

Quarterly Newsletter

2nd Quarter - 2009

Market Overview:

Optimism returned in the 2nd quarter with a vengeance. Many companies that were left for dead last year recaptured Wall Street's admiration (at least temporarily) and were bid up astronomically during the quarter. Some of the worst, lowest quality firms, which had dropped the most during the bear market, were the same firms to produce the best returns during this quarter. It was not an uncommon sight to see a sketchy, near bankrupt companies' stock prices rally 500% or more in the past few months, but what really made this quarter interesting was that it was not uncommon to see *quality* firms rally 50-150% in a few months.

It is crucial to remember though that many of these companies rallied mostly because their share prices had fallen so far to begin with, so in some sense these recent gains are only a payback for the pain investors have suffered in the last few quarters. Our accounts thankfully held several of the 50-150% returns holdings this quarter but very few of those riskier businesses whose share prices rose much faster.

Below is a table designed to summarize the most recent returns for some key investment markets compared to the Remick Capital account composite. The *Wilshire 5000* represents the aggregate US stock market, the *MSCI World* represents the entire developed world stock market excluding the US, and the *Lehman Aggregate Bond* is a representation of the entire US Bond market. These market indices are important to follow over time as they help keep the performance of your own account in perspective.

Returns* ended 6/30/2009:	1 Qtr Return	1 Year Return	3 Year Return (annualized)
Wilshire 5000 Index (Ticker: VTI)	+16.95%	-26.13%	-7.76%
MSCI World Index (Ticker: EFA)	+25.39%	-31.21%	-7.99%
Lehman Aggregate Bond Index (Ticker: AGG)	+1.65%	+6.14%	+6.35%
Remick Capital (Account Composite)	+44.70%	+10.35%	N/A

Below I have highlighted the [three major goals](#) that I strive to achieve for Remick Capital investment accounts and how I have done against those goals so far on a composite basis. As these are long term goals (3-5+ years), clients should judge my performance over time based on the criteria below:

Remick Capital Investment Objectives:	1 Year	Since Inception
#1: Don't Lose Money	Pass	Pass
#2: Outperform US Stock Market	Pass	Pass
#3: Provide Clients with a Real Return of 10%	Pass	Fail

While it has been (and will likely continue to be) a very volatile ride, I am confident that that over time the table above will show more green than red, and our accounts will continue to outperform.

* 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 I have summarized some of our investments and related news for the quarter. The performance of most of our investments this quarter was very good. While the market is clearly not always rational, ultimately the true value of our businesses will be recognized in the marketplace, and this quarter exhibited such recognition by my calculation.

Nicholas Financial (NICK) – Nicholas reported earnings this quarter that were better than I expected. They earned \$0.20/share in profit for the quarter, and there were a few early signs that perhaps the business may have turned the corner. Their business is highly sensitive to employment (which is worsening), but, at the same time, they have been living through tough times a bit longer than most considering around half of their business is based in the hard hit Florida region. Regardless of whether the economy continues to worsen, the shares trade for a 30% discount to liquidation value, so we have a nice margin of safety. The shares were up roughly 100% this quarter and are still cheap.

Wells Fargo (WFC/WFCpL/WNAp) – In my last letter I wrote about the continued plunge in Wells Fargo's stock price and how my opinion of the company, despite all of the scary headlines, was essentially unchanged. After the appreciation of Wells Fargo shares above \$25 and the continued bad news regarding the government banking intervention and economy, I sold all common stock of Wells Fargo for our accounts. I replaced a portion of the position with Series L preferred stock, as well as Wachovia Preferred Funding Corp preferred stock (both roughly equivalent). These preferred shares provide us with 7.25-7.50% interest payments and were acquired at meaningful discounts to their face value. Both shares even after continued appreciation pay 10% yields and have very little risk in my eyes.

Sears Holdings (SHLD/SSRAP/Sears Bonds) – Sears stock rallied quite nicely this quarter for a gain of more than 20%. In addition, the bonds I mentioned in my last letter have appreciated even faster. In most normal times, bonds are lower risk and lower reward than stocks, but March and April of this year were not normal times. The bonds we purchased that are due 2011-2013 appreciated 25-40% in addition to healthy 10+% annual interest payments we will receive. The bonds we purchased that are due 2017 appreciated over 100%. And the bonds we purchased that are due in 2032 (SSRAP) appreciated more than 50% in addition to their 25% annual yield. The only major news during the quarter was that Sears renegotiated their line of credit, which in my view is a slight positive, although unsurprising.

For clients who are a little cloudy on how bonds and preferred stocks function, I have added an [education tab](#) to the Remick Capital website containing a brief primer on Bonds. As always, please let me know if you have any questions or would like any clarifications on these topics.

Fairfax Financial/Odyssey Re Holdings (FFH/ORH) – Fairfax and Odyssey shares were basically flat for the quarter. Both companies will be reporting in one month that their asset values have increased smartly due to great portfolio performance in stocks and municipal bonds during the quarter, and these results will be accompanied by mediocre insurance underwriting results. Both companies are now valued at roughly 10-15% discounts to their underlying net asset value (assets minus liabilities) and are extremely compelling bargains at their current prices. At the close of the quarter, the combination of these two companies was the largest holding across Remick Capital accounts.

For more detail on my thinking on Nicholas and Fairfax, I have more detailed investment reports available [here](#) on the website.

