During my college years, Tom Petty and the Heartbreakers rose to prominence. Over the decades to come, Tom proved that he is an American original singer and songwriter. One of his top hits, “The Waiting,” provides very good advice to common stock investors (even though he was picking among women rather than stocks):

The waiting is the hardest part  
Every day you see one more card  
You take it on faith, you take it to the heart  
The waiting is the hardest part

Most professional and individual investors want the long-duration benefit of common stock ownership but are unwilling to keep their portfolio intact through the market's ups and downs. In the current market environment and since the summer, "Every day you see one more card;" and most of the time that card has said “down.”

As Mike Tyson said, "Everyone has a plan until they get punched in the face!" The current stock market environment punches the face of share prices who underperform consensus earnings estimates and/or guide 2016 expectations lower. In this earnings season, you look up and "Every day you see one more card."

Tom Petty wrote, "You take it on faith, you take it to the heart." Out of 20 common stocks selected by a portfolio manager, it is likely that four of those will produce a significant portion of long-term portfolio performance. Over 20 years, an extremely successful common stock might have as many as four gut-wrenching declines of 40-50% in price, even as it dramatically outperforms most other common stock price movements. Berkshire Hathaway (BRKB) and Disney (DIS) are good examples. Warren Buffett says, "If you are not willing to sit through a 50% decline in the price of a stock, don't buy it in the first place."

Well yeah I might have chased a couple women around  
All it ever got me was down  
Then there were those that made me feel good  
But never as good as I'm feeling right now  
Baby you're the only one that's ever known how
To make me wanna live like I wanna live now

What feels “as good as I [Tom] feel right now” and what is required to "Make me want to live like I want to live now?" It would be sitting on multi-decade gains which far exceed the gains of the S&P 500 Index. Changing portfolio composition often is like Tom Petty having “chased a couple of women around.” The most recent study shows that the average U.S. large-cap equity fund burns through 0.81% or 81 basis points in annual cost due to trading cost and cuts off numerous future winning positions in the process. Just like Tom, "All it ever got me [them] was down." Whether it is Warren Buffett regretting the sale of Disney in 1966 or Bill Smead regretting the sale of Humana (HUM) in 2000 and Costco (COST) in 2003, getting off the train of a wonderful business before decades of stock market bliss makes me "want to live like I want to live now!"

Charlie Munger said, "Envy is a lousy sin, because it’s no fun!" Unless an attractive alternative presents itself and capital needs to be raised, portfolio changes have a tendency to work like rubbing a bar of soap; the more you rub it the smaller it gets. We spend no time grieving about high-flying stocks that are too expensive, or those which are qualitatively unqualified, or ones without a sufficient history to be in our portfolio. A man down the road from us in Seattle (Jeff Bezos) runs one of those companies. "The waiting is the hardest part" because valuation matters dearly; we want to own businesses for a long time and only those which meet our eight criteria will join the portfolio.

The waiting is the hardest part
Every day you see one more card
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The concentrated-portfolio manager who practices low turnover, such as us, must "take it on faith" that it is worth sitting through stretches in the market where stock choices fall deeply out of favor. Nobody liked our companies in 2008 and they under-liked them in 2010. It is not shocking that as the U.S. economy's strength is being questioned today, investors are punishing consumer companies like ours. As if that isn't enough consternation, populist politicians and movie makers are beating on banks and biotech/pharmaceutical companies in an attempt to get their party's nomination and to sell movie tickets.

However, in our opinion, investors should do what the song says and "take it to the heart." Our portfolio, as compared to the S&P500 Index, is the most attractive on a valuation basis as it has been since late 2012 and offers the highest forward dividend yield since 2010. Investor sentiment has been as negative in the last six weeks as it has been since the 2009 lows (a good 12-month indicator). Lastly, companies which meet our qualitative screens provide comfort to long-duration owners by virtue of their staying power, even though "The waiting is the hardest part."

Warm Regards,

William Smead

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and should not be construed as personalized or individualized investment advice. Past performance is no guarantee of future results. Bill Smead, CIO and CEO, wrote this article. It should not be assumed that investing in any securities mentioned above will or will not be profitable. A list of all recommendations made by Smead Capital Management within the past twelve month period is available upon request.

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