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Hard Day's Night March 28, 2017

Dear Fellow Investors,

On a recent business flight, I watched The Beatles documentary (*Eight Days a Week*) which featured the song "A Hard Day's Night." The movie chronicled, via previously unseen footage, the early years of The Beatles and the mania surrounding their tours and albums. This documentary and song could teach us about how to navigate the stock market in the U.S. and what demographics mean to American culture and economic trends.

*It's been a hard day's night, and I been working like a dog
It's been a hard day's night, I should be sleeping like a log
But when I get home to you I find the things that you do
Will make me feel alright¹*

For anyone expecting to satisfy their long-duration return needs in the S&P 500 Index, the next ten years could be a "hard day's night." Prices in relation to earnings (P/E ratios) are elevated and popular tech favorites are extremely expensive, effectively have overloaded the index and private equity portfolios. This has occurred while cyclical energy holdings are asking for a Hail Mary from higher oil prices. In our view, realistic expectations in returns of the S&P 500 for the next ten-years might be in the range of 5% per year (counting dividends/before expenses) from a historical standpoint.

When we "get home" to our concentrated and high-active share portfolio, based on our eight criteria for stock selection, it makes us "feel alright." Our portfolio trades at a significant discount to both the S&P 500 and the Russell 1000 Value Index and over the next ten years could provide us a favorable time arbitrage spread. Add in the fact that our companies are qualitatively superior on average (better balance sheets, free-cash flow, longer histories of success, more shareholder friendly and stronger insider ownership) and it's easy to see why we believe you'll benefit from "the things that we do."

*You know I work all day to get you money to buy you things
And it's worth it just to hear you say you're going to give me everything*

*So why on earth should I moan, 'cause when I get you alone
You know I feel OK*

If we "could get you alone," we'd show you the demographics which bode well for a minority of S&P's 502 companies. A baby boom among 30-40 year old women, a big uptick in household formation and a huge jump in the population of 35-44 year old Americans could help us to "get you money to buy you things." This is true if you let your portfolio be dominated economic forces that work on Main Street as opposed to Wall Street. It means you need to avoid the euphoric episode associated with technology which is currently centered in Palo Alto and Seattle.

In the documentary, The Beatles were attractive, bustling with energy and artistically brilliant. However, the "Beatle Mania" was fed as well by the massive number of 10-20-year old's in the U.S. and the rest of the developed world. These same Beatle fans caused a housing boom in America from 1975--1985 at historically high mortgage rates!

*When I'm home everything seems to be right
When I'm home feeling you holding me tight, tight*

We are very much at "home" with a portfolio heavy with home builders (LEN), home renovation (HD) cable/high speed internet access (CMCSK), HGTV or the Food Network, (SNI) and local network news programming (TGNA). This means we need to "hold" our portfolio very "tight" as an expensive index gets gyrated in the next five years. Here is what *The Wall Street Journal* writer, Paul Overberg, wrote in his March 23, 2017 blog titled, "The Outer Suburbs Are Once Again Outgrowing Cities":²

Last year saw the strongest evidence yet that Americans are returning to traditional patterns in where they move—from cities to suburbs and from North to South—after a recession-driven pause of nearly a decade.

Central counties of metropolitan areas grew 0.7% last year while outlying counties grew 1%, according to new Census Bureau population estimates for the year that ended July 1.

If we are patient and stick to our discipline, we could navigate the next ten years with an advantage over the S&P 500 and many other active managers. In spite of a possible "Hard Day's Night" scenario, we could be "sleeping like a log" with under-loved, quality common stocks tilted toward the economic needs of 30-40 year old families. This combination could make us "feel alright."

Warm Regards,



William Smead

¹Source: The Beatles, “A Hard Day’s Night” Lyrics (<http://www.thebeatles.com/song/hard-days-night>)

²Source: *The Wall Street Journal* (<http://blogs.wsj.com/economics/2017/03/23/the-outer-suburbs-are-once-again-outgrowing-cities/>)

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