

Welcome!

This is our inaugural newsletter. We want to thank you for the support and enthusiasm that all of you have shown for Patient Capital Management. The initial number of clients and assets under management has been encouraging.

At the outset I would like to acknowledge some people who have had a significant impact on my career and investment philosophy. First and foremost I would like to acknowledge Anne Ritchie for providing me with my first position in the industry. I am forever indebted to her for giving me a chance. Anne sadly passed on a few years ago and I regret not having thanked her more times than I did.

Doug Greaves also deserves mention. Doug and I worked together at OMERS. It was from Doug that I learned the thorough process of analyzing companies and managing portfolios. Doug has trained many people who have gone on to exceptional careers. Doug is now a good friend who has provided wise council over the years.

The people that have the greatest impact on my career are the investment team at Hamblin Watsa Investment Council led by Tony Hamblin and Prem Watsa. I learned a great deal about long-term value investing and the power of portfolio concentration during my time at Hamblin Watsa. More importantly, I saw first hand what a small group of people who shared similar values could accomplish. I was fortunate to have been able to work with a group of people that respected, trusted and supported each other through both good and difficult times. If Patient Capital Management can come close to creating the culture and success that Hamblin Watsa has achieved then we will have been truly blessed!

Gary and I would also like to thank our many friends at Trimark for their encouragement and support.

Patient Capital Management was created to provide clients with a money management option that offers uncompromising discipline and focus on identifying absolute long-term values. In order to ensure that we are entirely focused on meeting that objective we guarantee that PCM will never become a marketing organization disguised as an investment operation. Such businesses, regardless of their best intentions, invariably distract the portfolio managers from what should be their only concern; properly investing your money. Worse still, the investment process often gets compromised at just the wrong moment as the pressure to maintain assets supersedes the investment philosophy. Serving more than one master invariably leads to compromises!

It is our belief that a money manager's interests and those of his or her clients' should be as closely aligned as possible. We believe that the most direct way to achieve this objective is to invest our personal money in exactly the same manner as yours. Virtually all of my family's capital and most of Gary's assets are invested along with your money. We eat our own cooking!

Our objective is to provide a compound annual return of 5% per year above the S&P 500 and TSE 300 over a long period of time. We will always sacrifice short-term returns in order to meet our long-term goal. This means that in some years our returns may not meet our objective. So be it! I will not speculate or risk your capital and ours to meet some annual benchmark. Long term investing is a marathon not a sprint! Our focus is also on the preservation of capital. As Warren Buffet has stated: "The first rule of investing is not to lose money. The second and third rules are not forgetting the first one."

Our primary means of communication will be our quarterly newsletters to you. Our objective through these newsletters is to talk about something that is current and relevant. Hopefully you will find our commentary insightful and thought provoking. We don't intend on discussing our individual holdings in our reports. In our view, our analysis and

investment decisions are proprietary to our clients. We are more than happy to talk about our investments and rationale with you in private.

Patient Capital Management has one foot in the new millennium and the other one in the tradition of long term value investing. For those of you on the Internet we would prefer to e-mail you our commentary and any other information. E-mail is faster and more direct than Canada Post. It also doesn't cost anything; something today's generation of Internet Stock investors seem to ignore. Most Internet enterprises have little prospect of generating significant revenue let alone profits. Stock prices eventually follow earnings per share. We have no doubt that most Internet shares will one day resemble their company's profits - negligible to non-existent!

Our first topic of discussion centers on the whole notion of "style diversification." This concept essentially encourages investors to choose a basket of money managers with different investment styles. According to the proponents of this view, style diversification allows investors to "smooth out" their investment returns. In other words when the value manager is under performing the growth manager will be outperforming; and vice-versa. As a result, the returns are averaged out. This notion has gained increasing acceptance and is now recognized as conventional wisdom. Wealth management "supermarkets" are being created around this strategy. Value managers are merging with growth managers and growth managers are adding momentum managers. New products are being introduced daily. Proctor and Gamble, the world's largest and perhaps most sophisticated consumer products company would be proud. As with most conventional wisdom in the investment industry we wholeheartedly disagree!

Our disagreement is based on two important points. Our first concern stems from our analysis of long-term historical returns, portfolio composition and investor behavior. The second and perhaps more important concern that style diversification raises is the fundamental role of the investment councilor for the high net worth individual.

The evidence we have studied suggests that there is little to differentiate between value and growth investing over the long-term. An analysis of the Barra Value and Barra Growth Indexes provides interesting insights. The returns from January 1975 to May 2000 are very close; the Barra Value Index returned 17.0% while the Barra Growth Index returned 16.2%. On a monthly basis value outperformed growth in 165 of the 305 months or 54% of the time; again very close. Since 1975 growth has had better returns than value in fourteen calendar years while value has provided superior returns in eleven of those years. Analyzing the data for risk confirms the long-term similarity between the two styles. The standard deviation of monthly returns (a measure of risk) are virtually identical; 4.2% for value and 4.7% for growth.

Given the evidence noted above we see no benefit in style diversification. We believe that style diversification increases costs for the high net worth individual without any real long-term benefit in returns or risk reduction. For example, an investor with three million dollars splits this amount evenly with two money managers. Under this scenario he/she does not get the economy of scale on the money management and custodial fees that the full three million dollar account with one manager would receive. In addition, style diversification also increases the probability that the combined returns of the two styles will approximate the index.

We have analyzed the portfolios of several individuals who are following this strategy either through mutual funds or private money management. In virtually every case the aggregate portfolio characteristics of the combined portfolios matched their respective indexes. The aggregate number of distinct securities owned in almost every case was well in excess of one hundred! This level of diversification assures below index returns after fees!

Style diversification also tempts the investor into buying high and selling low. Given the option, investors often jump from a poor performing manger and into a hot performing

fund. Study after study proves that this is exactly the wrong approach. Fourth quartile managers have a very high probability of jumping into the first quartile the following year and vice versa for first quartile managers. As Gary points out to our clients it's the client's actions that determine their particular returns. Switching from a poor performing fund to a strong performer is simply "locking in" the underperformance. The probability is high that the investor who switches once will change managers again. This activity only compounds the problem and ensures less than optimal returns.

Perhaps the most serious consequence of style diversification is the impact that such a strategy has on the client/manager relationship. In our view, investors who follow a style diversification strategy essentially view the money manager as a commodity whose only distinguishing feature is performance. We at PCM believe that this approach is short sighted. We strongly feel that a money manager and high net worth client should work hand in hand to ensure that personal, financial and tax-planning goals are achieved. For example, we have worked closely with our clients to ensure that cash is available to pay taxes when due. In another case we encouraged a potential client to closely review their goals and career aspirations before making an investment decision. Under a multi-manager system communicating and coordinating what is best for the client is extremely difficult if not impossible.

Our conclusion and recommendation is straightforward. We believe that one should choose a money manager that can demonstrate an uncompromising commitment to their stated investment philosophy. Once that decision has been made the investor should create a total financial plan with the investment councilor. The plan should be monitored, updated and communicated to the manager as circumstances change. The investor should then let the money manager worry about the investments and not be concerned about performance. A money manager who is good at what he/she does and is uncompromising in their investment philosophy will eventually provide satisfactory long-term performance at the lowest cost and in accordance with a thorough understanding of the client's needs.
