GLOBAL CONTRARIAN RESEARCH REPORT COMPENDIUM

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Featured Companies

Grupo Aeroportuario del Centro Norte (OMAB)
Grupo Aeroportuario del Sureste (ASR)
Viterra, Inc. (VN CN)
Fairfax Financial Holdings Ltd. (FFH CN)

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The Global Contrarian Research Report

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Murray's Musings

Trend Following

According to Bloomberg, as of Friday, August 13, 2010, the 10-year Treasury was yielding 2.67%, the 30-year Treasury 3.86%, the 20-year Inflation Indexed Treasury 1.59%, and the 30-year AAA Municipal Bond 4.31%, which is, of course, an average. One way of looking at the 10-year Treasury is that at a 2.67% yield it has some similarities to buying a stock at 37.45x earnings. Of course, occasionally a stock trading at such a high P/E ratio will have a high enough ROE to justify it. On the other hand, sometimes the business fundamentals are not what have been promised and you can lose a lot of money. With a 10-year Treasury at a 2.67% yield, if worse comes to worst, at least one has the unconditional guarantee of getting back par.

Treasuries can be purchased with enormous amounts of leverage. It's quite common to buy Treasuries with 10x leverage. One has to ask the question, because there are so many people in the world who believe in momentum investing, is this really the peak of the 10-year Treasury yield, or is it possible that the yield curve could flatten? If the yield curve were to flatten, what might happen? Would it be disruptive or would it not?

Momentum investing, or trend following, has become a very sophisticated practice in the last several decades, to the degree that it's beyond my ability to understand. The tools include parabolic stop and reverse (SAR) and mathematical concepts like neural networks in function approximation that I can't begin to properly comprehend. However, I can trace the very long history of trend following. The first trend follower that I've been able to find lived in Japan in the 18th Century and his name was Homma Munehisa, who was a rice trader in Osaka, Japan. Rice trading became popular in Osaka in the early 18th Century because, as opposed to trading the cash product, it occurred to somebody to trade the receipts for future delivery of a product and to do so with leverage. Thereupon was born trading. In 1755, Homma Munehisa, wrote a book in Japanese about trend following. Its title in English is *The Fountain of Gold—The Three-Monkey Record of Money*, for those who want to read such a thing. The other big classic, of course, is the fictionalized version of the life of Jesse Livermore, entitled *Reminiscences of a Stock Market Operator*, which is a classic.[1] There's a book called *The Basis of my Forecasting Method* by William Delbert Gann, who enjoys some renown in the world of technical analysis. He developed what have come to be called Gann Angles, which use a graph to approximate the derivative of a function, if the price action of a stock over time is viewed as a function.

In Japan in the 1870s, they came up with something called Kagi Charts, which has since evolved into a whole science of Japanese technical analysis, and it differs from Western

[1] Lefèvre, Edwin. *Reminiscences of a Stock Operator*.New York: G.H. Doran, 1923; John Wiley & Sons, 1994.

technical analysis. Another method is Ichimoku Kinko Hyo, which is the Japanese technical system developed by a person by the name of Goichi Hosoda in the 1930s, and it is practiced to this very day.

The United States has the famous Elliot Wave, named for its developer, Ralph Nelson Elliot, which makes use of what's known as the Golden Ratio, also called Phi, represented by the number, 1.618…. Basically, if you take a line and bisect it into two parts, the ratio of the larger to the smaller, divided by the ratio of the larger to the entire line segment supposedly equals 1.618…. This irrational number goes on forever. There are five stages in the Elliot Wave. The differential from the fifth wave to the first wave has a breadth of 1.618…, which is phi. The Elliot Wave Principle is based on the Fibonacci sequence, which is basically a series of numbers each of which is the sum of the two preceding numbers. The series begins with 0, 1, 1, 2, 3, 5, 8, 13, and continues to infinity.

The following books are considered the four bibles of technical analysis, of which many copies are sold to this day. The list includes the Magee and Edwards book entitled *Technical Analysis of Stock Trends*, the Elliot Wave Principle as expostulated by Robert Prechter and A.J. Frost, the previously mentioned *Memoirs of a Stock Market Operator*, and the *Market Wizards* series by Jack Schwager. The Schwager books contain very interesting interviews with people who trade. They're worth reading, because they offer an insight into analysis that is completely different from that of people who are given to fundamental investing, like I am. The featured traders come up with all sorts of mathematical principles, some of which come from fractal geometry. They've taken Mandelbrot's fractal geometry and come up with technical trading systems based on it. As I recall, fractal geometry involved the Hurst Coefficient, which is a measure of the relative tendency of a time series to regress to a mean or, alternatively, to cluster in a certain direction. It was developed for the science of hydrology for estimating drought conditions versus flood conditions of a river system. They have a variety of approaches like the Levy-Ito Decomposition. I won't go into the math of it, but its sophistication gives it a certain scientific appearance, which attracts many adherents.

Given the many ways of validating concept and trend following, and given that Treasuries are the most liquid market, bar none, and that it is the asset class permitting the greatest use of leverage, it's not unreasonable to conclude that the yield curve might really flatten. It is especially so now, since the Federal Reserve has made it very clear that it will buy Treasuries, and some of those purchases will be at the longer end. Therefore, it's hard to imagine that the trend followers are going to ignore that catalyst.

