THE RUDD COMMENTARY

{ JUNE 2010 }

We are excited to publish this first edition of *The Rudd Commentary*, which will be a monthly web publication designed to bring you a professional opinion on the current investment environment and some developing trends. Since we are in the business of managing investments for our clients, we will focus on information and events that we feel are material to that end. We will not comment on opportunities or challenges relating to specific securities as this would undermine the value we provide for our private clients. With that said, please feel free to forward *The Rudd Commentary* to family, friends, and business associates who might find this information valuable.

THE “F&I CRAM DOWN”

I recently had a family member call me to ask for some help with a car purchase. After doing an exhaustive amount of due diligence, she walked into a car dealership with confidence ready to buy a quality car at a reasonable price. After all, her research had shown a few compelling trends: First, the market for new cars had declined dramatically in the last two years creating an attractive environment to purchase a new car. Second, prices on used cars had risen to "all time highs", making her trade in more valuable. Finally, she had located a vehicle that was documented to have low operating costs and high quality manufacturing at comparatively a low price.

So why did our confident and well informed buyer walk out of the dealership in disgust with no new car when all the variables seemed perfect? In a word...distrust. After our buyer worked with the over-accommodating sales professional to select her ideal car from the lot, she was led to a small room to "work out the details." As most of us have experienced, this operation involved many forms written in legal gibberish, many trips by the "F&I" professional in and out of the room to talk to the sales manager, and quick discussions about insurance products that would make an auctioneer blush. Our buyer felt she was part of a "cram down", being forced to accept an unappealing transaction before she ran out of oxygen in the room.

This story bears a striking similarity to our current economic environment. It is not so much the price/value fundamentals of purchases (investments, insurance, cars, or starting a new business) that are persuading many of us to keep a tight grasp on our wallets; as it is a feeling of distrust in the process and those government officials and "financial experts" involved which raise the perceived risk of the transaction. For example, today many public equity investments are at compelling values from a historical perspective. However, when we turn on the evening news, many of us feel similar to the car buyer sitting in the small, insufficiently ventilated room being subjected to an F&I cram down. We feel we are being sold a basket of economic solutions that we feel have nothing to do with what we are trying to accomplish.

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So what do investors do in an environment like this? One option is to do what our car buyer did and walk out. Choosing not to participate is a choice to sit on our cash "until things get better". We wait out the storm and then take action when the clouds are gone and the sky is blue. The only problem with this strategy is that when things look better, prices are usually higher. Second, we can convince ourselves that "this time it's different" and that even though all our due diligence showed us that we should take a certain action at a certain time, we instead listen to our friend's expert advice (our friend is a plumber) and buy the first claims to Martian real estate (because our plumber

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THOUGHTS

So, how do we apply this new found knowledge of managing our expectations and focusing on fundamentals? First, we must look at the current situation. Here are some fundamental characteristics of the current economic environment...

- » High Unemployment.
- » Historically Low interest rates (meaning the next direction is probably up since we can't go below zero).
- » Massive increase in government spending that will raise our taxes over the long-term.
- » General risk aversion right now among investors to most asset classes.
- » High price volatility among public securities.

Some realistic expectations might be...

- » We might expect investments with regular and rising cash flow (i.e. dividends) to be more attractive over the next several years.
- » Long-term bonds will probably underperform other asset classes when rates rise.
- » Treasuries could end up being a horrible place to be if the economy recovers faster than expected and rates rise quickly.
- » Investments with tax advantages (i.e. municipal bonds) could offer superior returns to comparable taxable investments.
- » Risk seems to be on sale right now (i.e. quality, dividend paying stocks).
- » High volatility = Panic selling = Opportunity to buy something you have had your eye on.

friend informed us that the earth's natural resources will be depleted by 2012 and what's left will be contaminated by oil companies). Third, (and the advice I gave to our well informed car buyer) we can match our expectations to reality, realize that the F&I guy is there to sell us loans and insurance, and talk to the sales manager who just wants the car off his lot. By selecting this option, we have taken action based on good information, diligent research, and we have avoided the stress associated with being let down over high expectations of F&I professionals, government officials, or attorneys. We stop to realize that compensation (whether in the form of money, power, or free BBQ lunches) has a big impact on human behavior.

The key here is to remember that Value = Reality - Public Expectations. While none of us can predict what is going to happen tomorrow, we can use the facts of the situation to try to eliminate the obviously stupid choices. That "simple to say", but "difficult to do" task, is often what separates successful and unsuccessful investors. It is unfortunate that we can't all have a Vulcan Investment Consultant ("Mr. Spock" from Star Trek for the un-initiated), but recognizing our bi-polar nature as investors is the first step to success.

Invest Long and Prosper,

Josh Rudd

VALUE = REALITY - PUBLIC EXPECTATIONS

The Rudd Company, LLC is an independent investment management & consulting company. We provide objective investment advice and customized asset management services for individuals, family offices, and institutions. We specialize in serving clients with unique tax needs, liquidity concerns, and a desire to make a positive social impact with their investment choices.

If you are interested in our services, and have $1 million or more in investment assets, we welcome you to contact us at (877) 605-7833 for more information.