Ruminations of

The Contrary Investor

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Burlington, Vermont

49th Year, Number 1 January 2010

Hopenhagen

Last month representatives from nearly 200 countries gathered in Copenhagen, Denmark for the Summit on Climate Change. At about the same time, a study conducted jointly by the Social Investment Forum and *Pensions and Investments* magazine reported that 88 percent of U.S. investment consultants believe that their clients' interest in environmental and socially conscious investing will rise significantly over the next three years. Green investing is hot (pun intended), at least in the eyes of policymakers and the media.

But how do investors feel about putting real dollars into green opportunities? When all is said and done, Economics 101 teaches that prices rise when there are more buyers than sellers (with the understanding that for every trade, there is a willing seller for every buyer). The data suggests that despite the focus on green energy and other initiatives being touted by everyone from the Copenhagen representatives to the Obama administration, money is simply not flowing into green strategies.

Socially responsible investing (so-called "SRI funds") has been around for many years, but a slew of new offerings focused on green investing have come to market since 2007. While the returns these funds and ETFs have delivered have, in most instances, bested the broader market indices, investor interest as measured by net investment inflows has been at best tepid.

Take, for example, one of the larger and older mutual funds in the category — the $100 million Sentinel Sustainable Growth Opportunity Fund (WAEGX), started in 1994. Through the first 11 months of 2009, the fund outperformed the S&P 500 by about 600 basis points, but experienced more than $10 million in net *outflows*. And this is during a time of unprecedented interest in green issues and the associated investment opportunities.

The two most often-cited reasons for the lackluster demand on the part of investors are geopolitical risks and long development lead times for the new technologies required. Spain was a leader in solar energy, due in large part to incentives and subsidies targeting the technology. But in 2008, the government in Madrid cut subsidies by about 35 percent, crushing solar company stocks around the globe. At the same time, Japan was considering bringing back incentives to boost solar energy use. Similar rounds of political ping pong in Germany and the U.S., among other nations, keep investors guessing. Add to this regulatory uncertainty the likelihood that new technologies in alternate energy routinely take 10 years or more to fully develop, and investors will often look for other places to put their money.

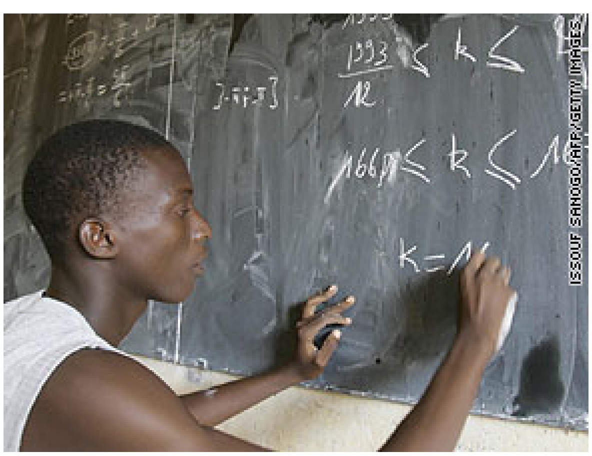
None of the foregoing discussion is meant to dissuade an investor from studying — and perhaps ultimately investing in — alternate energy and other green opportunities. The Contrary Investor believes that the real money is made at the beginning and the end of misunderstood or under-appreciated trends. Anyone can participate in the middle of a trend when it is well-established and in vogue as the subject of cocktail party conversation.

In the current state of green investing, politics is clearly colliding head-on with business fundamentals, creating an uncertain backdrop — never a good thing in the short run for stocks. But many of the solar and wind-energy-focused funds and ETFs, while up over 20 percent this year, are still off roughly 50 percent from their launch prices of 2008. For now, the popularity of green investments seems to come and go in fits and spurts, and there seems to be no indication of significant inflows of capital. It is clear, however, that phrases like “going green” and “sustainable practices” have moved from the fringes to the forefront. The Contrary Investor believes that companies that have a solid track record of reducing the environmental impact of their operations, as well as companies that offer alternative energy technologies such as solar and wind power will be excellent investments. It is not a question of “if”, but “when”, and removing one of these key uncertainties increases the chances for success. You pays your money, and you takes your chances!