Industry Thoughts

Intermediate Goods Producers

I'm going to invent an industry that I believe should exist. Most industry categorizations are based on the definition of a product; for example, there are food producers, utilities and banks, which produce a service rather than a product. However, another way of looking at industries is to look at the customer rather than the product. What type of customer does the industry have? In that sense, I would argue that there is an industry called the intermediate goods producers, which make raw material into some type of intermediate product. That product is in turn sold to a larger company to become a finished product sold directly to the consumer.

There are quite a few intermediate goods producers, and they span a wide variety of industries. I'll mention six examples to provide a sense of how many intermediate goods producers there are. The first is Sanmina-SCI (SANM), which is a custom manufacturer of components in the computer industry. The second is Ducommon Inc. (DCO), which provides specialized electronic components, usually for the cockpits of Boeing and Airbus aircraft. The third is Lear Corporation (LEA), which is classified in the automotive group, but it supplies automotive seating systems. The fourth is Sensient Technologies Corp. (SXT), which is in the food group, technically speaking, because it supplies flavors, fragrances and food coloring to the big food manufacturers. The fifth is Mine Safety Appliances Co. (MSA), which is clearly a company in the mining industry, but it supplies equipment to mining companies, including gas masks, head protection, gas detectors, thermal cameras. The sixth, and last, example is Alliance One International, Inc. (AOI), which is a processor of tobacco. It sells processed tobacco to Philip Morris International, Altria, Reynolds and like companies.

One of the characteristics of the intermediate goods producers, especially in the last two decades, is that they're not infrequently losing money. The extreme example of that is Sanmina-SCI, as can be seen on the table below that lists the company's profit margins from the year 2000 to the year 2009.

Net Profit Margin (%)

Sanmina-SCI Corp. (SANM)	
2009	(2.6)
2008	(6.8)
2007	(15.9)
2006	(1.3)
2005	(8.8)
2004	(0.1)
2003	(1.3)
2002	(30.8)
2001	1.0
2000	4.9

Source: Company Reports

For the last eight years, Sanmina-SCI has lost money. That's important to note, because it's preposterous to assume that the mission of Sanmina-SCI would be to lose money while producing components for computer companies like Dell and Hewlett-Packard. At some point, Sanmina-SCI will exhaust its funds, or it will exhaust its patience with the larger suppliers, at which point it will demand a profit. In fact, that is what's happening right now.

The last time Sanmina-SCI earned a profit was in the year 2001, the post-internet bubble period, and the net profit margin was near 1.0%. That has major implications for the larger companies, because if suppliers, some of which are private companies, are unwilling to continue their past practices, either the larger companies have to pass on a higher component price to their customers, which has certain negative ramifications, or they would have to absorb the higher costs in their profit and margins, that is if there are going to be higher costs.

The next table shows the profit margins of four Sanmina-SCI competitors, specifically, Jabil Circuit Inc., Flextronics International, Plexus Corp. and Benchmark Electronics. Looking at the various years, for a very large proportion of time these companies have lost money. Even during those periods when they haven't lost money, they produced very slender profit margins. It's simply not reasonable to assume that this situation is sustainable.

Net Profit Margin of Sanmina-SCI Competitors (%)

Jabil Circuit Inc. (JBL)		Flextronics International (FLEX)		Plexus Corp. (PLXS)		Benchmark Electronics (BHE)	
2009	(9.97)	2009	0.1	2009	2.9	2009	2.6
2008	1.05	2008	(19.8)	2008	4.6	2008	(5.2)
2007	0.60	2007	(2.3)	2007	4.3	2007	3.2
2006	1.60	2006	2.7	2006	6.8	2006	3.8
2005	2.71	2005	0.9	2005	(1.0)	2005	3.6
2004	2.67	2004	2.2	2004	(3.0)	2004	3.5
2003	0.91	2003	(2.4)	2003	(8.4)	2003	3.0
2002	0.98	2002	(0.6)	2002	(0.5)	2002	2.2
2001	2.74	2001	(1.2)	2001	3.7	2001	(4.3)
2000	4.09	2000	(3.7)	2000	5.3	2000	1.2

Source: Company Reports

If the same kind of table were prepared for the other five previously mentioned intermediate goods producers, they would be similar to the ones above. In just about every industry, the margins and the returns on equity of the leading companies supplying the end user are about as high as they've ever been in history. One commonly held belief is that the leading companies have become supremely efficient, and there's much truth in that. However, behind that supreme level of efficiency also stand the low profit margins of all the suppliers. That circumstance is a 20- or 25-year departure from history that might be beginning to reverse itself, as will be seen in the discussion of Viterra in the *Featured Companies* section.

Facts & Figures

Government & Household Debt

This section will feature data from the websites of the U.S. Treasury and the Federal Reserve. In the appendix of this report can be found some tables from the Federal Reserve website that show how leveraged the United States has become in one sense. The first three tables in the appendix that are labeled D.1, D.2 and D.3, are titled *Debt Growth by Sector*, *Borrowing by Sector* and *Debt Outstanding by Sector* respectively. In these tables one can view the growth rates in percent terms, as well as the absolute magnitude, of the billions of dollars that various sectors of the economy have borrowed. Of course, the leading culprit is the Federal government. From that standpoint, if the United States were viewed as a company, it would be a very leveraged one. According to the U.S. Treasury, public debt as of September 29, 2000 was over $3.4 trillion. That's not the total debt of the United States; it is merely the publicly held debt issued by the U.S. Treasury, as opposed to obligations to the Social Security Administration. That figure had grown to almost $8.8

trillion as of August 12, 2010, and it may well be $8.9 trillion, by the time these words are printed. That's a rise of 158% in nearly 10 years, or an almost 10% annual rate of growth, which is not possible to sustain.

