Ruminations of

The Contrary Investor

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Change in the Weather

Some readers may know that Fraser Management is very fortunate indeed to have collaborated with a preeminent climatologist to produce another newsletter for many years, namely, *The Browning Newsletter*. Evelyn Browning-Garriss is the author, and she followed her somewhat controversial father, Iben Browning in the passionate study of the significant effect of the earth's climate on social and economic patterns.

A number of factors have generated a lot of interest in Evelyn's work lately: unfamiliar weather patterns, increased volcanic activity, record commodities prices, high interest in "green" investing, and devastating hurricanes, to name a few. She regularly consults with a range of people directly impacted by our climate, from farmers and ranchers to sophisticated financial institutions with exposure to the effects of unexpected weather. I love that she is widely known as the "weather whisperer"!

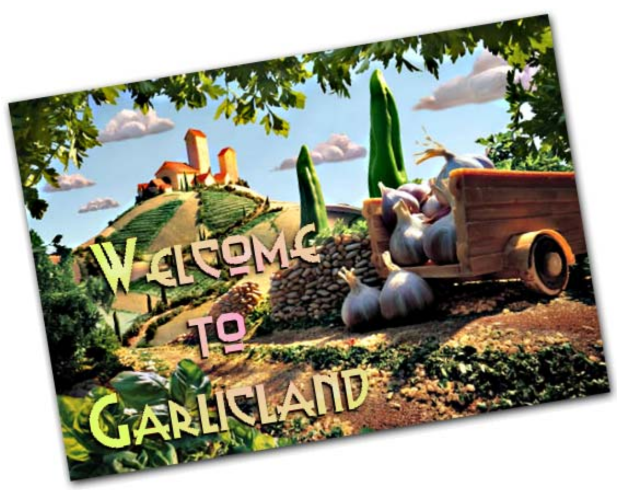
Evelyn is completely independent in her work, often goes against the conventional wisdom and prognostications of others who study the climate, and has been incredibly accurate. I know, because we routinely look back at her postings, checking to see if she was right. She has been right.

In the course of one of our recent evaluations of Evelyn's forecasting acumen, the Contrary Investor came across an unusual, but very interesting observation from the June 2010 newsletter:

"What has been the biggest, most profitable investment in the past two years? Gold? Oil? No — garlic! Garlic prices in China increased 605% to $1,200 per ton from March 2009 through February 2010. They settled briefly in April but are on their way up again.

Basically, it all began in 2008 when there was a glut of garlic. Prices plummeted, so China, which is the world's No. 1 supplier, cut its output by half in 2009. Then the swine flu struck. Garlic cloves are a Chinese folk medicine, so suddenly everyone was buying the spice. China was sold out by May. It made the US shortage of flu shots look like a picnic.

Since then speculators have made their fortunes speculating on garlic prices. Since there is no futures market [for garlic], speculation means going out and actually buying lots and lots of cloves and hoarding them. Of course eventually all bubbles burst. The new crop will be harvested and prices will drop. Someone will literally be left holding the bag. And in this case, the bag is going to stink."



Evelyn is addressing investments in commodities, not individual stocks of companies, so some wiseacre reader that rebuts her (and writes me) is surely going to be able to find a stock that has gone up more than 600% in the past two years.

But her point is valid. Our climate can have dramatic impact on investments. In the case of garlic price gyrations as the result of a swine flu epidemic, it is an amusing story; not so much when drought and fires decimate much of the world's wheat harvest, or a volcano in Iceland shuts down a significant portion of international air travel.

We hope that Evelyn will speak at our 49th Contrary Opinion Forum in Vermont next October. Some very smart people around the globe look to her for long term forecasts (she recently signed up her first Chinese subscriber!). The Contrary Investor would urge anyone interested in the study of our climate as it pertains to investment opportunities to read her letter. Evelyn does not make specific recommendations, but prefers that readers think for themselves as to how to use her information...and after all, isn't that notion at the core of contrarian thinking?

Fraser Management would gladly provide a free issue in pdf format to anyone emailing alex@fraser.com. It is difficult to gain an edge in understanding and selecting investment opportunities. There must be a bazillion experts studying financial statements and other quantitative measures to make their recommendations (or place their bets). But how many of these folks have stepped back from pure numbers, utilized unique and outstanding data not many others are using, and come away with a fresh — and the Contrary Investor would argue — more contextual, appropriate view of the entire investment landscape?

