SMEAD capital management

1.877.701.2883
info@smeadcap.com

3rd Quarter 2008

It's Different This Time.

It is said on Wall Street that the most financially damaging expression is, "It's different this time." An up or down trend gets established in an investment or economic market for a long time and human nature leads people to believe in its permanence. A look at the circumstances which drew this attitude in the past could tell us a great deal about where to invest as we look out into the fourth quarter of 2008.

At Smead Capital Management we invented a slogan to represent the crowd psychology which causes people of good logic to arrive at the opinion that "It's different this time." We call it a "Well Known Fact". A "Well Known Fact" is a body of economic information which is not only "known" by everyone in the marketplace, but has been acted upon by nearly everyone who could participate. Joe Kennedy, the father of President John F. Kennedy, used the shoeshine boys in New York in 1929 as an indicator to determine that stocks were overvalued. They were giving him stock tips after his shoeshine. He turned around and bet against the market and made a killing on the downside in 1929-1932.[1]

These "Well Known Facts" can be both positive and negative and ironically are the most destructive when they come true. I'll start with one of my favorite examples. In 1981, everyone knew and everyone acted on the idea that foreign automobile companies (primarily Japanese and German) would take away a large chunk of the market share in U.S. automobile sales. They were right! Foreign market share grew dramatically from 1981 to 1996 at US manufacturer's expense. Investors anticipated this fact by avoiding the common stock of U.S. automakers (GM, Ford, Chrysler) in 1981, even though it was traditional to buy into the automakers during a recession and hold them until the next prosperity. Because of the "Well Known Fact", investors thought it would be "different this time" and the U.S. automakers wouldn't make a comeback from the 1981-82 recession. Look below how Ford and General Motors did from the end of 1981 to the end of 1997.

	12/31/1981 Split Adjusted Price	12/31/1997 Split Adjusted Price	Cumulative Return	Annualized Return
General Motors	$15.21	$50.68	**233%**	**7.8%**
Ford	$0.68	$17.72	**2509%**	**22.6%**

"Well Known Facts" get cooked into the prices of securities so well that you can lose money from them being right or wrong! The phrase "It's different this time" usually gets brought up within about six months of the end of these major trends and is used to justify staying with a market which has been unusually hot. Also, think how intelligent the person who says it appears, because every situation is different in some way from all the other past similar ones. Mark Twain said, "History never repeats itself, but it rhymes." Whenever you see one-year returns in the 50% plus category in a market sector which had been strong the prior two to three years, assume the "Well Known Fact" is not only cooked in, but probably overdone. Here are a few to remember from my 28 years in the investment business.

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1983—Aggressive growth stocks culminate long hot stretch with IPO's of Apple and Genentech and follow with poor returns for seven years. The "Well Known Fact" was that you had to buy smaller fast growing companies to beat double-digit inflation.

1991—Biotech stocks on fire. The "Well Known Fact" was that the new research and science surrounding biotechnology would solve all our health problems, only to get blistered by the prospect of socialized medicine provided in 1993-94 by the Clinton Administration.

End of 1993—a four-year love affair with international investing triggered by the fall of the Berlin Wall in 1989 crumbles into eight years of dismal results. Asian Tigers and Latin markets went up a fierce 50-80% the last year of that move.

1999-2000—Tech Bubble created the "Granddaddy" of "Well Known Facts" and I heard, "It's different this time", more than I'd ever heard it before. The fact was that the Internet was going to change our lives. It was correct and it crushed the "It's different this time" crowd with 80% losses in three years.

2005—Residential Real Estate Bubble spawned by aging baby boomers and incredibly low interest rates relied on an old and overused "Well Known Fact", real estate only goes up. Warm weather destinations tried to convince everyone in their 50's that it was "different this time". Californians, Floridians, Nevadans and Arizonans now know that it wasn't different.

2006-08—The BRIC Trade became the "Well Known Fact". The assumption was and is that economic growth in emerging nations like Brazil, Russia, India and China would create uninterrupted demand for raw materials and commodities. People have tried to convince me that there won't be business cycles in those fast-growing countries because "It's different this time". This one was and is a whopper because it has positively affected cyclical U.S. stocks in energy, basic materials, heavy industrial companies, gold and mining shares and food production suppliers while simultaneously trashing the U.S. dollar and the common stocks of companies who benefit from prosperity in the U.S. At least temporarily this one has begun to severely punish its believers with oil and other commodities down 30% in 2.5 months.[2]

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2007-08—Credit Crisis and Panic of 2007-08. The "Well Known Fact" is that since the borrowing binge attached to home purchases and home equity lines of credit was the biggest ever, the securities of the surviving institutions will take much longer to find a bottom. After finding a bottom, the thinking is that financial service companies will be much less profitable than in the past and much slower to rebound in business and stock price. This one is yet to be determined, but doesn't information move much faster now and shouldn't that allow things to clear much faster?

1999-2008—Poor Performance of the U.S. Stock Market/The Lost Decade. The "Well Known Fact" that matters the most today is exemplified by the asset allocation of many of the country's largest pools of money. Large pension plans, endowments and wealth management organizations are investing the smallest part of their portfolios in U.S. stocks as they have anytime in the last 40 years. The most successful of these large pools has been Harvard's endowment fund and it disclosed it has 12% of its portfolio in U.S. stocks as of June 30, 2008 and had 33% in real assets (like commodities) at that same point in time. We have visited the University of Washington's endowment and they have the same U.S. stock allocation as Harvard, but only 4% of their overall value is in U.S. large capitalization stocks.[3] The "Well Known Fact" is that owning U.S. common equity is no longer a great way to build wealth with liquid assets.

We believe it is not "different this time" but this is a bigger and more multi-faceted test of the theory than we've seen in the last 25 years.

Individual investors in the U.S. own the least amount of directly-owned common stock relative to interest-bearing deposits that they have had since the market low in 1982. The public is doing 72% of the short sales on the New York Stock Exchange in recent weeks setting 45-year records. Mutual fund investors are liquidating U.S. Equity funds at record rates.[4] Are bad behaviors going to succeed because "It's Different This Time"? Is the "Well Known Fact" not going to ultimately crush those who pile in at the top or flee at the bottom? Is patience a sin? Does history matter? We believe it is not "different this time" but this is a bigger and more multi-faceted test of the theory than we've seen in the last 25 years.

In the eyes of Smead Capital Management, this is the best buying opportunity in U.S. stocks for a long-term investor in 26 years. Thank you for your ongoing patience, confidence and grace. ■

1. The Great Crunch of 1929, John Kenneith Galbraith
2. WSJ, Sept 14, 2008, Commodity Reserve Bereau
3. WSJ, Sept 3, 2008
4. Barron's, Sept 22, 2008, Value Line, Sept 5 & 19, 2008

Smead Capital Management
1420 Fifth Avenue, Suite 2625
Seattle, WA 98101-4149

Direct 206.838.9850
Fax 206.838.9851
Toll Free 877.701.2883
www.smeadcap.com