

# Quarterly Newsletter

## 2<sup>nd</sup> Quarter - 2008

### Market Overview:

Markets continued their extreme volatility through the 2<sup>nd</sup> quarter. Most bonds and stocks, both domestically and internationally, closed out the quarter on a down note. The main themes of the global investment markets were higher inflation, higher unemployment in the US, high energy prices, and fall asset values.

As much as I would like to say something really positive about the quarter; it was pretty dismal. Unlike last quarter, our accounts on average underperformed both our target absolute returns as well as comparable returns from the US stock indices. The end of the quarter ended with a selloff in virtually all major asset classes which continued into the first few weeks of July, and our holdings were not spared. Investing is a multiyear process and short term performance should always be viewed with the longer term in mind but there is no hiding that this was truly a poor quarter for all of us.

As to an explanation of 'why' we underperformed, I think the answers are straightforward, if not very comforting:

- 1) We are **underweight** oil, gas, and natural resource stocks which have all been strong performers in the stock market recently.
- 2) We are **heavily overweight** investments in the financial sector which have been undergoing a rough patch in the market recently.
- 3) Many of our investments appear to be misunderstood by the market and their end of quarter prices are strongly divergent from realistic true business values.

All of the above is not meant as an excuse for poor performance. We do have investments in natural gas, and I don't have an aversion to investing in energy or natural resource companies. However, I attempt to find where the most compelling *long term* values are, and I have found better investments in other areas recently. And while we are overweight financials, we do not own a lot of financials that are susceptible to current real estate and credit problems. Quite the opposite is true actually. Our holdings in Wells Fargo and the Fairfax group should be able to either gain from the chaos directly (as in the case of Fairfax) or to take market share aggressively as competition is weakened or goes bankrupt (Wells Fargo).

Returns* ended 6/30/2008:	1 Qtr Return	1 Year Return	3 Year Return (annualized)
Wilshire 5000 Index (Ticker: VTI)	-1.69%	-12.49%	2.77%
MSCI World Index (Ticker: EFA)	-2.27%	-10.73%	7.14%
Lehman Aggregate Bond Index (Ticker: AGG)	-1.08%	7.09%	4.78%
<b>Remick Capital Account Composite</b>	<b>-12.00%</b>	<b>-12.70%</b>	<b>N/A</b>

The market clearly disagreed with me on our companies' future prospects as of this last quarter; and that is painful for our account balance. Over the coming months and years I still believe that most of our investments will be very successful. I will continue to purchase businesses that have earnings power and assets that are much more valuable than their current stock prices imply. This will mean that I will usually be buying things when they are hated and when the collective participants of the stock market are casting aside the shares at bargain prices. I will also likely be selling (on occasion) some of our less undervalued holdings to buy new and existing investments that are more attractively priced. This past quarter hurt, but this is just the kind of treatment we should expect to receive from the market at times.

\* 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 above returns are based on Exchange Traded Fund (ETF) market returns to make the numbers representative of actual investor returns.

For Remick Capital performance data; please see our [performance disclosure](#) document for the basis of results.

## Investment Updates:

Below is a summary of some of our investments and how they have performed this quarter. Note that while some investments are held in all Remick Capital client accounts, oftentimes due to either the timing of investment cash flows, account size, or risk tolerance; some investments discussed below may not be in your account:

**Accredited Mortgage Loan REIT Trust, 9.75% Cumulative Preferred, Class A (OTC: AHHAP)** – During the quarter the parent company (Lone Star Fund V) of Accredited Mortgage entered into an agreement to buy some of the Bear Stearns mortgage assets from JP Morgan (Bear Stearns made the news this quarter as the Investment Bank that was rescued by JP Morgan and the Federal Reserve). In addition, Lone Star made a transaction with CIT to buy \$9+ Billion in mortgages and related business from Bear Stearns. Accredited Mortgage has also scaled back their corporate operations from several offices to only their San Diego location to reduce costs.