There's another way of looking at the debt figures that people should find equally fascinating. The fourth table from the Federal Reserve that can be found in the appendix of this report is entitled *Household Debt Service and Financial Obligations Ratios*. This table refers specifically to households. It breaks out the debt and financial obligations of renters of dwellings, versus owners of property, meaning those that have mortgages. In the first quarter of 2010, which is the last period of time for which information is readily available, the percent of disposable income, on average, for homeowners towards sustaining their mortgage and the associated cost was 10.52% for the mortgage itself, and 15.93% for the total, which includes property taxes and insurance.

Let's assume that the peak of the housing bubble, meaning its worst time, was in the third quarter of 2007. The total mortgage-related debt expenses for the homeowner in the third quarter of 2007 were 17.58%. The high figure for that bubble was recorded in the first quarter of 2008 at 17.64%. In more normal times, and we'll define more normal times to be the mid-90s, let's say the fourth quarter of 1995, the comparable figure was 14.80% and in the fourth quarter of 1997, the comparable figure was 14.95%. It didn't exceed 15% until the fourth quarter of 2000, and it didn't exceed 16% until the fourth quarter of 2002.

As of the first quarter of 2010, the most recent reckoning, the comparable expense figure for people who rent their dwelling was 24.21%. Clearly, the difference between that figure and the 15.93% for those with mortgages is powerfully influenced by lower mortgage interest rates. If rates were higher, it might be a very different number. It's interesting to observe that when rates were tremendously higher in 1980, the total figure for those homeowners with mortgages was 13.90% in the first quarter of that year. When rates were very high, people paid a lot less for homes.

There's a certain component of the United States that is highly leveraged and is unable to afford a home; and there's another component, obviously very large, that's not very leveraged at all. The sum leverage statistics are a bit misleading, because there are savers and there are borrowers. One can't generalize the behavior of the groups together, because they're very different in terms of what their obligations really are and they might behave very differently in the future.

How They Did It

Tales of the Greatest Investors of All Time

Leverage: Jesse Livermore

This section normally focuses on an individual person, but in this issue it is more about the use of leverage. As noted in the *Musings* section, Jesse Livermore's life was fictionalized in *Reminiscences of a Stock Market Operator* by Edwin Lefèvre. [2] According to that record, Livermore went bankrupt four times in his career. The last occasion was in 1940, after which he committed suicide in the Sherry Netherland Hotel. An abbreviated history of Livermore's life appears in his *Time* magazine obituary.[3] It's interesting if one studies the fictionalized version of Livermore's life, he was a person who undertook to control portfolio risk by the mechanism of the stop loss. If there's anything a reader should take away after reading Lefèvre's book, it is that one should not hold a losing position; one should cut one's losses.

One might ask how Livermore, who used stop orders to curtail losses, could go bankrupt four times. The answer is that he traded using very substantial leverage, and he didn't trade stocks; he traded commodities. Under those circumstances, a very small loss in nominal terms, after adjustment for debt, can be a very substantial loss that can lead to bankruptcy. Whenever markets experience what academicians might call a discontinuous market function—meaning it closes at one price and opens at another price, so the trader doesn't have the opportunity to react— it's not unlikely that one who has employed sufficiently high leverage could go bankrupt. Mr. Livermore had that experience four times.

Nevertheless, in the copious literature on financial analysis regarding the greatest investors and traders of history, there's remarkably little discussion of leverage. For example, let us take the recent biography of Warren Buffet, entitled *The Snowball: Warren Buffet and the Business of Life* by Alice Schroeder.[4] The index of that book has only 17 references to the perils of debt. Of course, debt does have its perils, but any regular reader of the Berkshire-Hathaway Annual Report must realize that as large as the returns of that company are, to a fair extent they are attributable to the use of float. There are many annual reports in which Warren Buffet illustrates how important float is to the company's returns, and float is a certain form of debt.

As important as the idea of float is, in Schroeder's biography, which is a very large book of over 800 pages, there are only six references to float in the index. On page 317 there are two paragraphs on float; on page 395 there's one paragraph on float; on page 397 there are two paragraphs on float; on page 479 there's one paragraph on float; and on page 833 there

[2] Lefèvre, Edwin. *Reminiscences of a Stock Operator.*New York: G.H. Doran, 1923.
[3] "Business: Boy Plunger." *Time Magazine* 9 Dec. 1940.
[4] Schroeder, Alice. *The Snowball: Warren Buffett and the Business of Life*. New York: Bantam Books, 2008.

is a portion of one sentence devoted to float. There's also a reference in the index that cites float on page 834, but I could find no such reference on that page. By my reckoning, there are five references to float, which is very little elucidation for a reader on how important it is to the returns of Berkshire Hathaway.

