



Missive

JANUARY 11, 2022

A Dr. Lecter Market

Dear fellow investors,

The beginning to 2022 has been dark to say the least. The year has begun with losses in the index with much deeper red ink spilled across many recently exciting investments. The ominous feeling of the moment reminds me of the suspense I first felt watching *The Silence of the Lambs*. It was creepy, dark and intellectually intriguing to figure out what would transpire next. Allegorically, the final scene of that movie is like the first week of stock trading in 2022.

(Agent Starling picks up the phone)

Agent Starling: Starling

Hannibal Lecter: Well Clarice...Have the lambs stop screaming?

Agent Starling: Dr. Lecter

Hannibal Lecter: Don't bother with a trace. I won't be on long enough.

Agent Starling: Where are you Dr. Lecter?

Hannibal Lecter: I have no plans to call on you, Clarice. The world's more interesting with you in it. So you take care now to extend me the same courtesies.

Agent Starling: You know I can't make that promise.

Hannibal Lecter: I do wish we could chat longer, but...I'm having an old friend for dinner. Bye.

Wall Street is agent Starling. They are trying to catch this serial killer, Dr. Hannibal Lecter, much like they are trying to predict anything else on Wall Street. While Starling wants to know where Dr. Lecter is, she was scared by the thought of him as she peered around the corner that was across the room looking for him. Dr. Lecter is indicative of vicious bear markets that are inevitable to Wall Street and stock investing.

By the end of bad markets, the investors (lambs) that are led astray scream until there is awkward silence. They lose the ability to respond, or they die off. Many of these lambs impair their personal capital to a point of not being able to participate, as they did prior, or they never trust the equity markets again. Wall Street, while fearful of these killers like agent Starling is, has a special relationship with these bad markets. As Lecter said, he (bad markets) believed that the world is a better place with agent Starling (Wall Street) in it. Wall Street survives, but many victims do not.

Like Dr. Lecter said, there's no need to trace him as he won't be long. Bear markets are normal. They are regular, but historically they don't last as long as positive stock markets. Starling knew

the elusiveness of Hannibal's brevity would do nothing to help her. It leaves her in suspense like it does Wall Street and all investors each time.

To understand the bottom that we will eventually see from this euphoric stock market mood ending, look no further than a prior scene in *The Silence of the Lambs*. A young lady is in the bottom of a short well. She is being starved and tortured. Her captor, serial killer Buffalo Bill, is prepping her for the same fate as her predecessors. The line that rings in the viewer ears is, "It rubs the lotion on its skin or else it gets the hose again."

At the bottom of bear markets, all investors understand their errors. The stock market forces them to take a humble position of what they have done wrong, what information they chose to ignore and what price they should have paid. It did this in 2003 by rubbing the lotion on its skin: price mattered. It did it again in 2009 when it rubbed the lotion on its skin: balance sheet mattered. The feedback loop of Buffalo Bill is oddly similar to what the market reinforces at those junctures. Investors that have been around for many of these remember what they learned, or they know they will get the hose again.

When I say investors, those are the survivors that made it out of the well. You have to look at the ones that didn't survive to understand what you shouldn't do. At the end of the final scene's phone call with agent Starling, Dr. Lecter finishes the call with "I'm having an old friend for dinner." He looks across the street to see a doctor, who had treated him poorly while imprisoned, stepping out of a plane in a third-world location. The line intimated that Dr. Lecter would be exercising his cannibalistic tendencies that night with his former acquaintance.

Bear stock markets are no different. They eat the same prey they always have. They eat the capital of people willing to be sold by Wall Street that believe "it's different this time." They eat the capital of people that are new investors in the stock market who are excited by the prospect of getting rich quickly. They eat the capital of investors who haven't done their homework but have entrusted their investments to "group think" prevalent at the time. Lastly, they eat the most popular investors of that era, as it is rare for them to have the popularity they once had when euphoric eras and manias end.

Stock market failure is on the horizon. We feel like Mark Baum in *The Big Short* at the mortgage brokers conference. When asked if it was a possibility or a probability that his sub-prime loan losses would stop at 5%, the Option One CEO said it was a very strong probability sub-prime loan losses would stop at 5%.

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Mr. Baum followed up the answer by raising his hand with a zero. After being called on again for a question Baum said, "Zero, zero, there is a zero percent chance that your sub-prime losses will stop at 5%." We believe it is a low probability that the S&P 500 Index will make positive nominal returns in 10 years. We also believe it's a zero percent chance the S&P 500 Index will make money in real terms over the next 10 years. Our best guess for the S&P 500 Index (not that it matters) is -2% compounded over the next decade, then subtract your best guess of inflation. We believe this market will eat the capital of investors.

Fear stock market failure,

Cole Smead, CFA

President & Portfolio Manager

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smeadcap.com

2777 East Camelback Road
Suite 375
Phoenix, AZ 85016

Sales Desk US 877.701.2883
Sales Desk UK +44 (0)20.8819.6490
info@smeadcap.com