In fairness to Evelyn, the piece from her newsletter presented here is not typical of her work. The entire June 2010 issue is available at www.fraser.com/news.html (click on "view sample" at the bottom of the page). It is rare indeed to find original thinking and research that is professionally presented, unique, timely, topical, and well, good! *The Browning Newsletter* is all of these, and is highly recommended. Many thanks to Evelyn for the opportunity to work with her on this truly outstanding publication.

❑ Alex Seagle

If Food Be the Language of Love, Play On

William Shakespeare

The Contrary Investor loves to cook, as well as eat out, and all this talk of garlic turned my attention to food. In searching for a theme, it occurred to me that a widely-held view in our current economic situation is that people are staying at home much more, and eating out much less. Simply put, disposable income or the discretionary dollar is not flowing to restaurants. Indeed, it might be difficult to find anyone at a cocktail party or business meeting who did not share this sentiment. Maybe not a classic case of Crowd thinking, but worth a look.

The restaurant business in the US is huge, with 2010 industry sales projected to be $580 billion, or about 4 percent of our GDP. Restaurant workers comprise 9 percent of our workforce. The NRA (National Restaurant Association, not the other NRA) is the leading business association in the industry, and they slice and dice data just about every way you can think of. They estimate that the total economic impact of restaurants is more than $1.5 trillion, making them a strong player in economic recovery efforts.

So if no one is going out to eat, how have stocks of restaurant companies fared since everyone got that first look at their brokerage or 401(k) statement in late 2008 and quickly tightened their belts in response? It turns out, not so bad.

2008 and 2009 were, to put it mildly, challenging for the industry — but then, show me an industry that wasn't in that time frame. By way of background, the restaurant industry is segmented into several broad categories. There is the quick-service segment and the full-service segment. Then segments like bars, coffee joints, and others can be added. Like almost every industry these days, indices and ETFs have sprung up to address an investor's preferences. These are in addition to traditional individual company stocks in the space. By almost any measure, these stocks, indices and ETFs are up between 30 and 35 percent this year. For only the second time in about half a century, the restaurant industry lost jobs in 2009, but it still outperformed the national economy. The reason for this outperformance, in both good, bad, and worse times is that one of, if not *the* first places people spend that discretionary dollar is at restaurants and bars. It's not too hard to understand, given that a night out with family and friends can be a great value (think about how much improvement in the economy is needed to have folks confident enough to cause a spike in spending on, say, durable goods — refrigerators, for example — vs. eating out).

This is a one-year price chart for one of the broadest indices in the industry, the Dow Jones US Restaurant and Bar Index. The Contrary Investor is not a technical analyst, but he knows a few good ones, and they assure me this is a good-looking chart (a gain of some 30 percent for one of the most broadly-diversified measures), particularly given the challenges individuals and companies alike face these days.

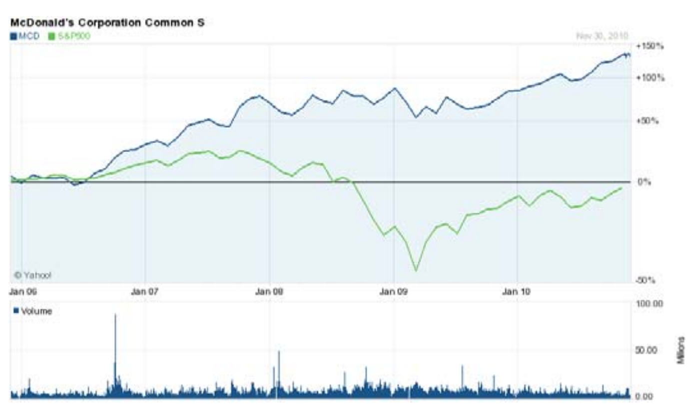
A sampling of individual companies' stock performance this year:

- McDonalds, the behemoth in the quick-serve segment has gone from about $63 to $78 per share;
- Panera Bread, also quick-serve, has risen from $63 to $100;
- Morton's, at the high end of full-serve restaurant pricing, $2.50 to $6;
- Starbucks — up from $22 to $31

Said another way, the S&P 500 index is up about 10 percent in 2010. McDonalds, up 25%; Panera, up 60%; Morton's, gaining 115%; and Starbucks, up 40%. Now the question becomes can this out-performance continue? Another concern is the short-term nature of the comparison. Extending our time frame reveals some interesting results.