Similarly, in the book by Jack Schwager entitled *Stock Market Wizards*, which is a compilation of interviews with the greatest traders of all time, the index has one reference to debt and six references to leverage (pages 49-50).[5] Those references include a discussion on borrowing stocks to sell short, which is a different kind of debt. On page 101, there is reference to the inherent leverage, if one can call it that, of collecting a performance fee. Page 165 includes an oblique reference to borrowing money, and page 199 has a reference to the occasional 140% exposure on behalf of one trader. As far as I can find, the first bona fide reference to leverage is on page 223, but it's less than one paragraph. On page 308 there are two sentences on the danger of leverage. It's interesting that traders typically like to employ futures instrumentalities, not merely for their liquidity, but also because they have inherent leverage properties.

I consulted both the 1992 and 2008 editions of Jack Schwager's *The New Market Wizards*, and neither has an index.[6] It's very difficult to find any references to leverage in the book. I can't guarantee that there are none, but I couldn't find any that are meaningful. In both the 1989 and 2006 editions of the original *Market Wizards* book, I could find no meaningful references at all. Only in a book entitled *Lombard Street* written by Walter Bagehot in 1873 did I find a detailed explanation of how leverage is used in the economic system, not merely for trading, but in commerce generally. That book could've been written last week, although it's in a much more elegant English style than that used at the current time. I'll end this section with the best quote from *Lombard Street*: "The greatest pleasure in life is doing what people say you cannot do." I think it applies to leverage as well.

[5] Schwager, Jack D. *Stock Market Wizards.* New York: HarperCollins,1989, 2003.
[6] Schwager, Jack D. *The New Market Wizards: Conversations with America's Top Traders.* New York: HarperCollins, 1992, 2008.

Featured Companies

Grupo Aeroportuario del Centro Norte, S.S.B. de C.V. (OMAB)

This Mexican company operates 13 airports, the seven most important of which are Monterey, Acapulco, Mazatlan, Chihuahua, Durango, San Luis Potosi and Tampico. It trades in the U.S. in the form of ADRs at a P/E ratio of 13.4 times estimated 2011 earnings. The earnings estimates are largely a function of what people think traffic will be in the airports, because the rental income is a function of that traffic. The willingness of retailers to commit to leasing property in an airport is a function of how much traffic is projected to come through that airport. This company has a $512 million market capitalization, and it yields 5.34%. The airports are expanding. In the month of June, the company opened Terminal B in Monterey. That expansion is large enough to change the dynamics in the Monterey airport, but it is not enough to change the statistical dynamics of the company itself, although at the margin it should be helpful.

To give one a sense of the passenger statistics, in the six-month period from January to June 2009, the total number of passengers through all of the terminals was 5.75 million. For the same period in 2010 it was slightly reduced to 5.675 million. The recent figures from the International Air Transport Association show that air travel for virtually every place in Latin America is dramatically increasing. It's not unlikely that the numbers for 2010 will be larger than for 2009. The table below lists the historical annual passenger traffic at Grupo Aeroportuario del Centro Norte.

OMAB Historical Yearly Statistics *(in millions)*

2005	10.6
2006	11.8
2007	14.2
2008	14.1
2009	11.5

Source: Company Reports

The current cycle is clearly a soft one in the sense that it's vulnerable to economic downturns. Over the long run, however, air travel is likely to grow in the various Latin American airports, and these are monopoly businesses. Normally, one values a cyclical in regard to normalized earnings and normalized returns on equity. The current P/E ratio on this company indicates that the investment community assumes that the current earnings are the normalized earnings as opposed to being unduly cyclically depressed earnings. If one were to suppose that the passenger traffic would one day rise to the 2007-2008 figures, even if it were two or three years from now, this company's earnings would be vastly in excess of those currently being forecasted. If that were to happen 36 months from now, if one were to forecast that the earnings would rise by that degree, and apply the same or

even a lower multiple than exists today, one would have a very large rate of return for a three-year hold, and it may not take three years.

Grupo Aeroportuario del Sureste, S.S.B. de C.V. (ASR)

Grupo Aeroportuario del Sureste is another Mexican airport operator, which is actually cheaper and more interesting in a sense than Grupo Aeroportuario del Centro Norte. Like Centro Norte, Sureste trades in the U.S. in the form of ADRs. The P/E of this company is 11.25 times estimated 2011 earnings and it yields 4.21%. It's actually meaningfully less expensive than Centro Norte, and its market capitalization is larger at $1.35 billion, which is actually not large for an airport. It operates nine airports, the most important of which are Cancun, Cozumel, Veracruz, and Villahermosa. Unlike Centro Norte, the passenger traffic at Sureste has been rising dramatically throughout the year. Year-to-date as of June 2009 there were 9.655 million passengers, while year-to-date through June 2010 there were 10.612 million. That's almost a 10% rate of growth. That growth has influenced the analysts to the degree that they've raised their estimates, yet the investment community has not raised the stock price. All that's happened is that the earnings are more robust and, therefore, the P/E multiple applied to this enterprise is lower.

If one isolates the second quarter of 2010 figures, as opposed to year-to-date, the numbers are a little more dramatic, with traffic up nearly 27%. In the case of this company, there is also a fair number of new retail and commercial leases being signed. Those new long-term leases signal that there are entrepreneurs who are confident about traffic growth at this airport. The lease income would cause the earnings to be more robust than they were previously, and that's apart from what might happen to traffic. This company has the very high margins that one would expect from a monopoly-type business. Even with the current volume figures, low as they are because of the recession, this company boasts a 33% net income margin. That's the kind of margin that you get with a real bona fide business franchise with monopoly characteristics, which this one has. It also has an almost debt-free balance sheet, and equity represents 83% of total assets. Unlike some airports in the world, it doesn't even have leverage to discuss as a risk factor. Therefore, this company is recommended.