- Alex Seagle

An Anniversary You Have Never Heard Of

The Contrary Investor likes interesting things, even when they have absolutely no bearing on investment ideas. In this spirit, we say Happy Anniversary to the Riemann Hypothesis, one of the most important math problems ever! Proposed by Bernhard Riemann in 1859, the Riemann Hypothesis deals with prime numbers. You may recall that a prime number is a positive whole number that has only two positive whole number divisors: one and itself. The first of them are 2, 3, 5, 7, 11, 13, in order.



This hypothesis would be able to provide a better estimate than ever before of a special function denoted as Pi(x). Pi(x) represents the number of prime numbers that are no bigger than x, where x is a positive number. For example, Pi(14) would be 6, because there are six prime numbers (2, 3, 5, 7, 11, 13) no bigger than 14. That's probably the most understandable explanation you're going to get that doesn't involve "zeta functions" and other technical terms.

Given that many of the best mathematicians have tried and failed to provide a solution, the proof is probably not easy or obvious. But if you can solve it, the Clay Mathematics Institute will give you $1 million.

A proof would have implications not only for mathematics, but also for cryptography and computer science, says Ramin Takloo-Bighash, professor at the University of Illinois at Chicago. Internet security protocols are largely based on prime numbers, and internet security is an increasingly important issue. Experimental and theoretical evidence has supported the truth of the Riemann Hypothesis, although there are a small number of naysayers who say it can’t be proven.

Still, there’s enough confidence in the truth of the Riemann Hypothesis that mathematicians have established “conditional” theorems, which can never be validated until someone proves the 150-year-old problem, says Kenneth Ribet, professor of mathematics at the University of California, Berkeley.

Riemann's paper on the subject was first published in November 1859, but no one knows the day. So, the American Institute of Mathematics picked a Wednesday in the middle of November to celebrate the 150th anniversary. Now aren’t you glad the Contrary Investor takes great pleasure in gathering generally unmarket-able information?

To COIN a Phrase

For thousands of years people have collaborated, from the first tribal bands hunting for large game to the feudal states in the middle ages to the large multinational companies of today. But only now with the emergence of the Internet and the Web do we have the means to solve tasks collaboratively at a large scale, with anybody, about anything, at anytime, and anywhere. Anybody planning a totally crazy project has the chance now to find the few other people in the world who care about the same topic with the same passion, and form a "COIN", or Collaborative Innovation Network, to tackle the issue and collaboratively develop a solution. Many, if not most businesses need to constantly innovate in order to remain competitive. What is the best way to effect innovation?

In about 2005, the term "swarm creativity" entered our lexicon, and it is a fascinating concept indeed. The simplest way to think about a swarm is to envision an ant hill. One ant, individually, can do very little, but the swarm – the collective – is a powerful force. One particularly good example of swarm creativity is the online encyclopedia Wikipedia, a collaborative, non-profit resource with more than 400,000 entries updated by thousands of volunteers. Wikipedia entries are surprisingly accurate and complete. Another compelling argument for operating in a swarm environment is Linus Torvalds' computer operating system Linux. In just over 10 years, Linux became the main competitor to Microsoft's dominance in this space. Search engine giant Google uses Linux to power its farm of thousands of Web servers.

If you and I swap a dollar, you and I still each have a dollar. If you and I swap an idea, you and I have two ideas each.

By openly sharing ideas and work, a team's creative output is exponentially more than the sum of the creative outputs of all the individual team members. The conclusion: open source innovation is developed faster, better, more secure, and at lower cost than closed source, proprietary innovation. In much the same way that companies embracing the concepts of sustainable business practices are outperforming (in terms of stock price performance) those companies resisting this trend, companies encouraging swarm creativity will likely win out.