For the past 5 years, the S&P is basically flat (OK, down a bit, but not a lot). Over that time period, Morton's is down about 65%; Starbucks essentially matched the market; Panera gained about 40%, and McDonalds is up close to 140% (these are all total return, not annualized return figures). These are vastly different businesses in many ways. For example, McDonalds has benefited enormously from their Asian/Chinese and European market exposure, plus they play at a cost attractive to a lot of consumers. They have also been very savvy by adding healthier options, specialty coffees, and their dollar breakfast value menu. Morton's, at the other end of the spectrum, and about as different as can be from Micky Ds, depends a great deal on expensive business dinners — obviously not the prime place to be in an economic crisis with corporate expense accounts cut to the bone.

At the risk of using my rear-view mirror to make a point, the Contrary Investor believes that real money in the stock market is made at the beginning and end of misunderstood or underappreciated trends. The perception of the Crowd has been that people are not eating out, but with even modest gains in economic data this year, the results have begun to confirm that restaurants are not going away, and will garner an even bigger share of consumers' money with continued improvement.



MCD vs S&P 500 ~ 5 Years

Perhaps it is a reflection of our instant-gratification society that investors' time horizon for evaluating stocks and performance has become incredibly compressed. The Contrary Investor does not necessarily agree with this philosophy, but I do think that investor sentiment for the restaurant industry swung too far to the negative as a result of primarily anecdotal evidence, not hard analytical work and independent thinking.

There are some interesting trends within the trend for restaurants going forward. Consumers will continue to seek value, convenience, and expanded menu options. "Word of mouth" has moved online, with more diners using the Web to browse menus, make reservations, and get recommendations from others. Social media will play an ever-growing role in restaurant marketing efforts. 4 in 10 consumers now say they choose a restaurant based on their conservation practices, and restaurants are listening. Locally sourced foods, sustainability, and health and nutrition will be the top trends for the foreseeable future. 70 percent of diners say they are more likely to visit a restaurant that offers locally produced food, and 3 out of 4 say they are trying to eat healthier than just two years ago.

Is it too late to pull up a chair at this table? The proof will be in the pudding, and will be largely based on our broader economic situation. Pent-up demand will almost certainly turn into increased restaurant traffic should the economic recovery continue, however anemic. Oh, and I apologize for the plethora of puny puns, but I couldn't resist! Bon appétit!

❑ Alex Seagle

An Idea That Might Grow On You

Many years ago, when the Contrary Investor was a young pup envisioning the future, I was pretty sure that by the year 2010 we would have jet packs and flying cars. As it turns out, I still seem to be walking or driving my trusty Honda Civic over potholed roads anywhere I need to go. But in some fields there have been astonishing advancements in technology that, while presently nascent, might be at the tipping point of offering game-changing, and possibly life-changing progress. One in particular is so-called regenerative medicine. This field of science is running smack dab into the ethical and political hot potato known as stem cell research, but advances are already incredible.

- For example, doctors are growing organs in labs and transplanting them in humans.
- Soldiers injured in wars are able to re-grow muscle and even achieve mobility and sensitivity with body parts transplanted from cadavers.
- And trials are ongoing across the globe, applying regenerative medicine principles to spinal cord injuries, organ failure, cosmetic procedures and a host of other uses.

For investment purposes, regenerative medicine falls under the broad sector known as biotech. Biotech has always been a high risk/ high reward proposition, but it appears investors have developed a greater appetite for risk after a couple of years of a no-risk attitude in the wake of the global economic contagion, and this might translate into an opportunity for more speculative ideas.

As is the case with most thematic opportunities there are a number of ways to approach investing in the developing science. Some are high risk, and others are really high risk, mainly due to the process of approval of their product offerings by means of clinical trials through the FDA. At the high end of the risk continuum, there are direct plays on regenerative science in companies trying to bring to market medicine that has or will make it past the early stages in the process through to "Phase III" trial approval — the Holy Grail for biotech companies. At the other end of the risk spectrum — the lower end (though still risky by most measures) — are companies that run clinical trials for other companies. These are known as Contract Research Organizations (CROs). And many others in between.

In terms of revenue earned, the regenerative medicine market is exploding. According to *Life Science Intelligence*, in 2008 the market pulled in about $1.5 billion. By 2013, it is expected to generate revenue of $118 billion. That's an increase of about 7,750 percent over that 5-year period.