Despite the uncertainty surrounding Accredited's core business, the bonds we own have paid all interest and the company has continued to originate a small amount of mortgages despite the ongoing housing crisis. This new business is at very high spreads due to the lack of competition and should result in solid profits. Accredited's corporate owners understand the value of the business as many mortgage competitors flee from the market or go bankrupt. They appear strongly committed to maintaining their footprint in the mortgage business. We get paid to wait for further developments surrounding this investment; the current yield on the shares we own is >25%.

*Update:* After the close of the quarter, S&P (a major credit/bond rating agency) updated its outlook on Accredited and removed it from 'credit watch' (which is a positive for us).

**Sears Holdings (NASDAQ: SHLD)** – Sears is a name that I'm sure is very familiar to all clients. Sears has been a struggling retailer for quite some time. Several years back an Investor named Eddie Lampert took Kmart from bankruptcy and proceeded to merge the two companies (he was also a holder of Sears) into a combined holding company. Mr. Lampert is the current Chairman of the holding company that owns both retailers and he is in the process of attempting to unlock the value embedded within Sears. The primary value in my eyes lies within the vast real estate and retail footprint that Sears oversees (many of their locations are un-mortgaged or have very long below market leases). If Mr. Lampert is unsuccessful in turning around the retail operations of Sears and Kmart, I believe that this investment will still do ok. If he can manage to improve the retail results of one or both companies, the shares should appreciate substantially. I do not expect things to change at Sears overnight, but I believe at the current price, those investors who have patience will be well rewarded.

**Fairfax Financial (NYSE/TORONTO: FFH)** – Interestingly enough, Fairfax (and Odyssey Re) is one of the main reasons that our accounts appear heavily weighted toward 'financials' and additionally why we have underperformed in the 2<sup>nd</sup> quarter of this year. Fairfax, while technically a 'financial', is really a company that has positioned itself perfectly for the current environment of financial turmoil. They will be making solid gains on many of their investments over the coming quarters and it should be very profitable for us as shareholders. The shares are down over the last 3 months, but if anything, the company has increased in value over that same timeframe.

**Wells Fargo (NYSE: WFC)** – Wells Fargo is another familiar name. I was pleased and excited when this company that I have followed from afar for many years finally got down to a price that was cheap enough for a new investment. You will see many articles over the coming years about banks going out of business, and real estate and commercial loans defaulting. Wells Fargo is guaranteed to share in at least a portion of these problems. However, Wells Fargo has several traits that I believe will prove to help make it a great investment. Conservative management, coupled with an extremely strong brand, wide product offering, strong risk controls, and an intense focus on the customer will all help Wells Fargo to survive and grow smartly through this crisis.

*Update:* After the close of the quarter, Wells Fargo announced 16% revenue growth, and earnings that were better than expected by analysts. Wells Fargo shares rose more than 25% on the day of the announcement.

**NOTE:** Some clients may own shares of a Fairfax Financial subsidiary Odyssey Re Holdings (NYSE: ORH) in place of Fairfax shares. These companies are not identical, but are very similar in many important ways. At different times, either one may present a more compelling buying opportunity than the other.

**Nicholas Financial (NASDAQ: NICK)** – There were no new developments with Nicholas Financial this quarter. Income declined slightly due to an increase in credit losses (and loss assumptions) in the most recent quarter, but NICK remains solidly profitable. Despite management correctly predicting trouble in the financial markets, scaling back their leverage by 50%, and being one of the few subprime lenders that is still *in business* (much less still soundly profitable), the stock market has slashed the bid on the companies' shares by more than 50% to less than two thirds of liquidation value. I will add that my view on the company has not changed substantially since our initial investment. Management is solid, the business is performing very well (all things considered), and competition is disappearing at a rapid clip. Currently the stock is trading at 5 times earnings; in my opinion, far too cheap even using very conservative assumptions.