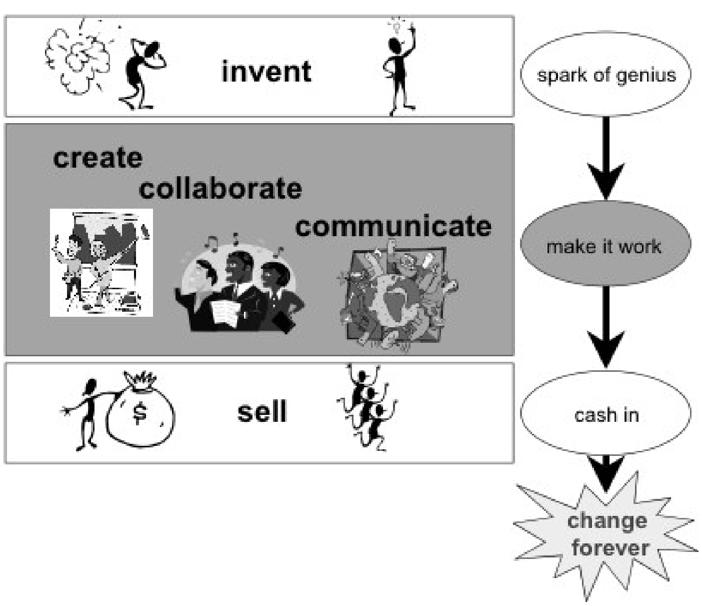
IBM is one company that has discovered the advantages of Collaborative Innovation Networks in combination with open source. The computer giant has invested more than $60 million into the open source toolset Eclipse, which has become the leading Java software development environment, attracting hundreds of vendors and millions of users. In fact, growth and adoption of Eclipse have been so rapid that companies such as Ericsson are evaluating it as a single, corporate-wide development platform to cut costs and boost efficiency.

In the beginning of 2004, IBM totally released its control over Eclipse and turned it over to an independent foundation. Why does IBM invest in Eclipse under an open source license? IBM recognized that it cannot build all the software tools itself, and needed a platform that helps integrate different tools so that partners can contribute and extend the toolset. Obviously, such a platform also helps IBM align its internal tooling efforts. Having a widely used software platform distributed under an open source license guarantees high quality, because it is tested and maintained by millions of programmers who discover, report, and fix bugs continuously. Second, IBM sells complementary software tools that are based on Eclipse, and having Eclipse available for free on almost any platform it a huge potential customer base for these tools. Third, IBM reaps lots of fame, goodwill, and the "cool factor" by being seen as a significant contributor of the best Java development environment to the public domain. And IBM is using Eclipse to develop some of its own commercial software packages, such as Lotus Workplace.

The Eclipse project provides a prime example of a COIN that has had a stellar success based on principles of meritocracy, transparency, and openness, garnering numerous awards. Even more important, users have cast their vote, downloading the Eclipse tool more than 18 million times since its inception.

It is important to distinguish between sustaining and disruptive innovation. Sustaining innovations do existing things in a novel and better way. For example, Wal-Mart revolutionized mass retailing by using information technologies in a much more massive and better-integrated way than its competitors. It optimized its supply chain by pioneering concepts like vendor managed inventory and automated demand forecasting and replenishment, beating its competitors and becoming the Number One Fortune 500 company globally as well as one of the most successful enterprises by many measures. But the "innovation" of Wal-Mart consisted of doing the same things that its competitors did, just "better." For example, Wal-Mart used available information technologies more thoroughly and consistently than its competitors by being one of the first companies letting its suppliers manage shelf space in Wal-Mart's own stores. In this sense Wal-Mart still did the same things as its competitors, only they did it much more efficiently.

On the other hand, disruptive innovations like the World Wide Web, Linux, the airplane, or the railroad totally changed the way in which something was done. Disruptive innovations are normally conceived outside of established organizations, or if they come out of organizations, they are developed without organizational blessing and are not aligned with the official organizational vision and goals. They have the potential to turn established organizational norms upside down and to redefine the way people work and live.



The Contrary Investor would encourage readers to seek out companies that are embracing swarm innovation. They will shape the future and make an investor money!

❑ Alex Seagle

It's All About Me

Besides food and shelter, what would you think was the last thing people stopped or reduced their spending in the current economic environment? Perhaps surprisingly, the answer is their appearance, or said another way, vanity. And companies that endeavor to make our aging population look more youthful might be the first to see increased sales as we recover from the "recession."

We are most certainly a vain, image-conscious bunch, and the proof of this fact can be seen in an ever-growing number of products and services being brought to market. One amazing manifestation: skin whitening.

