

Setting Expectations

There has been so much headline news yet so little of it seems to make much difference in this environment. The investment in Goldman Sachs by Berkshire Hathaway early in the week seemed to be a positive, for about six minutes. The supposed bailout later in the week rallied the markets for a little longer. But then we had the seizure by government regulators of Washington Mutual, now the biggest U.S. bank failure in history. We could go on but what's the point? It's great for the media but nauseating for individuals with their life savings invested in the stock market.

The one basic issue which makes this whole situation even more difficult is you don't know what to believe. If we think back to these large financial firms which have imploded, time and time again the public was reassured by the management of the companies of their stability. If we look even higher in the food chain of responsibility, the types of comments the investing public has had to listen to over the past few years are less than balanced.

"Homeownership rate is at an all-time high. That's a fantastic statistic, isn't it? We want more people owning their own home. When you own something you have a vital stake in the future of the United States of America."

- President George W. Bush, July, 2004

"What we dearly want is for Americans to spend like Americans - to do the patriotic thing and go out and spend."

- William McDonough, President New York Federal Reserve, October 15, 2001

Somehow it became patriotic to go and irresponsibly live beyond your means. The leaders of the country have beaten their chests and with such great optimism and ego reassured the average citizen time and time again.

"I believe that in years to come historians will see the beginning of the twenty-first century as the "golden age" of real estate. And I want to persuade you to take advantage of this historic opportunity ... I will paint a clear picture of today's real estate boom and explain why the boom will continue well into the next decade."

- David Lereah, Chief Economist, National Association of Realtors, March 2005.

"The private equity world is in its golden era right now."

- Henry Kravis, July 2, 2007

These are examples of the unbridled certainty in the future. Quotes like these, based on the prosperity of the last five years, could fill a book. We don't cite these comments to criticize their accuracy. We illustrate them because they were so unbalanced in their given roles. Those roles were often ones of Presidents, government officials, CEO's, Chief Economists, etc. We didn't want to include those of Mr. Greenspan, Mr. Bernanke, or Mr. Paulson since they were almost laughable. Instead of these individuals actually considering the risks to their outlooks and what their comments meant they now have as a group lost the confidence and trust of global investors.

Let's hold on a minute, it's easy to point fingers at the politicians and Federal Reserve and overpaid executives but that seems too convenient. We think we will see a change in attitude for the average individual. No one forced people to buy homes they couldn't afford, or second cars and expensive "stuff", they just made it easier. People wanted to live the "good life" without working and saving for it. Now they will be forced to pay for it. Unfortunately, so too will many who have been responsible.

We, as investors, need to question what we hear and consider the risks to the often convincing arguments of the so called experts. Today the story being widely spun is that the bailout should work and the underlying US economy is actually relatively healthy. Analysts still apply what we consider high multiples to many companies, and too often management of corporations are still living in the environment of the past five years rather than recognizing the change inflicted by the credit crisis.

We're not sure what is going to happen, our expectations are not for a swift economic recovery. This financial problem will translate into a general economic issue and individuals need to be more realistic and prudent with their finances.

As far as money managers telling you stocks are cheap, please appreciate stocks can get cheaper. We are here to help you in understanding the businesses we own. We refuse to put out the one sided blather that comes from so many in the supposed know. All we can say is we've been cautious to hold companies which we believe will be in business in five years and are priced to offer significant upside. We don't blame you if you are sceptical of that comment, in this environment you should be. But for what it's worth, we've been personally adding to our holdings in the past two weeks. If it goes down again we will do the same, the basic principle of dollar cost averaging is critical in this emotionally challenging period. Forget picking the bottom, it's easier to average it out over time.