

## → Second Quarter 2008 Performance Review

# Déjà Vu All Over Again

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“The world is unhappy. It is unhappy because it does not know where it is going and because it senses that if it knew, it would discover it was headed for catastrophe.”

– Valéry Giscard d’Estaing, President of France  
*speaking at a press conference, July 1974*

While the second quarter was by no means a catastrophe for us, we lagged by 200 basis points, down 1.4% versus 0.6% for the Russell 2000. This quarter the net of our top three winners and losers was positive, as it should be, thanks to a stronger boost from our winners. We were nicked and dimed by the rest of the portfolio, however, which was a disappointment.

We ended the quarter on a relative high note. Although June was the nastiest month of the year for the Russell, down 7.7%, it was our best relative month, as we were down less at 5.6%, due to our underweight in Financials. Banks, Savings and Loans and REITs, which make up 19.5% of the index, got crushed. Our total Financial Services exposure is less than 3%, and consists of Fair Isaac, the credit scoring company.

### Progress at PharmaNet and Shutterfly

Year-to-date we are down 11.1% versus a decline of 9.4% for the Russell 2000. That lag can be blamed on our top three losers (PharmaNet, X-Rite and Shutterfly), which have taken away more than our top three winners (ITT Educational, TETRA Technologies and Quicksilver Resources) could contribute, for a net hit of -1.7%. We sold out of X-Rite, but are very encouraged by the progress

PharmaNet and Shutterfly. We have done a lot of cross-checks that do support the freaky nature of PharmaNet’s cluster of clinical trial cancellations. We also are very impressed by new Shutterfly CFO Mark Rubash’s efforts to wring substantially more profits out of the business.

My relatives are now calling to ask whether to sell all of their stocks. That’s when a money manager knows that markets have gotten so bad they may be due for a dead cat bounce. As far as the economy goes, it’s a mixed bag. A few weeks ago I went to NeoCon, the office furniture industry jamboree held at the Merchandise Mart in Chicago, and although every company was bemoaning rising input costs, especially steel, they swore up and down that business was still holding up. The analysts in attendance were skeptical. We’ll see who’s right this earnings season, when sales activity pipelines have to be converted into the cold hard cash CFOs don’t feel much like parting with these days.

It’s important to be able to see the forest for the trees in this business, so at times like these I like to brush up on market and economic history. Online archives make it much easier to feed my old-news habit – reading news and commentary filtered through several decades’ worth of hindsight has taught me a lot about markets, people and life.

As bad as 2008 is proving to be both for the markets and the U.S. economy, we have been here before. Oil crisis, inflation, bad harvests, problems in the Middle East, nuclear threats ... the one thing 1974 has over 2008 is a political crisis – Watergate. This Talk of the Town piece from the December 16, 1974 issue of *The New Yorker* takes an interesting inventory of the country’s mood ...

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Composite returns are stated gross of fees. Please see Notes to Performance on the website.

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*Some observers see the crisis as a turning point in the history of mankind. This school tends to believe that man has run up against the limits of the natural resources of the earth, and it tends to foresee a catastrophic and perhaps permanent worldwide decline in economic growth, as though man were now about to be punished for his proud and wasteful ways.*

*Other observers see the crisis as the conjunction of a series of accidents, such as bad harvests around the world and unfortunate political developments in the Middle East, and they believe that for every technical obstacle to production a technical solution can be found ....*

*There is even a school that sees the nearly universal gloom of the last year as pure fashion and believes that when people tire of their pessimism the world crisis will go the way of "nostalgia" and other fads.*

### **Corrective forces**

It's too early to tell if today's "nearly universal gloom" on Wall Street is a mere "fad." One thing is certain: The global economy is a complex system. Not unlike an ecosystem, when things get out of whack, corrective forces can kick in to redress the imbalance. Sometimes those corrective forces are a person, like Paul Volcker, or a change in collective behavior, like a decrease in miles driven or a boycott of supersized cars. At least in 2008 the chairman of the SEC has yet to declare that "The individual investor has acquired the status of an endangered species," as his predecessor did in 1974.

Things really could be worse, as you can see from this *New York Times* article (June 9, 1974) seeking the answer to the question "Will the thundering herd ever return to Wall Street?":

*Among the potent depressants that acted on stock prices were recurring bouts of streaking inflation and spiraling interest rates, the unsettling impact of a fuzzy game plan for wage-and-price controls, which created uncertainties abhorrent to the stock market, a succession of crises on the international monetary front accompanied by weakening of the dollar and soaring prices for gold, the progressive erosion of public confidence as the Watergate-Nixon drama unfolded in the manner of a serialized horror story, the Middle East war and the supershock of the energy crisis, and, most recently, fears of another liquidity crisis.*



A surefire cure for the stock market blues is to read the press from 1974. It makes one positively giddy about how good things are now in comparison. In any case, a little perspective always helps when emotions run high in a market. As Giscard d'Estaing would have put it, "Plus ça change, plus c'est la même chose" ("The more things change, the more they stay the same").