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## “Sequels” — Why they provide a consistent audience!

I haven't seen it yet, but the latest installment of the Indiana Jones Saga came out recently. It reminds me of how powerful nostalgia can be to human behavior and how much we like to re-create experiences from our past. As I contemplate the idea of Harrison Ford being the sexy, leading man in the latest rendition, why don't we all consider how art might be reflecting investor attitudes as we look out into the second half of 2008 and beyond in the investment markets.

Hollywood studios are owned by profit making corporations for the most part and its clear that they would much rather produce a sequel to a successful movie rather than create an entirely new movie. There are some obvious reasons. First, the warm and fuzzy feelings attached to the original film or films are an intense draw. We take our families to events or establishments because of the affection we have for the people who took us there the first time or the enjoyable experience we had. Second, not as much creativity is required because you don't have to invent anything. Adding

to the existing concept is easier and much less expensive. Third, investors needed to finance production of the movie are easier to find because they view themselves as having less down-side risk. Fourth and maybe most importantly, you build a brand. The brand can be transferred to later sequels, but also to rentals, pay-per-view, movie channels and merchandising. The brand also defends you from competition (provides a moat).

How do sequels connect with today's investment climate? I have been in the investment business

since 1980 and we are having a sequel to a romance investors had in the late 1970's/early 1980's with Oil, Industrial and Agricultural Commodities and Gold. The warm and fuzzy feelings that remain from that time are very powerful, because it took the sequel over twenty years to get produced and still has been a huge draw at the investment box office. Jimmy Rogers, Boone Pickens, Jim Cramer and a host of others star in this Malthusian endorsed version of demand overwhelms finite resources. Malthus was not Jimmy Carter's therapist. He was a 19th century economist

who assumed that the planet would run out of resources long before we got to five billion people. In 1874, the Pennsylvania state geologist predicted the U.S. was going to run out of oil in four years. Despite being wrong every twenty years, Malthusian devotees will probably spend the rest of eternity trying to prove him right.

Not as much creativity had to be added with this version, just the “Well Known Fact”. The “Well Known Fact” is that the growth in the emerging nations of the world could permanently add demand for products like oil and industrial commodities and in this way never allow supply to catch up to an ever rising demand. Hence the academy award winning investment movie of 2004, 2005, 2006, 2007 and the first half of 2008 has starred three of the ten sectors of the S. & P. 500 Index (Energy, Basic Materials and Heavy Industrial) and didn’t include any other sector in the film. These stars had the “Well Known Fact” as an agent and the financial channel (CNBC) and other media leading the promotion.

There is a reason this movie went so long without being made. The success in those three sectors from 1981 to 2002 was as skinny as Harrison Ford’s girlfriend (Callista Flockhart). They are cyclical industries and that means when the business cycle moves against them there is nothing to protect these companies from losing money in many cases. It is one thing to sit through a difficult stretch like this one with a

recession-resistant brand-name company; it’s an entirely different thing to sit for 20 years to get your day in the sun waiting for the price of a commodity to go up. Including the recent fabulous stretch in these sectors,

they have been horrendous investments for most of the 28 years that I have been in the investment business.

Most of the movie critics don’t agree with me on my next point, but I believe that the attraction to these sectors has to do with the empowerment given by the “Well Known Fact”. When you believed in 1999 that the internet was going to change our lives, all you had to do was buy a leading technology company, tech mutual fund and/or large cap growth fund heavily weighted in tech (“light the candle” as the commercial said). When gold or oil or industrial commodities are “rocking and rolling” due to what is imagined as uninterrupted growth from China and India it is just as easy. You buy an Exchange-Traded Fund focusing on emerging markets or the commodity sector itself and sprinkle in a few of Jim Cramer’s latest touts and you’ve got everything you need. You are considered a great actor without being trained “Inside the Actors Studio”.

This leads us to what we believe we want to do, which is tied closely to what the Hollywood Studios try themselves. At Smead Capital Management, we prefer brand name companies and we currently believe they are as inexpensive relative to other investments as they have been at any time since late in 1982. First,

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customers have warm and fuzzy feelings about the products they bought from them in the past. Disney is the king of this genre. Second, we don't have to be very creative; we just have to have the faith to believe that the company will have success in the future similar to what they've had in the past. And we don't need fantasies like China is never going to have a recession or cyclical companies aren't going to have cycles. Third, the stock market decline of the last year has reduced the price of the shares of many of our companies, which means less down-side risk for new investors or less risk for additional investments by existing shareholders.

Fourth, you let your wealth get built by the brand. Which gourmet coffee brand are people going to want? What motorcycle is a baby boomer going to want? What sports channel are you going to watch and on which cable provider will you watch it? Which retailers will people trust once they get back to more normal buying patterns? Who will provide your cell phone service? Who will fill your medicine cabinet the next forty years as you live longer than any prior generation? Who will provide financial services to aging boomers once they get their confidence back from the panic of 2007-08 and the Oil shock of 2008?

The answer is that most of the time it's the Indiana Jones or Rocky or Jaws or Naked Gun or Spiderman or Godfather of that industry. They don't always win the Oscar, but they bring home the most money at the box office. We believe it is our opportunity going forward and we thank you for your confidence and trust. See you at the movies! ■

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