ACR
alpine capital research

Media Madness and the Music of Business

The world has gone mad with noise. Not the kind that pounds the eardrum. Worse, the kind that harasses intellect and sensibility. Political pundits, economic seers, pontificating and analyzing, all day, every day, in the 24-hour TV news cycle, on browser and Ipad, blogging, twittering, incessantly. The bottom-line result: very little high probability intelligence, and loads of speculation.

To invest successfully, one must tune out the noise of speculation and tune in the music of business. As fundamental value investors, investment success is contingent not on the fate of the Euro, who is elected President, or what healthcare system we adopt. It is contingent on the businesses one owns and the price paid for them.

Business profits belong to stockholders, so it follows that the proper focus of a stock investor is on the products, markets, management, costs, competition and ultimately, the profits and values of business. Admittedly, if we owned low quality businesses with large debt burdens, or if we overpaid for quality businesses, such a simple, sanguine view would not be possible. But we don't. We own a unique basket of solid businesses purchased at good prices.

Media madness and hyper-reactive markets are in sharp contrast to the steady rhythm of business profits. Below are the company operating profits that a $1 million investment in the ACR EQR portfolio would have produced over the past 10 years.

ACR Portfolio Company Operating Profits - $1 million invested, March 2002*

Mar-03	Mar-04	Mar-05	Mar-06	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12
$71,174	$92,403	$96,845	$100,995	$121,801	$139,664	$117,524	$133,758	$136,687	$142,766

* Includes all ACR portfolio companies owned today that have profits for 10 years. Fairfax profits included in the table above are adjusted lower in 2008 by $1.8 billion pre-tax due to an unusual gain on a credit default swap position.

How do these operating profits translate into real money that a shareholder can spend? Through *total return* from dividends and stock price appreciation. Dividends are paid directly to shareholders each year. Stock price appreciation will track the increase in business profits – holding all else equal and assuming a reasonable price was paid up-front (near intrinsic business value).

However, the noise of stock price volatility can distort the natural increase in stock prices that are produced from business profits in the short-term, even though business profit growth always drives stock price appreciation in the long-term.

The first chart below shows the erratic nature of short-term stock market (S&P 500) and ACR stock portfolio returns. The second chart then shows the reliable drumbeat of business profits manifested in *long-term* ACR portfolio total returns.

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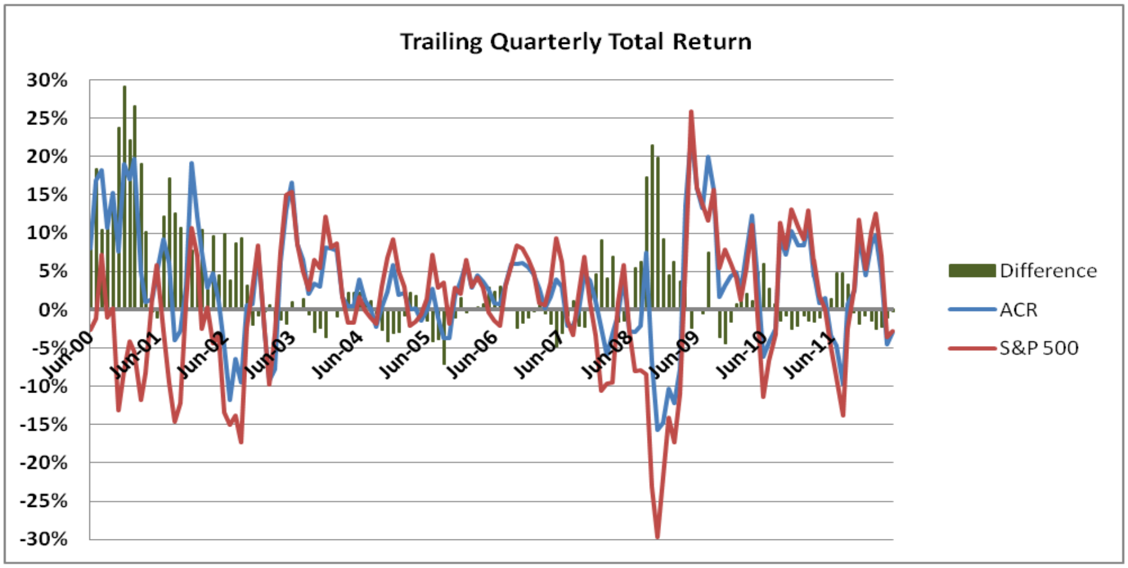

