Mead Capital Management

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"I am a better investor because I am businessman, and a better businessman because I am an investor." – Warren Buffett

Investing Like A Business ***Owner***

In my view, a great number of people are lost when it comes to investing. Investment "professionals" included. Owners of businesses have become so far removed from the actual source of their investment returns that they fail to reap the full rewards of equity ownership. Packaged into mutual funds and exchange traded funds, traded daily (or more frequently), and turned into casino betting with derivatives, too many have forgotten the ultimate *source* of their investment returns: **businesses**. Below I will provide a hypothetical example of an investor with $1 million to invest, and hopefully dispel some investing myths along the way. Our imaginary Jayne Doe begins with $ 1 million to be allocated among the following enterprises:

"…too many have forgotten the ultimate *source* of their investment returns: businesses"

	Target Allocation		Price Per Share	# Shares	Actual Allocation	
Berkshire Hathaway	$ 400,000.00	*40.0%*	$ 162.98	2,454.00	$ 399,952.92	*40.0%*
Nestle	200,000.00	*20.0%*	71.74	2,787.00	199,939.38	*20.0%*
McCormick	100,000.00	*10.0%*	93.33	1,071.00	99,956.43	*10.0%*
Coca Cola	100,000.00	*10.0%*	41.46	2,411.00	99,960.06	*10.0%*
Disney	50,000.00	*5.0%*	104.22	479.00	49,921.38	*5.0%*
Clorox	50,000.00	*5.0%*	120.02	416.00	49,928.32	*5.0%*
Home Depot	50,000.00	*5.0%*	134.08	372.00	49,877.76	*5.0%*
Cash	50,000.00	*5.0%*			50,463.75	*5.0%*
	$ 1,000,000.00	***100.0%***			**$ 1,000,000.00**	***100.0%***

Notes:

Nestle is an American Depository Receipt (ADR)

Share prices as of December 31, 2016

An academic or "professional advisor" might look at this portfolio and see nothing but risk. Investing the portfolio in just seven stocks, not to mention 40% in one stock and 70% in just three stocks, is highly risky, they might say. Putting many eggs into one basket is reckless. But is it?

Examined in more detail the seven stocks are in reality many different businesses. Berkshire Hathaway, for example is made up of four main business segments and hundreds of individual operating businesses. Yes, 40% of the portfolio is in one "stock" but that stock owns many different insurance companies, an entire Class I railroad, several large, independent, utility companies, and scores of industrial, manufacturing, and service businesses. On top of that Berkshire owns partial stakes in other companies through its investments in common stocks. Likewise, Nestle has numerous operating units and businesses world-wide that have been around for decades or longer. The portfolio is admittedly made up of blue chips and might not encompass the entirety of investable businesses, but so what? They are all simple and easy to understand.

Where the academic might begin by looking at the statistics of the stocks (volatility, beta, co-variance, etc.), the business owner would cut right to what really matters. The business owner would begin by answering the question, 'what do I get for my money?'.

Viewed as a single entity "Jayne Doe, Inc." is a business with a book value or net worth of $393,238, generating annual revenues of $424,202. The business earns $53,120, of which $14,850 is sent to Jayne as dividends throughout the year. The business earns a respectable 12.5% on sales and a 13.5% return on equity while employing only a moderate amount of financial leverage. When backing out the cash portion, return on equity increases to 15.4%.

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The business owner knows that what happens to the prices of the securities in the portfolio matters very little over the short-term. For example, if others were to suddenly appraise the value of the stocks in the portfolio 25% lower because of fears of a recession or an interest rate change, or a host of other reasons, the business owner wouldn't panic. The business owner would know that the underlying companies don't change as rapidly as the opinion of others in the market. Provided the businesses are sound enterprises with favorable long-term prospects, the business owner knows others will come to see their true value over time.

