Ruminations of

The Contrary Investor

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Light — God's Eldest Daughter

~ Thomas Fuller

A few months ago, the Contrary Investor added a new name to our portfolio: Cree, Inc. Cree makes Light Emitting Diodes (LEDs). We have studied the characteristics and market opportunity in this space for some time.

LED technology was first introduced in 1962, beginning with a low-intensity red light. Semiconductor-based diodes or valves produce light from the excitation of electrons as they are moved over a "light" bridge by a direct electrical current. LEDs differ from traditional incandescent light bulbs, which produce their light from heat generation.

Over the years, white LEDs have been developed by combining chips that produce different colors into a single package, or by adding a yellow phosphor layer. Improvements in light intensity and cost reductions are now resulting in impressive growth in the adoption of LEDs.

The tipping point in our investment decision on Cree was an announcement in January of last year that the company had been selected to provide LED lighting in the Pentagon. Folks, the Pentagon has a lot of lights! It is the largest office building in the world, with some 6.5 million square feet in total. Independent tests done by the government suggest the retrofit to LEDs will result in:

- 22 percent reduction in energy usage, with improved light quality
- Payback on investment of less than four years
- Additional and ongoing savings from reduced maintenance costs, and reduced loads on cooling systems
- Elimination of mercury-laden fluorescent bulbs
- 140 tons of CO_2 emissions per year eliminated

Adoption of LED lighting seems to be accelerating, sitting squarely at the intersection of highly desired green and socially-responsible technology, and the funding needed to really, truly launch the technology, thanks in large part to President Obama's American Recovery and Reinvestment Plan.

Typically, new technologies take 10 years or more to flourish, if they ever do at all. LEDs, in my humble opinion, represent the future of energy-efficient lighting, and that future is pretty close to now.

General lighting accounts for about 20 percent of global electricity usage. General lighting is a $100 billion per year business, and that business is going through a major disruption. Recent studies indicate that going to all-LED lighting would reduce demand by 75 percent. Major retailers like WalMart and Starbucks have started

to replace their lighting with LEDs.

And the technology is enjoying attention and growth outside of general lighting applications. One example: at the 2009 Consumer Electronics Show in Las Vegas (the biggest such event, and home to more “wow” products than one can imagine), Samsung announced the introduction of their lineup of LED TVs to much skepticism. In the eight months following the show, Samsung sold some 2.6 million LED TVs, and controls 80 percent of the market share. They expect to quadruple sales to 10 million units this year. The sets offer improved brightness and contrast, energy efficiency, and slimmer screens. Needless to say, competitors have now entered the fray.

Like any investment opportunity, there are risks, not the least of which is commoditization of LED components. A similar situation occurred with flash memory or so-called DRAMs. The Contrary Investor remembers buying his first USB stick about 5 years ago. It had 256 MB of memory and a cost of about $60. Now, 8 *gigabytes* of memory costs next-to-nothing. This is natural as very large players begin to enter what was hitherto a fragmented industry.

However, it is rare to find a market with such potential at such a pivotal point. One indication is the interest in LED startup companies by private venture capital, and the number of recent acquisitions of fledgling lighting companies by the likes of larger companies like Cree and Philips Lighting.

It is interesting to note that the first big installation of LED lighting came at the Pentagon — an organization better known for crafting a procurement system where $600 hammers and $400 toilet seats were purchased, not one known for their fiscal restraint and interest in energy savings!

While we have limited our discussion to the US market, the LED phenomenon is global, with Japan and several European countries mirroring the growth we are experiencing at home. Even stately, stodgy Buckingham Palace recently made the transition to the new technology. Consider global LED powerhouse Philips Lighting. Philips still considers the industry in an infant state. But total sales of LED products at the company grew 42 percent in the final quarter of 2009 (versus 2008...not exactly an economic environment primed for growth), and LED sales rose above 10 percent of the company’s total global lighting sales for the first time. For years, the knock on LEDs was their cost relative to incandescent bulbs. The cost of manufacturing LEDs has been cut in half in the past year alone, and while more savings need to be realized in order for LEDs to truly compete in the open market, huge advancements are being made in the key “lumen per watt of electricity used” measure.

Lighting as we know it is likely to undergo a major transformation in coming years. Nadarajah Narendran, director of research at the lighting research center at Renssalaer Polytechnic Institute may have said it best. “It is like the way you keep updating computers. When did you buy your first computer? 10 years ago? 20 years ago? You could have waited until today for better computers and better prices.” But you didn’t!

- Alex Seagle

The Search for a Disconnect

Sophisticated investment advisors that deal with ultra-high net worth individuals, foundations and the like are always looking for so-called “non-correlated” assets as they make asset allocation decisions for their clients’ portfolios. A very over-simplified description of non-correlated assets would be those investments that do not track the stock market indices — they zig when the market zags. Again over-simplifying, the advisors build a core of investments that are often similar to index funds, then sprinkle in non-correlated bits at the edges to hopefully outperform the market and hence earn their fees.