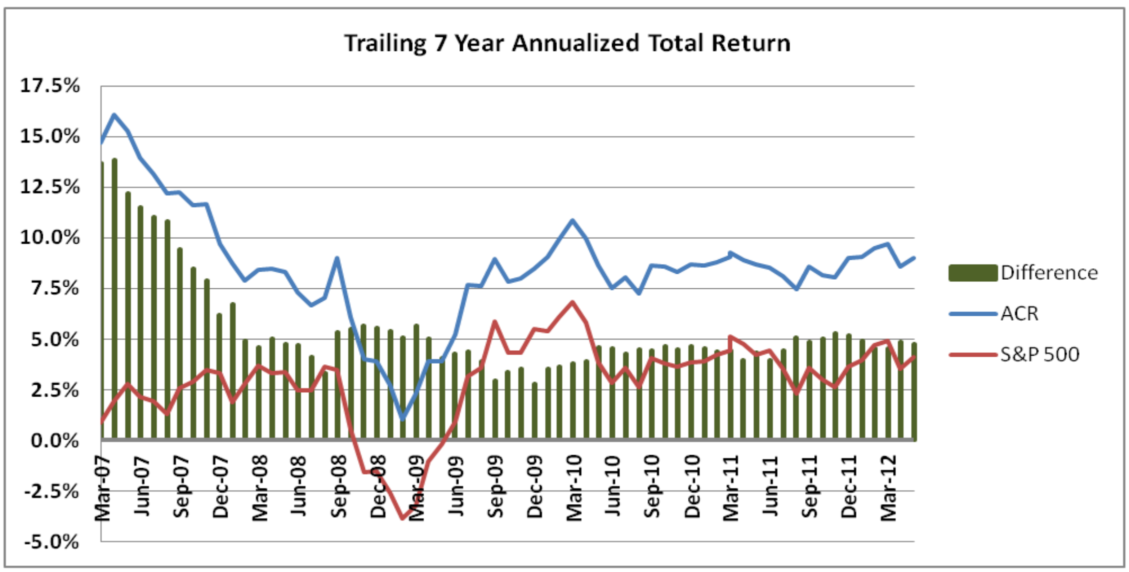

* Total return includes dividends and price appreciation. ACR total return is for the EQR SMA/Advised Composite and represents "pure" gross-of-fees returns, which are net of transaction costs for non-wrap fee accounts and gross of transactions costs for wrap fee accounts. Pure gross-of-fee returns are supplemental information. See our full performance presentation at www.acr-invest.com.

Stock market and ACR short-term "returns" are volatile, unpredictable, and wide-ranging. This is the noise of the market – we don't really consider them returns at all. ACR stock returns over the long-term, defined above as 7 years, are largely satisfactory, while stock market returns are mostly unsatisfactory. ACR returns reflect dividends and business profits of companies purchased at reasonable prices. Stock market returns reflect dividends and business profits of companies that were largely over-valued during this lost decade in the stock market.

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Though ACR's long-term returns are steadier, even long-term returns are subject to sudden and significant changes due to short-term stock price volatility. An increase or decrease in stock prices of 20%, which can easily happen over a year, and has happened several times in a single quarter, can increase / decrease a 7 year return by +2.6% / -3.1% per year. Since we believe the ACR portfolio is selling at approximately 20% below its intrinsic value, we would hope to improve on the annualized returns above, although of course there can be no assurance this will happen.

The poor rolling 7 year stock market returns shown above refute the wisdom that stocks are always a good investment in the long-term. From the stock market peak in 2000, we believe there is likely to be an approximately 20 year period in which the general stock market return is poor. The reason is not the financial crisis. It is that stock prices became wildly over-valued relative to intrinsic business value. The reason the ACR portfolio produced satisfactory returns is that we did not give into high-priced purchases.

It really is that simple: buy good businesses, don't overpay. The key is execution. The investment team is continuing to work hard – turning over lots of stones to find the best values, valuing as many companies as well as we can, and looking for unseen risks in every corner of our portfolio – to help assure that we continue to execute in the years to come.

Nick Tompras
Chief Investment Officer
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IMPORTANT DISCLOSURES

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All statistics highlighted in this research note are sourced from ACR's analysis unless otherwise noted.

It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the examples discussed. You should consider any strategy's investment objectives, risks, and charges and expenses carefully before you invest.

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The Equity Quality Return (EQR) Advised / SMA Composite consists of equity portfolios managed for non-wrap fee and wrap fee clients according to the Firm's published investment policy. The composite investment policy includes the objective of

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providing satisfactory absolute and relative results in the long run, and to preserve capital from permanent loss during periods of economic decline. EQR invests only in publicly traded marketable common stocks. Total Return performance includes unrealized gains, realized gains, dividends, interest, and the re-investment of all income. Please refer to our full composite performance presentation with disclosures published under the performance section of our web site at www.acr-invest.com.

The S&P 500 TR Index is a broad-based stock index including reinvestment of dividends and has been presented as an indication of domestic stock market performance. The S&P 500 TR index is unmanaged and cannot be purchased by investors.

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