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Jonathan Smith & Co.
INVESTMENT COUNSEL

If all were right in the world, when you turned on CNBC last week you wouldn't have heard about gas prices, consumer indices, store comps, or earnings surprises. Rather, you would have heard about Sir John M. Templeton, the legendary founder of the Templeton Funds, who died from pneumonia last week at age 95. Known as much for his philanthropy as for his investment success, Mr. Templeton will be missed by many and deeply so by me.

I had the privilege of working for Sir John from 1978 to 1991. (That's me, standing next to him, in the water-damaged photograph to the right - back when I had a little more hair, a little less waist, and a lot less experience.) Four decades my elder, it was more like teacher and student than manager and client. Mr. Templeton granted me investment authority over a portion of his money that he had earmarked for giving to charities. True to his nature, he named his accounts *Kindness* and *Gentleness*.

Once, I heard him speak to the students, faculty, and trustees of a well known university. Someone asked Mr. Templeton how he produced such good results. With humility, as always, he cheerfully replied, "I've spent my whole life surrounding myself with people who are smarter than I am." Mr. Templeton told us eager listeners that if we owned a diversified portfolio of undervalued stocks, remained patient, and spent no more than, say, 5% of our capital in good years and bad years, that we could stack the odds greatly in our favor of not exhausting our principal. After he emphasized the miracle of compounding, the joys of freedom, the responsibilities that come with having a free-market, and the blessings to have been born in the greatest age of all time, the crowd gave him thundering applause.

It has been eighteen years since I worked for Mr. Templeton, but I've never stopped learning from him. Little did I know that the mission, vision, and values he imparted during our thirteen year association would become the DNA of Jonathan Smith & Company. The influence of John Templeton left me with a burning desire to care for others, an unending quest for investment excellence, and an instinct to always surround myself with people smarter than I am.

Templeton had an ease and comfort with investing; he never let a mistake control him or a success deceive him. The market and economy, with all of its chaos and noise, never governed his thinking. He once said that the four most expensive words on Wall Street are "it's different this time." He knew that while history does not repeat itself, it does often rhyme. This thinking guided his investment approach and deeply influences ours.

So here we are today, within days of his death and many people are once again predicting the death of the American Consumer. They note that Mr. Consumer's home is dropping in price daily, his monthly gasoline bill for his SUV equals the mortgage payment on his first house, his stock portfolio seems to be falling in an inverse relationship to oil prices and he's never had more debt than he has today. He turns on the television only to discover his bank is fighting for its life to avoid bankruptcy, and his daughter's college tuition is rising at double digit rates. What's an investor to think?

128 E. Fisher Avenue | Greensboro, NC 27401
☎ Office: 336-272-9488 | ☎ Fax: 336-272-2654 | ✉ Email: info@jonathansmith.com
www.jonathansmith.com

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Mr. Templeton was a strong believer that our economy is more resilient than conventional wisdom purports and that there are many unknown and unintended consequences from the turmoil that plagues us today. News reports stoke fears that things are different this time and that we are in for multiple years of economic difficulty arising from the bubble in the credit markets.

But this is what we see: consumer spending appears to be picking up significantly. The effect of higher fuel prices has not been enough to undermine the fiscal stimulus package passed by Congress earlier this year. While consumer confidence is at an historic low, consumers still seem willing to spend money, even if they are not in a good mood about it! In May, personal consumption expenditures (PCE) increased 0.4%. If that continues, it will equal an annualized rate near 5%. With retailers this week announcing stronger sales figures, a similar gain now appears likely for June.[1]

We don't have foresight into the economic future, but we do believe that the Land of Opportunity is still open for business. Supply and Demand still function and so the oversupply of houses will work its way off. Foreclosures will continue as overstretched consumers (and dishonest borrowers) walk away from houses they never could afford. Banks will continue to lose money on mortgages that should have never been made. In the end, like a controlled fire in a dense forest, excesses will be burned off, new growth will emerge and balance will be restored. This will take time. How much time? We don't know. However, we *do* know that it is *not* different this time. This is what always happens.

What will stop our pain?

While all of these excesses are being burned off, what will happen to our investments in the meantime? Most investors have seen their stock and bond portfolios decline as a result of the deflating credit bubble. It's human nature to project our most recent history into the future indefinitely and so we find ourselves feeling like Bill Murray's character, local weatherman Phil Connors, in the movie *Groundhog Day*: "It's gonna be cold . . . it's gonna be gray . . . and it's gonna last for the rest of your life!"

What makes things even more difficult is that when an investor looks at performance, she observes the results of price changes in the securities held in her portfolio. What she is not seeing is the real underlying business value represented by the shares she owns, but rather the market quoted prices for those shares at a point in time. In fact, the quoted price and the real underlying business value are not only different, but it is *this difference* that creates the opportunities for investors to earn good returns. The more distance there is between the price paid and the value received, the larger the opportunity for a high return. Templeton knew this, but more than knowing, he acted on his knowledge.

We expect continued volatility in the market. The only protection we see is sound security analysis, a good knowledge of history, and the courage to act as Mr. Templeton did: buy good businesses when the price is too good to pass up, don't sell because you feel bad and don't ever trade scared. His advice to "buy when there is blood on the streets" seems more than applicable now. Even though you may not know it for a long while, these are the times when fortunes are made, just ask anyone who knew Mr. Templeton.

[1] Source: Patrick J. O'Hare. "June Same-Store Sales." Briefing.com, Taking Stock. July 10, 2008.