**Compton Petroleum (NYSE: CMZ, TORONTO: CMT)** – This quarter was again one of strong performance for Compton. Natural Gas prices rose substantially with Oil and Compton will be making much more money this year. In addition, Compton management has decided that for the best interests of all shareholders that the company should sell itself to a larger partner who can more fully exploit the company asset base. I am agnostic to the sale (or continued independence) of the company, but I believe that any deal <\$17/share would inappropriately undervalue the company. I will wait to see if there are any new developments with Compton; it will be nice to see if a suitor finds value where I see it today.

## \$150 Oil? Inflation? Real Estate Meltdown?

Well, there certainly has been some interesting news recently. Oil has gone parabolic in the first half of the year to reach heights of more than \$140 per barrel, and a ferocious debate is roaring about 'why' and 'who' is causing this (*hint: it's probably mostly related to our continued consumption of oil/gas in spite of the high prices*). At the same time many news outlets are beginning to share their concern about the potential for high inflation which is already climbing (just over 5% as of the last 12 months). Finally, the poor real estate environment, which has been in news for more than a year shows little sign of getting better soon. As an investor I get many questions from people about the above issues, and I think it will be instructive to give you an idea of my thoughts on these important issues and how it drives my investment process.

First off, as disappointed as it may make some of you to hear me say this; *"I cannot predict overall economic trends much better than anyone else."* When I look at macroeconomics (which is not that frequently), I try to focus on things that appear to be grossly out of place; but if it's not obvious pretty quickly to me, I won't spend too much time trying to make bold predictions about the future. What I think is far more important to do is to select investments in companies that have the ability to perform favorably in a wide variety of economic conditions. There will always be something unforeseen on the horizon that can cause problems for any business. But companies with solid competitive advantages, superior branding, outstanding management, strong culture, and low costs will always do better than *most* of their competitors in *most* economic environments. Below are a couple of examples of companies that are in our portfolio(s) that appear well positioned to survive this financial downturn stronger than ever; even though they are seen as being hurt by it.

**Fairfax Financial** is a great example of good management and good culture coming together to provide a strong defense against economic weakness. The company accepted lower returns (and less risk) in the past 5 years while other companies in their industry were reaching a little (or a lot) for extra return. Because of their conservative nature and strong independent culture, Fairfax saw some of the excesses in the industry for what they were; and they took advantage by buying what others didn't want to own, and vice versa. Now even some of the strongest insurance companies in the world are being brought to their knees due to their mistakes and at the same time Fairfax will be able to grow and take share in the insurance market to exploit their less prepared competitors.

**Wells Fargo** is a great example as well of a financial firm that is not nearly as threatened by the financial downturn as many pundits would have you believe. When times are good, Well's makes good money, and grows nicely. When times get bad, and the economy is shaky Wells' makes less money as they experience more defaults and their customer feel the economic pinch. However, during times of great stress, high oil, high inflation, and increasing unemployment, Well's faces *much less* competition from other banks and mortgage companies. Because of this Wells' is able to grow their market share so that when the economy turns their business footprint is much larger than before (along with their profits).

While it is always disappointing to see any of our investments lose value in the marketplace. I hope it is reassuring to know that the companies we own are well positioned to stand up to the economic tests at hand. Certainly not all of the investments will end up as planned, and the economy will no doubt take its share of victims, but I like the chances of the companies we are invested in. If that ever changes, I will communicate those changes to you here.

As for the questions of “where are oil prices heading?” or “when will real estate prices hit bottom?”; I don’t have an answer. But whatever the answers are, I’m confident our investments will make it through and prosper. It will likely take some time, but the stock market will realize the value of our investments at some point in the future; we will be rewarded for buying when others were fearful.

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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 trust you have placed in Remick Capital as your Investment Advisor; I will work hard to make our relationship as profitable as possible.

If you ever have any questions about this report, your investments, or anything financially related in general; please do not hesitate to call me.

Sincerely,



Benjamin Hacker  
Principal,  
Remick Capital, LLC  
(503) 702-2712  
[www.remickcapital.com](http://www.remickcapital.com)

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