

Quarterly Newsletter

2nd Quarter - 2007

Market Overview:

The 2nd quarter was a profitable one generally for the world stock markets. The bond markets on the other hand did not fare nearly as well due to increasing interest rates (bond prices and interest rates move in opposite directions). There is beginning to be many more signs that the real estate market which has been concerning many commentators and investors for the last 12 months has begun to worsen. Real Estate prices in several key markets appear to be declining, and lending institutions across the board are instigating policies to tighten their loan standards to be more selective about whom they allow to borrow.

It is yet to be determined if this will be a 'business-as-usual' kind of slow down or if it will turn into something more. As always, Remick Capital accounts will be managed for the long term, and any volatility will be looked at as a possible opportunity to buy new (or existing) investments at attractive prices.

Returns* ended 6/29/2007:	1 Qtr Return	1 Year Return	3 Year Return (annualized)
Wilshire 5000 Index (Ticker: VTI)	6.00%	19.92%	12.29%
MSCI World Index (Ticker: EFA)	5.91%	26.13%	21.41%
Lehman Aggregate Bond Index (Ticker: AGG)	-0.70%	5.92%	3.74%

It's Lonely Out There:

The nature of successful investing often leads to some psychologically uncomfortable situations. It will likely be the case that when an investment is purchased it is on the heels of bad news and a downward trending stock price. While it intuitively makes sense to buy stocks when they are 'on sale', it is often lonely to go against the crowd who is yelling 'sell!'. Humans by our nature generally seek belonging and acceptance from a group. Acting independently and at times going directly against the herd is a pre-requisite for successful investing, but that does not make it entirely comfortable.

It is important to know that just because a stock goes down; it is not necessarily because the underlying business is worth less than it was the day before. Over many years, the stock market has been much more volatile than the earnings of the aggregate underlying businesses that make up the market. This phenomenon (sometimes cited by academics as a sign of 'irrationality') is due to the habit of market speculators/investors to let cycles of fear and greed influence (too much) what they are willing to pay for businesses, and to let their emotions take control of their decisions.

My job as your advisor is to not only to be able to see through what the 'market' is telling us about companies and compare that with the actual facts of the situation, but also to help you understand when the market and the facts disagree. It is generally pleasant to see one of our investments appreciate in price, but it is crucial to understand whether anything has fundamentally changed to make the business and its shares worth more. The same is true when one of our investments loses 'value' according to the market. Is it time to buy more, or is it time to cut our losses?

Many times, the market gyrations that our investments make are just noise. There is no business impact or reason for the stock price to change at all. Many times, the stock price of a business actually moves in the opposite direction of what it 'should' based on the facts. These kinds of situations are wonderful to find!

* The Wilshire 5000 Index is a collection of stocks that is designed to approximate the returns of the entire US Stock Market.
The MSCI World Index is a collection of stocks that is designed to approximate the returns of the global stock market with US stocks removed.
The Lehman Aggregate Bond Index is a collection of bonds that is designed to approximate the returns of the entire US Bond market.
All returns are based on Exchange Traded Fund (ETF) returns to make the numbers representative of actual investor returns.

One non-intuitive example of this is when the actual movement of the price of the stock downwards actually causes an *increase* in the per-share value of the business. This somewhat odd scenario can happen when a company is returning excess cash to shareholders by purchasing its own shares on the open market (and thus consolidating per-share ownership) at a price that is much lower than the value of the business that each share represents.

To clarify, here is an example of a situation where a lower stock price, actually can increase the future value of a company:

Suppose company ABC has 1 million Shares of stock that is trading @ \$10/share. The company has a business that generates \$2 million in profit per year, and currently has \$4M in cash in the bank. If you suppose that this basic business that makes \$2 million / year is worth \$16 million, then you have a company that is worth \$16 + \$4 million (Business + Cash value).

So if we know that there are 1 million shares, then each share should be worth \$20 each (for a \$20 million total).

Now, because there is a discrepancy between what the company is currently trading for (\$10) and what it is worth (\$20), the companies' management decides to spend the \$4 million to buy back 400,000 shares of stock at \$10 each.

After the buyback we have a company that still has \$2 million in profits, but now it has zero money in the bank, and only 600,000 shares outstanding. Assuming the corporate value is still \$16 million; those shares are now worth \$26.67 (16 m / 600 k) / share, instead of \$20.

If the companies' shares were trading at \$30 (above business value) before the buyback, then purchasing shares by the company would have had a *negative* impact on the per-share value.

The above analysis works as long as we can assume that the true business value stays at \$16 million and does not change in some unexpected way so that the company makes less money and is therefore less valuable to us as investors... this assumption will not always be true.

I should also note, that while the above analysis seems simple, the real world is often more complex. If a company is very cheap, it is unlikely that they will be able to buy 40% of their shares at depressed prices. They may only get a few % before the stock price jumps up closer to approximate the value of the business.

In the end, the most successful aspect to investing in my mind is the ability to drown out the noise that the market makes on a daily basis. By focusing on the business, we can take advantage of the market's mood swings by buying low when it is depressed, and selling high when it is exuberant. It may be lonely to seemingly be the only buyer of depressed companies, but it can also be very profitable once the value of the company begins to shine through for others to see. It is also important to always remember that while the market prices for most stocks generally are a good estimate of the underlying business value; that is not always the case. It is where this discrepancy is greatest that we will make our best returns. It will indeed be a lonely path to follow, but it should be the quite profitable.

As always, my money will be invested right alongside yours so you can be sure that I will work diligently to make sure our investments will be profitable ones; regardless of the market conditions. I appreciate the faith and trust you have placed in Remick Capital as your Investment Advisor; I will work hard to make our relationship as mutually profitable as possible.

Sincerely,

Benjamin Hacker
Principal,
Remick Capital, LLC