Chinese Airports

Q: *In light of the comments you made on the Mexican airport companies, do you have any kind of updates on the Beijing Airport (694 HK) and the Hainan Meilan Airport (357 HK)?*

A: In the case of Beijing, the issue there is that they have to grow into the new terminal. The new terminal has vastly expanded capacity. Even though the traffic is growing at a fairly robust clip, the expansion of the airport was designed to embrace what might be growing traffic for the next decade. In this case, as the revenue increases from the growing passenger traffic, the operating costs do not increase proportionately, and the earnings rise

disproportionately. In a normal environment, the market would discount that; in the current environment, the market won't even discount what's happening with the Mexican airports where it's even more near term. In other words, the equity yield curve is extraordinarily steep at the moment.

In the case of the Hainan Meilan Airport, the traffic there has been even more robust, and they haven't expanded that airport. The P/E multiple is even lower and the stock's done slightly better, but the best you can say is that it is only slightly better. Again, the market doesn't discount that. However, the market is beginning to discount the increased load factors of the various Chinese airlines, including China Southern Airlines, China Eastern Airlines and Air China; they are clearly being discounted. Therefore, the Chinese airline industry is on the road to fairly robust profitability, and it seems that the airports should be a better business with higher valuations that will follow in due course.

Viterra, Inc. (VN CN)

Viterra is a Canadian grain storage company that also produces fertilizer, seed and crop protection products. With a 45% market share, it is the largest grain handler in Canada in terms of owning grain elevators, which are used to store grain after it's been harvested. In Australia, Viterra is one of the largest wool brokers and also one of the largest grain elevator companies in that country. It's one of the world's largest processors of oats, which makes it an intermediate goods producer of the type discussed in the *Industry Thoughts* section of this report. This is an example of the type of company that takes title to the raw material produced by the farmer, processes it to some degree, and then sells it to a food company for further production into a branded consumer product.

The history of this company goes back to the Great Depression when grain prices were so low that the farmers in Canada were at the mercy of the owners of the grain elevators. The terms of trade were against the farmers and in favor of the grain elevators. As a result, various provinces in Canada formed what were known as wheat pools, which were essentially cooperatives that were designed to own the hard assets like the grain elevators and operate them at breakeven. That's what was done for many years until, in the 1990s, the various provincial governments began to experiment with the privatization of the wheat pools and converting them into for profit enterprises.

Running the grain elevators at breakeven was clearly impossible to continue, because it meant that the companies couldn't accumulate enough capital for the replacement or enhancement of the grain elevators. Only a profit would enable the companies to bring their equipment up to date.

In 1996, Saskatchewan privatized its wheat pool and it became a publicly traded stock known as the Saskatchewan Wheat Pool. The province of Alberta also had a wheat pool,

and there was also a company called Agricore. In the late 1990s, these companies operated at very low profit margins, because the branded food companies would play them against one another. For example, one could buy processed oats from the Saskatchewan Wheat Pool or the Alberta Wheat Pool, but not both. Therefore, for many years the wheat pool profit margins were miniscule.

In early 2000, the various wheat pools began to merge and modestly resist the pricing pressure. The first of the mergers occurred in 2002 when Agricore merged with the Alberta Wheat Pool. In 2007, the Saskatchewan Wheat Pool merged with Agricore. About a year ago in 2009, the Saskatchewan Wheat Pool, now known in its merged sense as Viterra, merged with ABB of Australia, which was formerly known as the Australian Barley Board.

In its history, Australia had practiced a policy that was very similar to that of Canada. The Australian Barley Board had previously merged with the Australian Bulk Alliance, which itself was partially controlled by Sumitomo, the big Japanese trading company. Over the years, the Australian Barley Board had bought some wool processors, including Adelaide Wool, Wardle & Company, and Stawool. They formed an alliance with a private French company called Groupe Soufflet that does the same sort of thing around the world. (The name 'Soufflet' has nothing to do with the cooking of that dish.) It's a family-owned company that happens to be the largest malting company in the world.

All that background is necessary in order to understand what's going on with Viterra, which now trades at 90% of book value and still has fairly low profit margins. It has a current return on equity of 3.2%, which is an improvement vis-à-vis its history, since in 2001 and 2006 the company actually lost money. However, it has a much better balance sheet right now, with $500 million of cash, and it has reduced its debt-to-capital ratio to 27.42%. It keeps buying processors in its business and is aligning itself with much larger private companies.

For example, in the field of malting, it now owns a 42% interest in a company known as Prairie Malt in partnership with Cargill. Sixty days ago, it bought Dakota Growers in the United States, which is a miller of durum wheat for pasta. It also announced very recently that it is buying 21st Century Grain in Nebraska. There's major consolidation going on in the intermediate producing realm with a goal not merely of achieving a certain economy of scale, but also for the elimination of certain competitive factors, both of which it clearly is accomplishing. Its ultimate end objective is to attain a much better bargaining position vis-à-vis the branded food companies. Achievement of that goal has implications not merely for Viterra itself, which we think is undervalued, but ultimately for the branded food companies as well.