Predicting the Future

Investing is a tricky business. It is very simple on the surface, but the application of it can get sticky. It is key to realize that the process of actively selecting investments is an extremely egotistical thing to do; you are betting that a nameless, faceless individual or institution with whom you are trading stocks/bonds is doing something irrational. You are making a bet that you know better, that you can forecast the future better, and that the other person is wrong. It is true that in certain circumstances, both parties may very well be making a smart decision and are just in different circumstances, but in many cases successful investing (in today's environment) will require profiting at the expense of someone else.

So one key question we should all be asking is: "How on Earth is it that I will be able to outsmart lots of really talented (and well paid) investors who are out there trying to find bargains? What is my advantage? This is a *great* question.

As I have said before, having great clients is a key advantage. It does not matter how smart an advisor or investor is, if their clients want their money back right at the bottom of the market because they are panicking when stocks are the cheapest, an investor or advisor is *forced* to sell. A forced seller is someone who can be taken advantage of easily, so avoiding such a situation is critical to successful investing.

Another key advantage that I think is very much underappreciated at times by investors is very simple, although hard to quantify. By simply aligning your investment capital with good people and good businesses *even when* you cannot exactly quantify the benefit of doing so, you gain an advantage. This may sound silly or obvious to some people, but many investors (including me) sometimes forget to apply this simple rule. Let me expound.

When researching a company, you can look in the past and see how the company and management have performed. Businesses with strong brands and good competitive positions in due course will show superior financial performance relative to similar businesses without these advantages. Similarly, companies that have honest and high quality management teams will *ultimately* display superior results. You would think given this truism that companies with better than average management teams and companies with better than average business models would trade for premium prices to similar companies without such traits. The puzzling fact that superior companies can sometimes be had for average or better than average prices creates fertile investment ground, one cultivated by simple market inefficiency.

Obviously we ask, "Why is this so?" Simply put, the 'market' often focuses extremely closely on short term items. If a business is wisely building up its competitive advantage for the long term at the expense of short term profits, the market may decide to value the business as if it is 'average' or worse. A management team that has a history of being honest, ethical, and intelligent can easily be devalued by the market after a single mistake is made. In the market the mantra is often not "What have you done for me?" but more aptly "What have you done for me *lately*?" But just because this occurs does not make this logical or correct.

I will provide an example of this phenomenon to explain in more practical terms what I mean. Warren Buffett's company (Berkshire Hathaway) has been public and under his stewardship for about 50 years. In this time Buffett has applied some simple and well executed strategies to produce shareholder returns with what most would consider to be limited risk. He has run a core insurance business while using the premiums it generates to invest in wholly owned as well as minority owned businesses. He has created a \$200 billion company through this simple strategy as Berkshire has achieved equity growth well above 15% on average with only a handful of years producing a negative result. In the most recent 10 years, Berkshire's results have continued to outpace the market (albeit at a reduced pace).

There are some negative forces facing investors in Berkshire which are relevant. Buffett is now over 80 years old and many shareholders (including myself) worry about what happens when he is gone. He has sold large insurance contracts on the performance of world stock markets and also invested heavily in many companies making negative headlines in the news (Goldman Sachs, and GE). Both of these maneuvers have been questioned by some in the media but remain consistent with Buffett's previous modus operandi over the last several decades.

At recent prices though, the market is placing a value on Berkshire of roughly 1.25 times the net asset value of the company while the valuation of the US stock market is 1.71 times net asset value. This valuation metric alone is not a precise tool, but suffice to say that other valuation measures show Berkshire similarly cheaper than the market average.

While it may be scary that Buffett is getting old or even losing his touch (he's not), the truth is that even if Buffett dropped dead today, Berkshire would still be an *above average* collection of diverse businesses. Further assuming that his subsidiary companies are 'just' average, there should still be no *discount* for Berkshire versus the market. At times the market simply focuses too much on near term concerns (Buffett's age and his 'new' investments) ignoring the more important positive qualities of the business (diverse revenue streams, big cash flows, and competitive advantages).

How does this all relate to predicting the future? I recently came back from my high school reunion and had a chance to catch up with old friends and classmates from long ago. What struck me was not how much was different, how people

looked ten years later, or the stories I had forgotten. What surprised me was how much of what I saw I could have *predicted* 10 years ago. The people who I would have labeled “most likely to succeed” or “most likely to get a good job” for the most part achieved what I would have guessed. These were not necessarily the people who had money or were the smartest, but they were usually the ones who had a drive to succeed and parents, friends, and mentors who supported their goals. They were winners before they had played the game, and I predicted it.

The fact is that in the real world and in investing, talk is cheap. Short term results are cheap, and pretty presentations are cheap. Businesses that have obvious competitive advantages and people who have an innate drive to succeed and demonstrated integrity will (on average) prevail. Real drive is rare, real competitive advantages are rare, but when you find them, they are worth paying for. At times, the market forgets this because these things are difficult to quantify.

Aligning yourself with strong managers and great businesses does not help you predict the future per se, but it does help ensure that in the future you will get more than your fair share of positive surprises as opposed to negative ones; it is like stacking the deck in your favor.

A friend of mine once said that investing is about predicting the future. I agree. But while some attempt to forecast next *month*, it is important to remember that businesses (and people) will face many challenges over the coming *years*. By investing in great companies with great managements, the future will more often than not take care of itself as good businesses and good people will adapt to new situations. It will not always work, and we are all aware of the many former titans of industry that have fallen from grace. However, *on average*, this strategy should help improve returns. And remember, if you only have to pay *average* prices for these advantages, it is very unlikely to cause any harm. If you can actually pay a discount to get these advantages, the outcome can be tremendous. The key is to have the patience to wait for the right price.

Finding great companies with great managements who are sacrificing short term results for longer term rewards is a proven path to investing success.

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,



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