for long holding periods.

This brings us to our theme for this year-Hall of Fame Companies. Hall of Fame Companies have unusual success, great consistency and long duration. Why haven't more investors participated on an uninterrupted basis in the common stock of McDonald's (MCD) or Disney (DIS) or Merck (MRK) the last twenty years? Why do investors put their investable assets with money managers, financial advisors or financial institutions which make no attempt to own the same good quality common stocks for a long time? We believe one of the main reasons is that these terrific companies and their common shares are liquid every business day of the year. Someone offers to buy your shares every day. The temptation to time the cycles or shorten the reward period is overwhelming.

The New York Stock Exchange reported in 2009 that the average holding period for common stocks dropped below a year for the first time since the late 1920's. Since investors invest in their rear-view mirror and good quality common stocks have had one of their worst ten-year stretches in history, investors don't believe that they can get a long-term reward from the very thing that they are the most likely to get it from. One of our main jobs as portfolio managers is to help these very liquid investments become illiquid. Most investors and money managers take their cue from stock market trends, economic growth expectations or views of the current political leadership. We want to shepherd folks through long holding periods with companies that fit our Eight Criteria. In the process, we believe we will be able to look back in twenty years and realize that our client's wealth has been determined by the companies we own which end up making the Hall of Fame.

Best Wishes,

William Smead

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