Hoarders
March 23, 2010

William Smead
Chief Executive Officer
Chief Investment Officer

Dear Fellow Investors:

"Hoarders" is a popular TV show currently. It tells the story of people who buy and collect things and virtually never throw anything away. As we look out to the rest of 2010, some of the lessons from the show could help us as investors over the coming years.

Like most addictions or idolatrous behaviors in a person's life, hoarding starts out with the best of intentioned purchases. None of the original items, be they knick knacks, clothing or even collectibles are in and of themselves harmful. Unfortunately, hoarders don't stop there. They continue to buy new things and never throw anything out.

In the US investment markets there has been some major hoarding going on the last five years. First, between 2004 and 2008, US investors hoarded Oil, Basic Materials and Heavy Industrial company's common stock and international mutual fund shares to participate in the popularity of the emerging stock markets like Brazil, Russia, India and China (the BRIC trade).

Second, US households and corporations hoarded Treasury Bills and Money Market Funds during the market meltdown between October of 2007 and March of 2009. In a recent Barron's' article, money manager William Priest points out that the ratio of cash to total assets surged to 35-year highs for both non-financial corporations and households. Since March of 2009, they have been hoarding bond Mutual Funds, despite the stock market marching upward. Various reports from Lipper and Morningstar have reported net inflows into bond funds at $350-400 billion, while US stock funds and ETFs saw net liquidations.

On the TV show, extreme problem hoarders end up with a great deal of useless trash in their house. The piles of junk collect dust and have no value to future buyers. It would be one thing to hoard works of art from Picasso or Chihuly, but the folks on the show buy and keep things that nobody else ends up wanting.

At Smead Capital Management, we watch what the crowd is hoarding and try to avoid those popular areas. Bond funds and most investments tied to the BRIC trade appear as over-crowded as the dust covered rooms in the TV show. Simultaneously, the lousy results of the last ten years have caused investors to avoid the kind of Hall of Fame companies we like. In our opinion, these works of art can make us wealthy by buying and hoarding their shares for ten years or longer until the building gets overcrowded. We have formed museums (portfolios) to collect what we believe are "works of art". We do this under the assumption that the companies that meet our Eight Criteria will successfully execute their business purpose and plans. In so doing, they grow their earnings and free cash flow. Ultimately, the hoarders of cyclical businesses, commodities, emerging markets, money market funds, T-bills and bond funds may someday have to look at what they hoarded and reevaluate what creates long-term wealth. This could cause a transition away from formerly useful investments into the kinds of "Hall of Fame" companies we like.

If interest rates in the US rise for many years and/or China's economic growth slows down, we believe you should watch for a giant yard sale in bond mutual funds and the BRIC trade. Hoard quality when it is out-of-favor and avoid holding Hall of Fame companies only when maniacal pricing threatens to turn future returns into junk.

Best Wishes,

William Smead

The information contained in this missive represents SCM's opinions, and should not be construed as personalized or individualized investment advice. Past performance is no guarantee of future results. Some of the securities identified and described in this missive are a sample of issuers being currently recommended for suitable clients as of the date stated in this missive and do not represent all of the securities purchased or recommended for our clients. It should not be assumed that investing in these securities was or will be profitable. A list of all recommendations made by Smead Capital Management with in the past twelve month period is available upon request.

This Missive and others are available at www.smeadblog.com.