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The Trend Is Your Friend
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Dear Fellow Investors:

On Wall Street there are a number of old adages and one of the all-time favorites is *the trend is your friend*. In this week's missive, we at Smead Capital Management would like to talk about trends that exist in today's market. In the process, we will try to determine if they truly are the investor's friend.

We are contrarians and look for extremes of psychology primarily to attempt to spot trend changes early. The biggest trend which exists today is the secular decline of US Treasury interest rates over the last 29 years and the bull market that has occurred in the bond market as a result of those lower rates. In 1981, the ten-year Treasury Bond peaked at an interest rate of over 15%. Today it is just below 4% and bottomed out below 3% in the panic and stock market meltdown of the fall of 2008 and the winter of 2009. Many highly respected experts are predicting that interest rates could rise to 6% on ten-year Treasury Bonds in the next couple of years. The avalanche of money which flooded into the bond market from the middle of 2008 right up to today is an indication that this secular trend could be changing. The only caveat we have is that overall borrowing in the US should drop to lower levels in the next ten years as we work off the leverage of the prior ten-year borrowing binge. Our vote is that the long-term secular trend of declining Treasury interest rates is not your friend.

Since the year 2000, bull markets in emerging market stocks and commodities which benefit from the above-average GDP growth, has been a major trend. We believe that the maintenance of this trend is dependent on un-interrupted growth in China. We are biased toward the contrary thinking of Jim Chanos on this subject. Since commodities and emerging markets have been the best place to be for ten years and China is due for a stumble, we don't think this trend is your friend.

Starbucks is a coffee/restaurant company which has prided itself on being hip, cool and on the cutting edge. Starbucks has had a tendency to be a corporate *game changer*. They recently declared their first dividend of $.10 per quarter. Non-financial public companies are sitting on record setting amounts of cash on their balance sheets and are generating very high levels of free cash flow due to cost cutting. As sales and earnings rebound, look for other companies, which either pay no dividend or a low percentage of after-tax profits, to pay or raise their dividend. Not only does this make good sense for shareholders, but it makes great sense for top executives who would like to get paid more for their efforts. If the board raises your salary or pays you a bonus, the media and populist politicians are going to be all over you like a blanket. If you pay a dividend or raise the dividend and you own a big slug of your common stock, you get a sizable pay increase without criticism. Howard Schultz got a huge annual income increase from the Starbucks dividend and I haven't seen one media article of condemnation or a populist politician offer a comment. We own a number of companies in this situation like Ebay, Amgen and Microsoft. We think this is a new trend and for the long-term investor, it could definitely be your friend.

Best Wishes,

William Smead

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