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Downton Abbey Stock Market

Downton Abbey is a Masterpiece Theatre show on PBS which has taken US television viewers by storm. It is the story of an aristocratic family in England which perpetuates a dynasty in a small town through the operation of a huge estate. Devotion to this estate and huge family home are accomplished by employing a small army of servants, who maintain the home and the aristocrats. We believe there are strong parallels between what goes on at Downton and what has been going on in the US stock market since 2009. We also see this as a recurring theme for the next 5 to 7 years.

The Crawley family, led currently by the Earl and Duchess of Grantham, have owned and managed the Downton Abbey estate for multiple centuries. The first lesson they provide is that long durations or time periods are important for the compounding of value. Productive land and housing for as many as twenty people only becomes more valuable as long stretches of time pass. World War I, inflation, scarcities, and fumbled venture capital investments haven't been able to thwart the Crawley family.

Our view of owning high-quality US common stocks and our devotion to owning them for long time periods is similar to Crawley family devotion to Downton.

Deep recessions, US government budget deficits, high unemployment, and threats of higher inflation are no more worthy of moving us away from our companies than WWI was of moving Lord Grantham.

You put up with the difficulty to get to the long-term reward. Those rewards are greater because of low turnover. This is because frictional costs caused by trading are the enemy of the common stock owner. These expenses detract directly from annual returns. Those who have sought to analyze macroeconomics for market timing purposes the last three years have cost themselves and their followers billions of dollars, in our opinion.

The Crawley's and the Downton Estate are not free of internal problems. Pre-marital sex, racial and social discrimination, snobbery, adultery,

and lying happen from time to time in the family and at the estate. Ms. O'Brien and Mr. Barrow, two of the key servants at Downton, are always anxious to stir up trouble. The family, servants, and the estate are far from perfect, but they have family bonds, a culture of grace, and a code of honor that seem to heal the relationships among both employer and employee.

Our companies make mistakes from time to time and suffer through negative circumstances which are outside their control. Our US bank stocks got caught in the housing meltdown from 2005-11; our pharmaceutical companies got caught in the crosshairs of politics, regulators, and the legal world. Our consumer companies have had to fight through the most powerful austerity period in the US since the 1930's.

The main reason that common stock ownership provides the highest return among liquid asset classes is the variability and volatility of returns.

Nobody living at Downton Abbey is anxious to sell just because of current tribulation. Jim Collins, the writer of "Good to Great" and "Great by Choice", concluded that great companies have good luck and bad luck just like other companies. Collins says that great companies handle bad luck better and take more advantage of their good luck.

The future looks bright for the Crawley family and the Downton Abbey estate. The oldest daughter, Mary, has been wedded to Matthew Crawley. A distant cousin to Mary, Matthew has significant legal and business skills. These skills will come in handy to enhance the returns

from farming and from renting the massive family real estate properties. On top of that, he inherited a huge sum of money from his deceased fiancé's father, which can be used to shore up the balance sheet of the family and the estate.

We believe the future is very bright for our companies. The US economy has been cleansed by the bloodbath/meltdown of 2008 and by the political, legal and regulatory scrutiny which followed. The US has recapitalized its banks, corporations have created stellar balance sheets, and households have retracted spending far back inside their means. The Federal Reserve reported in mid-March that the household debt service ratio is the lowest since the numbers were first computed in 1980. This means that when confidence comes back there is a healthy ability for US consumers to use leverage to buy houses and/or big ticket items like cars.

The most affordable housing in my lifetime is going to be combined with the naturally positive onslaught of the maturing of our largest population group, echo-boomers. These children of boomers currently are at an average age of 28. Recent reports indicate that the average male gets married in the US at the age of 28.7 and the average female marries at age 26.5. The last five years of economic tribulation and high unemployment has probably created "pent up demand" for weddings, babies and house purchases.

We would not be shocked to see a large uptick in household formations, fertility and single family housing starts as Americans go back to building their own estate.

In July of 1977, the US government census showed that the US had a population of 220 million people. In 1978, there were 1.4 million housing starts as baby-boomers entered the first time home-buying market in droves. We think 2 million housing starts in a single year is highly possible in the US five years from now.

Therefore, we like the idea that those who emulate the Crawley family's un-interrupted ownership of Downton via ownership of wonderful companies which meet our eight proprietary criteria for stock selection will be highly rewarded over the next 5 to 10 years. We believe this knowing full well that next week's episode and every remaining episode will include trials and tribulation. ■

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Smead Capital Management

1411 Fourth Avenue, Suite 1550
Seattle, WA 98101

Direct 206.838.9850

Fax 206.838.9851

Toll Free 877.701.2883

www.smeadcap.com