If Viterra can earn a 12% return on equity on its current book value, that's enough to get it to trade at a reasonable premium to book value, and that's all that's required for one to earn

a fairly robust rate of return on this investment. Since this company is seriously undertaking actions to achieve that goal, which represents an enormous departure from its past, it is recommended for purchase.

As a footnote to this commentary on Viterra and the consolidation in its industry, there's a large Canadian agribusiness company called Agrium that is trying to buy AWB, formerly known as the Australian Wheat Board, which trades on the Australian Stock Exchange. GrainCorp, which is also an Australian company, had previously made an offer for AWB, but Agrium is offering a premium. They've all been consolidating, and ultimately there will be only a handful of companies in this field, which is one of the reasons we recently recommended Archer Daniels Midland and Bunge. Theoretically, when you have a company that operates at very low profit margins, let's say of 1%, the movement to a 2% or 3% profit margin is a doubling or a tripling of earnings. Slight improvements in bargaining position and in profit margin from increased efficiencies are enough to create a very sharp advance in earnings and, therefore, a sharp advance in the stock price.

Fairfax Financial Holdings Ltd. (FFH CN)

Fairfax Financial is an insurance company that trades at a modest premium to book value. It is known as the Berkshire Hathaway of Canada. As successful as it has been historically, one wonders why Fairfax Financial only trades at a 10% premium to its own book value. The answer is that investment companies of this type are not readily analyzable, because they don't engage in a definable business with predictable characteristics. They may have a definable investment philosophy but, like every company in this form, it has unpredictable investment moves. For example, under the leadership of Prem Watsa, this company started shorting the subprime mortgage group in 2003. Towards that end, it purchased a credit default swap on 20 to 30 companies active in that field with an $18.5 billion notional value at a cost of about $350 million.

Ultimately, that investment proved very remunerative and the company probably made about a $1 billion dollar profit. That was a near tripling of its investment yet, if one looks at it from a notional standpoint, it's not even a 10% move. The reason for that is related to the interesting saga of Fairfax Financial from 2003, when it commenced that investment, to 2007, when it looked like that investment would begin to bear fruit. During that time, the company did nothing other than lose money on that investment, although it's hard to believe at this stage of history, because the company remained a disciplined, long-term investor. During the years between 2003 and 2007, there were more than a few who were interested in selling short the shares of Fairfax Financial. To understand how valuable that short was considered to be, one need only look at the put option premiums on Fairfax Financial at that time. At various points during that period of history, Fairfax Financial had a fairly substantial loss on its CDS position, both on a cost basis and on a notional basis. If that position had been marked to market, it would have represented a fair degree of erosion of its equity capital. The view at the time was that Fairfax Financial was not properly

capitalized, which is intriguing because it was shorting various subprime mortgage participants, many of which were represented by the CDS, and which were all considered to be properly capitalized and prudent as far as risk control goes.

In any event, that history explains why companies of this type trade at low valuations at the moment. Fairfax Financial actually has a superb investment record, with a book value compound annual growth rate of 25.7% from 1985 to 2009. At the moment, it owns $3.7 billion worth of common stocks, and its equity exposure is 93% hedged with swaps. Fairfax Financial is recommended, because the valuation accorded the company is not commensurate with the record it has produced over time.

Fairfax Financial Holdings

Year	Inc/(Decr) in Book Value Per Share	Book Value Per Share	Year	Inc/(Decr) in Book Value Per Share	Book Value Per Share
1985	-	$ 1.52	1998	30.4%	112.49
1986	179.6%	4.25	1999	38.3%	155.55
1987	48.2%	6.30	2000	-4.8%	148.14
1988	31.1%	8.26	2001	-21.0%	117.03
1989	27.1%	10.50	2002	7.0%	125.25
1990	41.3%	14.84	2003	30.7%	163.70
1991	23.9%	18.38	2004	-60.0%	162.76
1992	0.9%	18.55	2005	-15.5%	137.50
1993	42.3%	26.39	2006	9.2%	150.16
1994	17.7%	31.06	2007	53.2%	230.01
1995	25.2%	38.89	2008	21.0%	278.28
1996	62.8%	63.31	2009	32.9%	369.80
1997	36.3%	86.28			

Source: Company Reports

From the Readers

Forestar Group Inc. (FOR)

Q: *What are your thoughts on Forestar Group Inc.?*

A: Forestar basically consists of three parts: property, natural resources and fiber resources. The property company is the only one that I follow, and there's no question that it's undervalued, but that's a function of real estate in general. When a company has a real estate asset that is either dormant in the sense that it isn't developed, or is quasi-dormant in the sense that it earns a rate of return that is subpar, the market values it on its current characteristics, without regard to any potential it might have in the future. That situation is in accordance with the equity yield curve. The realization of value, at least according to the typical equity investor, is so far in the future that it requires a very high discount rate. In other words, the investor is paid to hold the dormant or quasi-dormant asset. That's really the value of Forestar. It's not possible to know when the asset value might be realized, because the real estate market itself is so depressed, and one can't forecast what the management might do. However, there's no question that it's undervalued.