Syneron Medical Ltd. (NASDAQ: ELOS), an innovator in the development, marketing and sales of medical aesthetic devices, in November announced the commercial launch of the elure™ topical whitening products in several Asian markets.

Skin whitening is one of the fastest growing segments of the global beauty industry. The Asian market is estimated to be around $18 billion per year! The global whitening market is expected to grow over 10 percent annually, with major opportunities emerging from the rapidly expanding Asian markets.

Don't ask me why, but celebrities from the late Michael Jackson to Sammy Sosa seem to be on board this trend, and the Contrary Investor is frankly amazed at the size of this tiny slice of the beauty market. In the interest of full disclosure, Fraser Management has a position in our portfolio in ELOS.

The treatments that Syneron and other companies offer address every aesthetic issue from wrinkles to hair removal to acne to vein removal. One particularly intriguing treatment is a "circumferential reduction process" to alleviate cellulite.

Not the Contrary Investor's Tummy...
But it Looks Mahvelous!

Founded in 2000, the corporate, R&D, and manufacturing headquarters for Syneron are located in Israel. From a contrarian, value-oriented perspective, the company's stock traded at around $43 per share in late 2005; it is now less than $10.

The main problem for Syneron seems to be competition from other aesthetic laser players. Palomar (NASDAQ: LMTI) and Cynosure (NASDAQ: CYNO) are the most notable. This is a fickle industry, but one that is focused on what consumers with disposable income seem willing to spend in a big way — looking good.

Another negative for Syneron is the recent sell-off of shares by noted hedge fund manager Seth Klarman's Baupost Group. Baupost reduced their exposure to the company by about 28 percent in December of 2009. Mr. Klarman is one smart guy, and going from owning approximately 2 million shares to 1.5 million in the past two and a half months is troubling, although harvesting profits is never a bad thing.

Nevertheless, for investors interested in a play on vanity as the economy recovers, ELOS and others in this space might end up looking pretty.

❑ Alex Seagle

Words to Consider

One afternoon at Cheers, Cliff Clavin was explaining the Buffalo Theory to his buddy Norm. Here's how it went:

" Well ya see, Norm, it's like this... A herd of buffalo can only move as fast as the slowest buffalo. And when the herd is hunted, it is the slowest and weakest ones at the back that are killed first. This natural selection is good for the herd as a whole, because the general speed and health of the whole group keeps improving by the regular killing of the weakest members. In much the same way, the human brain can only operate as fast as the slowest brain cells. Excessive intake of alcohol, as we know, kills brain cells. But naturally, it attacks the slowest and weakest brain cells first. In this way, regular consumption of beer eliminates the weaker brain cells, making the brain a faster and more efficient machine. That's why you always feel smarter after a few beers."

James Cameron's new motion picture *Avatar* is projected to cost about $380 million! Does that sound like a foolhardy investment? Consider that the 50th-highest grossing movie of all time, 2006's *Casino Royale* has taken in almost $600 million to date. Hell, *Mamma Mia!*, the dreadful 2008 musical — with Pierce Brosnan and Meryl Streep, of all people, singing — has made about $610 million. The Contrary Investor is in the wrong business! Go figure...

Man has been endowed with reason, with the power to create, so that he can add to what he's been given. But up to now he hasn't been a creator, only a destroyer. Forests keep disappearing, rivers dry up, wild life has become extinct, the climate is ruined and the land grows poorer and uglier every day.

~ Anton Chekhov, 1897

The things we fear most in organizations — fluctuations, disturbances, imbalances — are the primary sources of creativity.

~ Margaret J. Wheatley

I did not attend his funeral, but I wrote a nice letter saying I approved of it.

~ Mark Twain

Try not to become a man of success, but rather try to become a man of value.

~ Albert Einstein

When great changes occur in history, when great principles are involved, as a rule the majority are wrong. The minority are right.

~ Eugene V. Debs

If only we'd stop trying to be happy we'd have a pretty good time.

~ Edith Wharton

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Ruminations of the Contrary Investor letter is published monthly by Fraser Management Associates, 309 South Willard Street, Burlington, Vermont 05401, 802-658-0322, Fax 802-658-0260, E-mail: alex@fraser.com.