

# CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

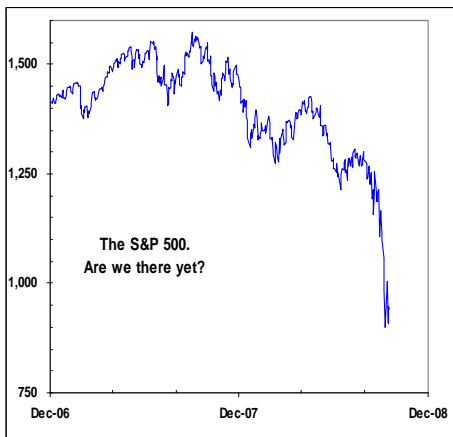
October 19, 2008

## Financial Rescues in Place ... ... Attractive Stock Prices Beckon

*Credit conditions improved last week; the banking system may leave the Intensive Care Unit in time.*

*Extraordinary values for equity investors are on offer. We plan to take advantage of them.*

Another week is in the books. On Tuesday morning, Treasury, the Fed and the FDIC announced plans to use \$250 billion of the rescue package to make preferred equity investments in various big banks, to guarantee new bank debt for a period of three years, and to expand deposit insurance guarantees. European central banks and governments have been similarly active. With the sense that governments are now acting decisively on an enormous scale, credit market improved through the week. Stock markets had tremendous rallies all day Monday and through Tuesday morning in New York. In came the sellers then--probably hedge funds (about which more below)--and equity markets fell sharply for forty-eight hours until Thursday morning in New York. Then another rally, which we would have characterized as one of epochal scale until the recent swings rendered us dizzy and jaded.



Even more amazing than all this is that we went to bed on Friday night without the anxiety that the banking and investment world might be turned upside down by Sunday night. Paulson, Bernanke, and their counterparts abroad did not have to reorder the world in time for the 8 pm Sunday (New York time) opening of the Tokyo market on its Monday morning. Colin Powell made the news on Sunday, not Hank Paulson. That's a change.

Two weeks ago, when the market was in its climactic plunge, we made two small equity investments which I believe will serve us very well. Last Monday morning, fully expecting a very substantial rally, we made an investment in an S&P 500 fund. Although the banking crisis appears to be easing, it is apparent that some very large hedge funds, with huge positions and big losses, are selling into any rally to reduce their own leverage. Such sellers and such uncertainty throughout the system make it very likely that the astounding volatility will continue. Huge price swings are an added risk--as if we needed another.

**Warren Buffett's view.** As everyone in the world seems to know, Warren Buffett wrote an Op Ed piece for Friday's *New York Times*. The link for the article is in the box on the next page; I copy the article in the text of my email conveying this letter. I commend it to you. In it, Mr. Buffett declares that he is buying US stocks now, and repeats his decades-old slogan, "Be fearful when others are greedy; be greedy when others are fearful." I will not attempt to paraphrase his argument. Apart from his being the most successful investor for the last fifty years and (according to *Forbes*) the world's richest person, he is a really superb writer. He says that, with his personal funds, which have been solely invested in US Treasuries, he is investing in US stocks, and, in his words, "[i]f prices keep looking attractive, my non-Berkshire net worth will soon be 100 percent in United States equities."

By

*Jack Mayberry*

*The link to Buffett's New York Times piece. Worth reading.*

<http://www.nytimes.com/2008/10/17/opinion/17buffett.html?em>

*Closed-end funds are like a mutual funds (properly called 'open-end funds'), in that they are pooled investment vehicles with underlying portfolios of stocks or other assets. The difference is that closed-end funds raise a set amount of capital and then invest it. They are not "open" every day, as mutual funds are, to take in new capital or to pay out capital to withdrawing investors.*

*Closed-end funds trade on stock exchanges and their market price varies around the value of their underlying portfolios. Sometimes, especially during panic selling in bear markets, the market price is far lower than the net-asset value of the underlying portfolio. These discounts from NAV create opportunities for us to buy a dollar's worth of assets for 80 or 90 cents. These opportunities are abundant now.*

A number of people have phoned or emailed me about the piece, including some Core clients. One point made by more than a few is that Buffett is so rich that he can afford to lose a great deal of money and still have far greater wealth than he can possibly need. That is certainly true, but it is not the end of the argument: Almost everyone for whom Core manages money has lots more capital than they or she or he need to spend in the next two years or the next five years. We may not feel that we have enough capital to live comfortably for the next several decades, but we do have more than we need for the next few years. If we can be confident--and I am--that Buffett is correct in seeing extraordinary value in the market now, we should invest the capital we do not need to spend in the next few years fairly aggressively. We can expect large gains.

It goes without saying that your portfolios and mine have declined sharply in the recent weeks of this savage credit crisis and bear market. For the months ahead of us, expect really poor economic results, acute problems in credit markets and the global banking systems, and a palpable and recurring sense of crisis. These factors will certainly cause scary sell-offs in stock markets. But Buffett is absolutely right: the country, the economy, the banking system, and the good companies will come out of this. Global economic growth and higher stock prices--much higher--lie ahead.

Our job at Core is to invest your capital so that you will have enough when you want to use it and when you need to use it. Many of Core's clients take regular distributions from their portfolios. Others are not yet making withdrawals; they expect to do so in the future. Many plan to make occasional substantial withdrawals to fund home purchases, education expenses for family members, or for other reasons. We all want our capital to grow and we expect it to be available for uses not now anticipated.

We have held lots of cash reserves all year--and a good thing, too. Your capital and mine have suffered a fair knock recently, but we are in far better shape for having sold lots of stuff months ago. Now what? There are, as Mr. Buffett points out, really remarkable values out there. Moreover, we can buy fine portfolios of strong companies at big discounts from even their now-depressed values by investing in closed-end funds. We have had closed-end fund investments from time to time for years; they are particularly apt now, because in severe bear markets they typically trade at big discounts to their underlying portfolios. Two weeks ago, we bought an old favorite, an Eaton Vance equity fund with the symbol ETG. It has a diverse portfolio of financially-strong, dividend-paying companies. As of Friday's close, this fund traded at a discount of 13% from the present market value of its portfolio and it pays a very large dividend. We can buy indirect ownership interests in companies whose stock prices are so depressed now that even Warren Buffett wants to buy them. Because some closed-end funds trade a big discounts, we can buy them for 87 cents on the dollar, to use the present ETG example. When calmer conditions return--and we know they will--the discounts in these closed-end funds will shrink and the stock prices of the companies in their underlying portfolios will rise. These are good investments for which we will be well rewarded.

We will invest at least some cash reserves in deeply-discounted equity-oriented closed-end funds in coming months. We are examining the audited financials of various funds to understand fully their condition. We expect to move slowly. We will have plenty of time to talk with every client fully and often. As Mr. Buffett reminds us, the market has real attractions now. For better or for worse, it will have such attractions more often than we might wish for the next several months. We will take advantage of them. We intend to move slowly through this process, but we intend to come out the other end with very healthy portfolios worth lots more than they are now.

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