Money Manager Index

From Jan 1983 to July 2010

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Yr. End	Index	Yearly return	Annualized return (since inception)
1983								1.00	0.81	0.76	0.87	0.75	1983	0.75	(60.5)%	(50.2)%
1984	0.75	0.71	0.70	0.66	0.67	0.67	0.61	0.83	0.79	0.76	0.67	0.65	1984	0.65	(13.5)%	(26.5)%
1985	0.92	0.93	0.99	0.95	1.20	1.30	1.32	1.38	1.28	1.50	1.86	2.02	1985	2.02	211.8%	33.7%
1986	2.46	2.78	2.47	2.31	2.36	2.33	2.03	2.23	1.98	2.37	2.34	2.34	1986	2.34	15.9%	28.2%
1987	3.21	3.27	3.16	2.55	2.37	2.30	2.39	2.47	2.22	1.56	1.44	1.52	1987	1.52	(35.0)%	9.9%
1988	1.80	1.87	1.78	1.79	1.69	1.94	1.92	1.96	2.01	1.97	1.95	2.07	1988	2.07	36.0%	14.3%
1989	2.42	2.37	2.54	2.63	2.64	2.64	2.93	3.12	3.07	3.05	3.23	3.26	1989	3.26	57.8%	20.2%
1990	3.12	3.15	3.53	3.06	3.47	3.45	3.30	2.70	2.68	2.40	2.52	3.02	1990	3.02	(7.3)%	16.1%
1991	3.08	3.49	3.70	3.68	3.71	3.61	3.86	4.05	4.07	4.69	4.47	5.72	1991	5.72	89.4%	23.0%
1992	5.76	5.61	5.30	5.12	4.98	4.99	5.93	6.06	6.19	6.56	7.25	7.36	1992	7.36	28.6%	23.6%
1993	8.06	8.04	8.20	7.94	8.15	8.57	9.05	10.00	9.99	9.31	8.97	8.90	1993	8.90	21.0%	23.4%
1994	9.52	8.73	8.05	7.85	7.81	7.53	7.66	8.31	8.15	8.52	7.88	7.95	1994	7.95	(10.6)%	19.9%
1995	7.74	8.38	8.72	8.77	9.20	9.35	9.93	10.78	11.22	10.53	10.89	10.40	1995	10.40	30.8%	20.8%
1996	11.12	11.50	11.33	11.62	11.86	12.53	11.91	12.36	13.32	14.03	14.42	15.02	1996	15.02	44.4%	22.4%
1997	16.04	16.81	15.32	17.27	18.42	20.29	22.28	21.39	25.31	24.95	24.95	25.50	1997	25.50	69.8%	25.2%
1998	25.67	29.00	29.89	30.60	28.90	30.44	27.67	21.33	21.74	25.16	27.27	25.41	1998	25.41	(0.4)%	23.3%
1999	26.00	23.71	23.92	26.77	28.94	29.74	28.78	26.74	25.89	27.73	28.54	30.55	1999	30.55	20.2%	23.2%
2000	31.07	31.19	36.01	35.60	35.20	40.32	43.58	45.75	45.62	48.69	44.05	49.84	2000	49.84	63.1%	25.2%
2001	50.23	46.41	44.27	46.96	48.90	49.98	50.67	49.70	46.47	44.81	48.04	51.91	2001	51.91	4.2%	23.9%
2002	53.62	53.74	55.11	52.52	52.83	50.48	42.58	44.92	41.54	42.66	45.78	43.17	2002	43.17	(16.8)%	21.4%
2003	42.72	41.18	42.36	45.98	49.02	50.71	53.47	53.97	53.46	56.12	55.83	58.49	2003	58.49	35.5%	22.1%
2004	64.38	65.08	64.63	61.68	60.86	62.30	58.71	64.08	65.73	68.86	73.53	78.16	2004	78.16	33.6%	22.6%
2005	76.46	77.94	74.06	72.83	77.02	80.25	83.59	83.07	86.03	89.19	96.58	97.35	2005	97.35	24.6%	22.7%
2006	107.62	111.44	110.75	111.88	101.89	100.61	100.62	104.98	114.61	116.64	113.78	118.05	2006	118.05	21.3%	22.6%
2007	125.73	123.77	122.62	127.58	133.57	134.68	126.61	124.07	133.57	148.09	135.13	135.56	2007	135.56	14.8%	22.3%
2008	127.53	115.76	115.94	121.58	130.51	115.68	119.94	120.55	109.69	72.70	62.95	67.91	2008	67.91	(49.9)%	18.1%
2009	57.51	51.76	65.63	79.49	85.67	90.79	99.97	101.69	107.32	107.36	110.94	115.01	2009	115.01	69.4%	19.7%
2010	106.84	110.32	118.13	114.91	100.179	88.170	97.650							97.65	(15.1)%	18.5%

Name	Amount Invested	Name	Amount Invested
Affiliated Manager	$ 22,947	Pzena Investment Mgt	$122,426
Alliance	$ 7,633		
BlackRock	$ 23,205		
Waddell & Reed	$ 27,513		
Eaton Vance	$ 2,641		
T. Rowe Price	$ 2,423		
Franklin resources	$ 908		
Legg Mason	$ 1,000		
Federated Inv	$ 26,381		

