

RCB Manager Commentary
June 30, 2009

Our last commentary was written within days of what we think in hindsight was both a cyclical and secular low in equity markets worldwide. Oddly enough, this commentary is a lot harder to write. On paper, an environment composed of oppressive news headlines, massive forced selling by hedge funds & global institutions, tremendous market volatility and near zero percent US Treasury bond yields is an ideal setting for a long-term value investor to put money to work, and we did not shy away from the task. Like every investor, our list of “would have, could have, and should have” is long, but on balance we leaned into the wind and added new ideas at superb prices as well as redoubled our efforts in existing positions where our research suggested that the only thing wrong with our work was the current price of the stock. These activities added to our performance which has rebounded nicely on both an absolute and relative basis across all strategies.

The past quarter marked the end of particularly poor absolute and relative performance for the RCB small cap team. We are a relatively concentrated value-oriented manager, and so almost by definition, the possibility exists of short-term differences between what is going on within our portfolio and what is going on around us. This recently concluded period was the second in 16 years - 2002 being the predecessor – where relative and absolute performance were painfully “different” than what might be considered reasonable expectations. While our patience was tested, it was the second time where sticking to our guns and flexibly standing on our research strengths and discipline paid off in the evitable rebound and has set us up for once again continued longer-term success.

With the massive rally in the second quarter, things are now a bit more interesting. While stocks can and historically do have “V-shaped” rallies, global economies tend to follow in a much longer and shallower “U-shaped” fashion. Much valuation work in the midst of a recession is subject to not only the extent of an economic recovery but its duration, and any reader can offer a number of very real reasons why the global economy will legitimately be in a funk for an extended period of time. In certain cases, we have reduced positions where we think that stock prices have truly come too far, too fast in relation to a reasonable assessment of the timing and extent of a recovery in their earnings and cash flow. We also remain very cognizant of the possibility that “peak profitability” of a number of specific companies or industries was a mirage, or at least unsustainable and now is an unobtainable goal. Nonetheless, the key issue in successful long-term investing is equating the uncertainty of the future with a price, and prices in many cases still more than discount a fairly painful future, even after the rally from the bottom. As we always say, good things tend to happen to cheap stocks.



The values in the portfolio are positioned across a variety of offensive and defensive industries and we make no claims of genius on how to resolve the uncertainties mentioned. Our focus remains finding the best combinations of “business, value and people” within the realm of publically traded US equities, and there remains no shortage of possible ideas.

A new position in the Washington Post Company is an excellent demonstration of our discipline and internal work. While the world prefers to see the corporation as a “newspaper” company, the fact is that over half the revenues and in our view, more than 100% of the value of the company is in their Kaplan Learning subsidiary, which is a high margin and double digit growing business whose competitors trade at significant market premiums. Despite our sense that The Washington Post is likely one of three US newspapers to have any value in a digital medium in the long run, its value is barely a footnote to the overall valuation of the company. We see material appreciation in the equity as the market begins to appreciate the difference between “the name” and the underlying value of the education business.

As always, we welcome your comments and inquiries, so please feel free to contact us anytime.

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