Sell What the Promoters are Promoting

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Chief Executive Officer
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Dear Clients and Prospective Clients:

Among our most golden rules for investing is the rule that says to avoid or sell investments which are being most heavily promoted after a lengthy stretch of success. Here are the first few paragraphs of an offering announcement from May 27th on Bloomberg:

Claymore Investments Inc. has raised $400-million for its new gold bullion fund -- an amount that could swell to $460-million, making it the largest structured product offering and one of the largest initial public offerings in at least two years.

The fund, which includes a number of novel features, including a hedge against the U. S. dollar, capitalizes on seemingly unquenchable thirst for the metal amid growing concern over inflation and the outlook for the greenback.

Notice in the second paragraph that it "capitalizes on seemingly unquenchable thirst for the metal". Language like this happens at the top of the market and every single hot market that we have witnessed in the last 29 years seemed unquenchable until it was quenched by massive offerings like this. Isn't it interesting that oil and gold are right back at the forefront of popularity even though Oil peaked at $147 per barrel one year ago and gold has gone relatively dead now that it doesn't have Financial Armageddon stirring up investors. We covered oil earlier in the week, so let's take a shot at gold while we're in the mood.

Gold was $800 per ounce while I was in college in the late 1970's. If it was such a good inflation hedge, why have folks who owned it so long lost their purchasing power?

Gold pays no dividends and has no earnings power, so you lose whatever you could have made in a productive investment like common stocks or bonds or CDs (Opportunity Cost). Lastly, the vast majority of demand for gold comes through the acquisition of jewelry. Jewelry sales are down 20-30% this year from last year and it is safe to say that it would be surprising that expensive jewelry would be the first category to bounce back in the new and more frugal environment of the next few years.

We at Smead Capital Management don't buy the hyper-inflation story. Lending and securitization of loans has been permanently damaged in the recent credit crisis/panic and Americans will establish permanently higher savings rates than the last two decades. Excess capacity in manufacturing and services will persist for years and unemployment will take years to work down from the 9-10% levels. We add it all up and conclude that we want to own the premier companies with the strongest balance sheets, most recognizable brands and the most consistent customer bases. Besides, how can you thirst for a solid anyway?

Best Wishes,

William Smead

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