August 13, 2008

Dear clients and friends,

I read the attached article on the weekend and it is worth a quick read. It is written by an American with forty years experience investing in bonds. Two main points to consider from it:

I agree with the author's criticism of a short term mindset in business. Looking at the "long run as a series of short runs" is seductively appealing in investing but wrong headed. Following this logic, the best twelve month return will be had from buying your favorites for January only to sell and replace them with the best stocks for February and so on etc. After considering the commissions and taxes incurred from buying and selling your whole portfolio twelve times in a year, never mind the speculative element behind a one month investment horizon – the hole in this logic becomes clear. Yet this mindset is rampant in the industry today. I view a difference of opinion such as this as an opportunity. Few portfolio managers are focused on what the best ideas will be over a five year horizon. This may sound boring but it is exactly the mandate of LCM.

The other point worth considering was the author's experience in the 1970's. It is always instructive to look back and learn from the past. The environment back then was very different than the one that prevailed over the last two decades. Many market participants today have been conditioned (perhaps by a forgiving Central Bank) into taking a cavalier attitude towards leverage (in an investment context this would include borrowing to buy stocks in a hedge fund or buying companies in bad financial condition). Part of LCM's approach is to minimize the potential for permanent capital loss by avoiding such leverage. With a bit of insight and some patience, the returns from exploiting opportunities using a concentrated approach should negate the need for leverage. And if another period like the seventies arises (let's hope not!) the portfolio will have the legs to weather the storm.

Any questions feel free to give me call.

Kind regards,
Dan

PS normally the opinions of bond investors should be ignored in favor of equity investors but we have made a rare exception in this case