The range of offerings that fall under the banner of non-correlated assets is broad and often esoteric. There are complicated hedging strategies that seek to outperform the broader markets without mimicking them. Other choices the Contrary Investor has discussed in the past include fine art, timber, and even aquaculture (raising fish for profit!).

Two Swiss economists have recently completed a study on what might be the ultimate liquid investment: fine wines. Philippe Masset and Jean-Philippe Weisskopf concluded that wine prices have outperformed one US stock market index over the last 13 years, covering two recessions.

They compared wine prices with the Russell 3000 Index between January 1996 and January 2009. The researchers studied more than 400,000 prices on regularly traded wines from the 13-year period, which included two bull markets and two bear markets for stocks. To construct an index of wine prices they took prices from 144 auctions with a combined value of $237 million, using vintages from 1981 to 2005.

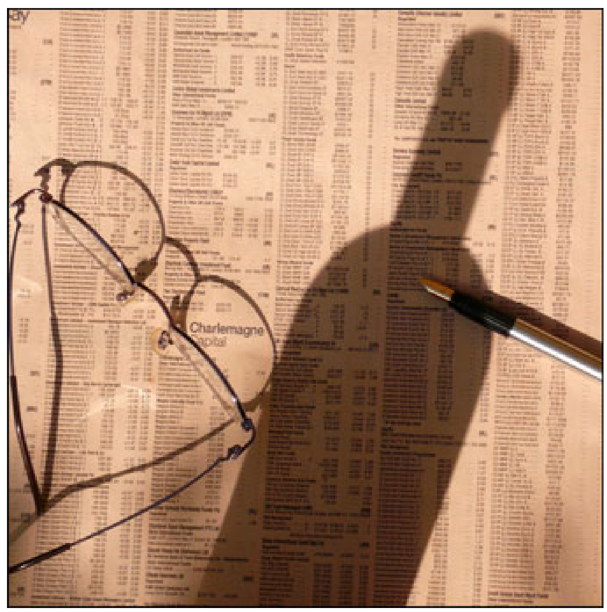
The general wine index beat the Russell 3000 over the period, largely because it held value over the most recent market downturn — and did so with lower volatility than equities. Since mid-2008, the wine measure fell 17 percent, while the stocks gauge declined 47 percent.

The index of highest-quality wines, "first growth wines of top vintages only," in particular from 2005 onward, "hugely outperforms" the other two indexes, the authors said. The elite gauge has a more than fivefold return, while the regular wine index has more than doubled. The Russell 3000 gained about 50 percent.

"Our findings show that the inclusion of wine in a portfolio and, especially, more prestigious wines, increases the portfolio's returns while reducing its risk, particularly during the financial crisis," wrote Masset and Weisskopf in their study, "Raise Your Glass: Wine Investment and the Financial Crisis."

Some would argue that fine wine and fine art are not investments, but speculative instruments, in large part because the market is thin and generally opaque as to current value. But the internet is making the market better organized and transparent as well as bringing down transaction costs. Indeed, wine is not a venture for the unprepared. Besides the thin market, bottles need to be handled carefully and stored properly to avoid breakage or spoiling. Collectors who aren't familiar with vintages, varietals and appellations could find themselves saddled with a product that's much less desirable than they'd expected. Not all wines appreciate equally and while lesser-quality wines may increase in value, they will rarely show the same performance as choice Bordeaux like Châteaux Pétrus, Ausone, and Cheval Blanc, or Burgundies from Domaine de la Romanée-Conti and Henri Jayer.

Top wine vintages have been the best performers since 1996 with wines costing more than $200 a bottle — and particularly collectible bottles above $400 — as much as quadrupling their value. That compares with a 170 percent increase in the price of wines selling below $100 and a 120 percent return for those between $100 and $199.



In a world where interest rates are zero and money is being printed around the world, there's a demand for hard assets — whether it is wine, comic books or baseball cards — because they can protect the investor from that environment. Collectibles have become a viable and serious tool for investment diversification. And hey, wine tastes good too!

- Alex Seagle

โชคช่วยคนหาปลา

"Good Luck Fisherman" in Thai

The Contrary Investor is amazed and disheartened at times by how little the American public knows or cares about world events. A cursory look at a nightly BBC News broadcast shows an almost completely different world than a nightly ABC News show. Such misunderstandings or disconnects can lead to contrarian investment opportunities.

Done well, contrarian investing is a lonely endeavor. Buy when there is blood in the streets! Every investor worth his salt knows the phrase, but very few have the intestinal fortitude to put it into practice. Indeed, most investors run for cover at such times. So what if we look at a situation where there is blood in the streets — literally — and an almost complete ignorance on the part of a lot of investors as to the current political and economic condition of an emerging market with prospects solidly tied to the two behemoths in emerging markets — China and India? That situation could be Thailand.

The best most investors can come up with when asked about Thailand is "didn't they just have a civil war, or something?" This is a classic case of sentiment lagging behind reality...in other words, a contrarian buying opportunity.