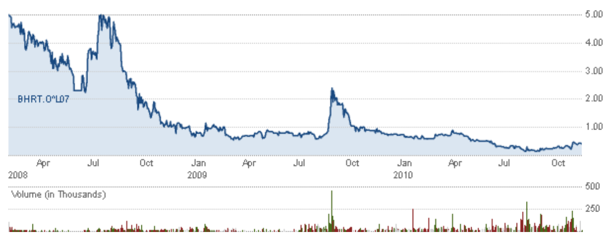
Here's the rub on investing directly in the high end of the risk spectrum: Clinicaltrials.gov, our government's database of clinical trials, lists 3,050 trials involving stem cells. But only 186 of them are in Phase III. Even worse, of those 186, only one involved a publicly traded company that was studying the effect of injected stem cells. That company is Bioheart (OTCBB: BHRT), which is currently in a Phase II/III trial for congestive heart failure.

CROs — the more indirect option — include companies like Charles River Laboratories (NYSE: CRL). Investing in a CRO or equipment company lets you participate in the expansion of the regenerative medicine market without making what is often an all-or-nothing bet on some of the earlier-stage companies.

At the really speculative end are companies like Tengion (NASDAQ: TNGN), which has several products in Phase II clinical trials with the FDA. Their products focus on bladder and urinary solutions, which are more common than most people realize. It surprises many people to learn that there are more than twice as many surgeries every year to repair or replace bladders as there are to transplant hearts.

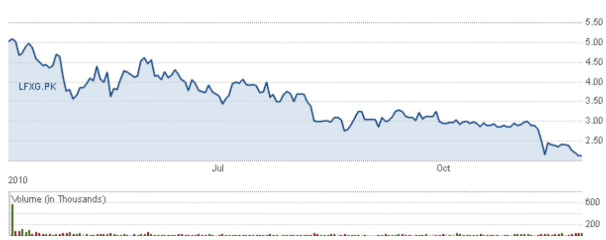
It appears that the wind may have shifted to the backs of the companies. The importance of developing the technology and products to address critical life-improving — indeed, life saving — issues is difficult to overstate. Consider that in the US, there is a death every thirty seconds from organ failure, and that our current system utilizing organ transplantation is facing a serious shortage of organs and donors. And those fortunate to receive a transplant will face a lifetime of treatment to prevent rejection of the organ.

The stocks of these representatives in the regenerative medicine space have all been taken to the woodshed over the past 5 years. From a contrarian point of view, this might be a classic case of a very low cost to enter into a powerful longer-term trend. ~ A. S.



Biohart ~ 5 Years

Charles River ~ 5 Years



Tengion ~ 5 Years.

Words to Consider

When a great genius appears in the world the dunces are all in confederacy against him.

~ Jonathan Swift

From Monty Python's *The Life of Brian:*

Brian: Look, you've got it all wrong! You don't *need* to follow me. You don't *need* to follow *anybody!* You've got to think for yourselves! You're *all* individuals!
Crowd: *[in unison]* Yes! We're all individuals!
Brian: You're all different!
Crowd: *[in unison]* Yes! We *are* all different!
Man in crowd: I'm not…
Crowd: Shhh!

The sublime and the ridiculous are often so nearly related, that it is difficult to class them separately. One step above the sublime makes the ridiculous, and one step above the ridiculous makes the sublime again.

~ Thomas Paine

The most sincere form of love is love for food.

~ George Bernard Shaw

The murals in restaurants are on par with the food in museums.

~ Peter De Vries

A new social network is about to alter the playing field of the social media world, and it's called PhoneBook.

According to its creators, who invented the network in their dorm room at Berkeley, PhoneBook is the game-changer that will leave Facebook, Twitter and even the much anticipated Google Buzz in a cloud of dust.

"With PhoneBook, you have a book that has a list of all your friends in the city, plus everyone else who lives there," says Danny Fruber, one of PhoneBook's creators.

"When you want to chat with a friend, you look them up in PhoneBook, and find their unique PhoneBook number," Fruber explains. "Then you enter that number into your phone and it connects you directly to them."

Another breakout utility of PhoneBook allows the user to arrange face-to-face meetings with his or her friends at restaurants, bars, and other "places," as Fruber calls them.

~ The Borowitz Report

A Blatant Plug

In case you didn't know, Fraser Management Associates manages money for individuals and institutions on a fee-based platform, utilizing the thematic philosophy espoused in this newsletter and by our founder, Jim Fraser. Despite the ramblings presented in this humble missive, we think we're pretty good at it. It would be our pleasure and honor to provide information on our holdings, history and performance for anyone interested in an alternative to more traditional and mundane offerings. Give us a call at 802.658.0322, or shoot an email to alex@fraser.com.

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