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Three Articles and One Conclusion
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William Smead
Chief Executive Officer
Chief Investment Officer

Dear Fellow Investors:

At Smead Capital Management (SCM) our contrarianism and urge to purchase stocks with low PE ratios has led us to own what we think are the finest and most recession resistant companies in the world. To understand our portfolio and where we are in history you must read Randall Forsyth's column in Barron's dated June 21, 2010, an article written by Jason Zweig in the Wall Street Journal over the weekend called, "So that's why investors can't think for themselves" and Brian Belski's research note at OPCO yesterday (June 21st, 2010). Randall quotes work by Jason Trennert on "The New Lords of Finance: Policy's Long Shadow Over the Markets". In it Trennert argues that a small group of policy makers in places like Washington D.C., Brussels and Beijing (whether elected or not) are "exerting enormous influence over the economic cycle". He says and Forsyth reiterates, "All of this has led to a certain sclerosis when it comes to the behavior of certain large companies. Among the symptoms is that these companies sit on record levels of cash." Forsyth points out that it wouldn't be so bad if the cash was being used to raise dividends and do stock buybacks instead of hoarding it in t-bills earning virtually zilch. He also goes on to show how investor behavior has been led around by reaction to the policy makers and the inaction on the part of the leaders of large US corporations:

> *"Leaving aside the philosophical implications, the practical investment effect is that investors appear willing to hold cash earning 0% or 10-year Treasuries yielding 3.25% "and yet remain unwilling to buy large-cap growth stocks with fortress balance sheets and decent dividend yields trading at low double-digit earnings multiples," Trennert says.*

Jason Zweig's article cuts to the core of the current opportunity in Large Cap Non-Cyclical US stocks. Here is his thesis:

> *"Sometimes the most interesting answers to financial questions come from scientific labs. A study published last week in the journal Current Biology found that the value you place on something is likely to go up when other people tell you it is worth more than you thought, and down when others say it is worth less. More strikingly, if your evaluation agrees with what others tell you, then a part of your brain that specializes in processing rewards kicks into high gear. In other words, investors often go along with the crowd because—at the most basic biological level—conformity feels good. Moving in herds doesn't just give investors a sense of "safety in numbers." It also gives them pleasure. That may help explain why market sentiment can change so swiftly, why true contrarians are so hard to find and why investors care so much about the "consensus view" on Wall Street."*

Therefore, at the "basic human level" it is unnatural to be a lonely contrarian and what could be more lonely than owning large quality companies which have not been the place to be since they peaked in popularity back in 1999. Throw in the worldwide policy elites publicly dressing down your industry and demonizing large profitable companies in general and you have what we believe is a prescription for historically extreme undervaluation and absolute low PE's. This makes us at SCM just drool and lays the groundwork for what we believe will be 7 to 10 years of above average performance.

People say things like, "small to mid-cap stocks are still doing way better", even though they are dramatically more expensive on a trailing and estimated PE ratio basis. The smaller your company is the less chance that the policy makers are going to use you as a populist punching bag. We believe the biology study proves what John Templeton clearly understood in creating an incredibly good track record in the Templeton Growth Fund from 1950-1990. He said, “The time of maximum pessimism is the best time to buy". The price you get without any reinforcement from the crowd is the price that will generate the most future success with the least amount of risk.

In a report out yesterday called "Dividends and Buybacks Increasing", Brian Belski and his folks at OPCO show that despite the coma that the circumstances of the last three years have put companies and investors in, that the dividend increases and stock buybacks are coming anyway. Templeton might have called that the first light at the end of the tunnel. Belski also shows that it bodes well for overall stock market returns. Rejuvenation phases in dividend and stock buyback activity in the past has coincided with very solid and positive results in the S&P 500 Index. Our portfolios are loaded with recent dividend increases and massive added stock buyback activity because our companies have strong balance sheets for the most part and generate way above average free cash flow. From all of this we believe there can be only one conclusion for the patient investor.

Best Wishes,

William Smead

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