It's true, the literal blood fell in Thailand in April, when supporters of the former Prime Minister, Thaksin Shinawatra – often called red shirters, for their sartorial choices – rose up and protested in the streets. They occupied Bangkok's main airport for a week; they drove some leaders out of the country, breaking up a conference; and they demanded the dissolution of the government.

It was looking pretty bad for a bit. And tensions continue today.

But the reality on the ground is that the red shirt movement is dead. Thaksin has lost his passport, and there is an arrest warrant on his head. He'll spend the rest of his days dodging Thai officials. Leaders of the red-shirts turned themselves in – they literally walked into police stations with their hands held together before them. The reason for the sharp turnaround is one difficult for westerners to understand, but no less effective. The Thai people absolutely *love* their king, and the king has taken steps to effectively end the unrest and restore confidence in the Thai democracy.

Granted, the truly brave contrarian would have placed a bet on Thailand before now, but the prospects for the country remain good. Over the next few decades, Thailand is a brilliant hidden play on two of the best emerging markets of the world: China and India.

As a major trader with both countries, Thailand will benefit enormously from their growth. And, as one of the premier vacation spots in Asia, Thailand is also looking at decades of a booming tourist business, as Indians and Chinese start to achieve middle-class prosperity in large numbers.

Frankly, Thailand is far enough away – literally halfway around the globe, 6 a.m. here is 6 p.m. there – that the U.S. economy is a distant echo. It's much more about China, India, and the other Asian giants. And, in today's world, that's exactly where you want

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More will be announced as they confirm their availability.

a portion of your money to be.

A diversified play on Thailand is the iShares MSCI Thailand Index Fund (NYSE: THD). This closed-end fund removes the headaches of overseas trading and currency conversion, and offers exposure to the biggest and best Thai companies. Another participant is the Thai Capital Fund (AMEX: TF), set up over 20 years ago. Both are trading at hefty discounts to net asset value.

In the aftermath of the worst political unrest in Thailand in 20 years, the risks are pretty clear. The Thai SET stock exchange is under pressure; ratings agencies (if one puts much stock in them anymore!) have cut Thailand's credit rating to Negative; tourism, which accounts for about 20 percent of GDP by some estimates, is way off — down by 50 to 70 percent.

But big foreign manufacturers in Thailand — most of them with plants well away from the capital and its violence — are maintaining their investment policies and say business is carrying on as normal. A recent comment from Ford Motor is typical. "There is no change to our business plans in Thailand." Thailand is one of three Asian countries where Ford has made major investments in recent years. The others are China and India. Other companies echoing Ford's confidence in a return to normalcy include General Motors, Honda, Chevron, Seagate Technology and Mitsubishi. Many of these companies have invested in Thailand for over 40 years, evidence of their long term commitments.

Another big risk to investing in Thailand under the previous regime has been largely mitigated. So-called "Thakin-omics" was based on ever increasing consumption, mostly done on credit. This is not the case today. Long term growth for the country is on much sounder footing — economically, if not politically, speaking.

Political crises are not new or unexpected in Thailand. Since absolute monarchy was abolished in Thailand in 1932, there have been about 24 successful and failed coups, unrest, and changes in the constitution. These are incidents that give a great many investors pause. But the long term growth prospects for Thailand remain robust.

Until the recent unrest, Thailand was one of the three best-performing stock markets in Asia ex Japan in 2010. For historical perspective, in 2006 the military government put in power by a coup instituted capital controls that caused the biggest one-day drop in the Thai stock market in 31 years. Similar outcomes are not impossible now; this is not investing for the faint of heart, and overseas investors are likely to avoid the Thai markets in the short term.

At present levels, Thai stock valuations are among the lowest in Asia, essentially discounting many of the political concerns.

The Stock Exchange of Thailand

For investors seeking exposure to emerging markets that might be rapidly coming out of the global recession, Thailand — albeit with political risk — looks to prosper over time. It also looks cheap compared to India and China, the big drivers of growth Thailand will share.

❑ Alex Seagle

Words to Consider

Bad decisions make good stories.

~ Unknown

The man who is denied the opportunity of taking decisions of importance begins to regard as important the decisions he is allowed to take.

~ C. N. Parkinson

An idealist is one who, on noticing that a rose smells better than a cabbage, concludes that it will also make better soup.

~ H. L. Mencken

Think of how stupid the average person is, and realize that half of them are stupider than that.

~ George Carlin

It is better to live rich than to die rich.

~ Samuel Johnson

A synonym is a word you use when you can't spell the word you first thought of.

~ Burt Bacharach

I hope that when I die, people say about me, 'Boy, that guy sure owed me a lot of money.'

~ Jack Handey

Humanity has advanced, when it has advanced, not because it has been sober, responsible, and cautious, but because it has been playful, rebellious, and immature.

~ Tom Robbins

To succeed in life, you need two things: ignorance and confidence.

~ Mark Twain

You can tell whether a man is clever by his answers. You can tell whether a man is wise by his questions.

~ Naquib Mahfouz

It's one thing to feel that you are on the right path, but it's another to think yours is the only path.

~ Paulo Coelho

The well-bred contradict other people. The wise contradict themselves.

~ Oscar Wilde

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