The true business owner thinks about the important subjects. When the academic or "professional" worries about how the prices of the securities behave when placed in a portfolio of other "risky" assets, the business owner focuses on the prospects of the businesses, such as:

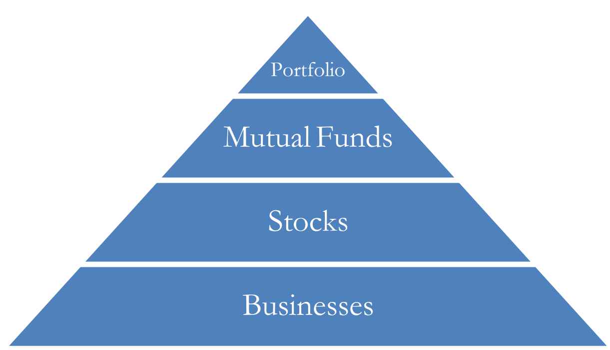
- What are the conditions in the industries in which the businesses operate?
- Are there new competitors coming in that might affect the long-term prospects of my companies?
- How do my businesses compare to others in the industry?
- Is management doing a good job controlling expenses?
- What are the long-run normalized returns on capital for my businesses?
- Is management compensating themselves fairly and not at the expense of shareholders?
- What does management say about their strategy for coming years?
- Does management take the time to communicate with shareholders candidly and rationally?

Of course, the price that our Jayne paid for her businesses is all-important. Her $1,000,000 investment earns 5.31% - better than current bond yields but not by much. However, because the underlying businesses earn satisfactory returns on capital her net return should steadily increase over time as Jayne's businesses reinvest the portion of earnings not paid to her as dividends. Nevertheless, what Jayne gets in return for laying out $1,000,000 today is the economic equivalent of 94% of the 2015 real median income in the United States. Add the fact that she is likely to see those earnings grow faster than the median income over time and one can only conclude our Jayne is in a quite-favorable position.

Notwithstanding my reservations above, the invention of the mutual fund – and in particular the affordable mutual fund, such as those offered by Vanguard – was a wonderful thing. It allowed investors to participate in the benefits of equity ownership with minimal to moderate cost. However, as is the tendency of Wall Street, what started as a good idea quickly ballooned into something unrecognizable, complex, and expensive in terms of fees and turnover costs. Investors should take advantage of the products offered to them provided they never lose track of where the ultimate source of their investment returns originate.

Rationally yours,

Despite making up the base – the foundation – of the pyramid, the underlying businesses of a portfolio are, in my view, too often neglected. Each level is like a pane of glass which, from one level to the next appears clear, but when stacked four layers' deep blurs reality.



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Appendix: Jayne Doe Look-Thru Portfolio

	Revenues	Earnings	Dividends	Book Value
Berkshire Hathaway				
Insurance - underwriting	*$ 45,663*	*$ 1,363*		
Insurance - investment income	*4,500*	*3,619*		
Railroad	*19,735*	*3,552*		
Utilities and energy	*17,774*	*2,276*		
Manufacturing, service and retailing	*119,487*	*5,604*		
Finance and financial products	*7,638*	*1,420*		
Investment and derivative gains/losses	*8,264*	*6,466*		
Other / Misc.	*(523)*	*(341)*		
Total Berkshire Hathaway	**$ 222,539**	**$ 23,959**	**$ -**	**$ 248,418**
Nestle				
Powdered and Liquid Beverages	*$ 17,410*	*$ 3,616*		
Water	*6,522*	*$ 797*		
Milk products and Ice Cream	*12,607*	*$ 2,322*		
Nutrition and Health Science	*13,228*	*$ 2,441*		
Prepared dishes and cooking aids	*10,686*	*$ 1,598*		
Confectionary	*7,635*	*$ 1,047*		
Pet Care	*10,615*	*$ 2,230*		
Total Nestle	**$ 78,703**	**$ 14,052**	**$ 6,266**	**$ 48,929**
McCormick	**$ 36,916**	**$ 3,941**	**$ 1,842**	**$ 15,026**
Coca-Cola	**$ 23,112**	**$ 3,604**	**$ 3,375**	**$ 14,659**
Disney	**$ 16,259**	**$ 2,745**	**$ 680**	**$ 13,173**
Clorox	**$ 18,156**	**$ 2,042**	**$ 1,281**	**$ 832**
Home Depot	**$ 28,516**	**$ 2,399**	**$ 1,027**	**$ 1,737**
Subtotal Invested	**$ 424,202**	**$ 52,741**	**$ 14,472**	**$ 342,774**
Cash (@ 0.75%)		**$ 378**	**$ 378**	**$ 50,464**
Total	**$ 424,202**	**$ 53,120**	**$ 14,850**	**$ 393,238**