International Money Manager Index

From Jan 1983 to July 2010

Year	31-Jan	28-Feb	31-Mar	30-Apr	31-May	30-Jun	31-Jul	31-Aug	30-Sep	31-Oct	30-Nov	31-Dec	Yr. End	Index	Yearly return	Annualized return (since inception)
1986											1.00	1.02	1986	1.02	10.0%	10.0%
1987	1.25	1.37	1.48	1.48	1.37	1.33	1.39	1.40	1.33	0.81	0.76	0.73	1987	0.73	(27.7)%	(23.3)%
1988	0.75	0.92	1.02	0.95	0.80	0.89	0.88	0.82	0.86	0.88	0.89	0.93	1988	0.93	26.4%	(3.4)%
1989	1.03	1.02	1.06	1.17	1.19	1.18	1.25	1.16	1.17	1.20	1.21	1.28	1989	1.28	37.8%	8.1%
1990	1.24	1.24	1.18	1.19	1.22	1.24	1.26	1.26	1.23	1.24	1.25	1.33	1990	1.33	3.7%	7.0%
1991	1.34	1.52	1.56	1.58	1.57	1.47	1.52	1.64	1.81	1.89	1.94	1.92	1991	1.92	44.8%	13.5%
1992	2.01	1.93	1.88	2.14	2.19	2.13	2.08	1.99	1.95	1.77	1.76	1.96	1992	1.96	1.9%	11.5%
1993	1.98	2.03	2.20	2.39	2.42	2.45	2.54	3.05	3.01	3.07	3.01	3.30	1993	3.30	68.7%	18.1%
1994	3.72	3.39	3.17	3.04	2.99	2.89	3.01	3.14	3.13	3.19	3.15	3.15	1994	3.15	(4.7)%	15.1%
1995	3.07	3.12	3.28	3.41	3.56	3.59	3.87	3.76	3.76	3.77	3.70	3.73	1995	3.73	18.6%	15.4%
1996	3.76	3.85	3.70	3.79	3.96	3.90	3.75	3.96	4.16	4.47	4.90	4.86	1996	4.86	30.3%	16.8%
1997	5.11	5.37	4.99	4.96	5.43	5.94	6.57	6.32	7.45	7.24	6.80	7.19	1997	7.19	47.9%	19.3%
1998	7.12	8.05	8.78	9.25	8.95	8.74	8.91	6.67	6.08	7.01	7.51	7.71	1998	7.71	7.3%	18.3%
1999	7.99	8.21	8.68	9.07	8.71	8.61	8.63	8.43	8.47	8.79	9.80	10.79	1999	10.79	39.9%	19.8%
2000	11.23	12.27	13.95	13.50	13.73	15.39	15.85	16.82	17.07	16.31	14.43	16.76	2000	14.43	33.8%	20.7%
2001	17.42	15.88	13.46	15.14	15.84	15.15	14.21	13.61	10.77	11.43	13.90	14.12	2001	14.12	(2.2)%	19.1%
2002	14.74	13.78	15.09	15.11	16.38	14.14	12.92	12.10	11.23	11.06	11.33	10.50	2002	10.50	(25.6)%	15.7%
2003	10.18	9.52	9.69	10.62	12.17	13.04	13.98	15.38	16.67	17.88	18.16	18.07	2003	18.07	72.1%	18.4%
2004	20.00	22.41	29.98	35.46	26.68	30.80	25.37	25.20	23.67	23.34	27.56	31.48	2004	31.48	74.2%	20.9%
2005	32.19	32.57	31.88	27.79	27.36	29.05	30.38	31.49	33.39	32.24	32.95	37.18	2005	37.18	18.1%	20.8%
2006	41.01	40.97	43.69	46.45	42.39	41.58	40.60	43.32	43.55	43.70	44.58	49.38	2006	49.38	32.8%	21.3%
2007	50.95	51.18	53.59	56.09	58.16	56.37	53.90	48.65	50.96	57.03	48.21	45.75	2007	45.75	(7.3)%	19.8%
2008	38.71	39.71	38.59	40.18	39.25	35.10	34.59	33.33	26.09	18.72	14.50	15.79	2008	15.79	(65.5)%	13.3%
2009	14.62	13.24	14.96	19.63	22.82	23.73	26.14	27.05	28.41	28.53	28.69	29.83	2009	29.83	89.0%	15.8%
2010	28.50	27.58	29.90	29.58	25.53	24.72	27.82							27.82	(6.7)%	15.0%

Name	Amount Invested	Name	Amount Invested
IGM FINANCIAL INC	$1,000	HENDERSON GROUP PLC	$14,447
F&C ASSET MANAGEMENT PLC	$1,203	RAB CAPITAL PLC	$24,603
INVESCO PLC (PREVIOUSLY AMVESC	$1,357	AZIMUT HOLDING SPA	$21,908
SCHRODERS PLC	$1,208	EVEREST FINANCIAL GROUP LIMITED	$23,437
RATHBONE BROTHERS PLC	$1,208	CHARLEMAGNE CAPITAL LTD	$36,848
ABERDEEN ASSET MGMT PLC	$1,208	PARTNERS GROUP-REG	$36,848
CI FINANCIAL INCOME FUND	$2,585	INVISTA REAL ESTATE INV MNGT	$36,589
MAN GROUP PLC	$2,862	ASHMORE GROUP PLC.	$36,688
AGF MANAGEMENT LTD-CL B	$3,343	BLUEBAY ASSET MANAGEMENT/UNI	$37,469
SPARX GROUP CO LTD	$11,762		