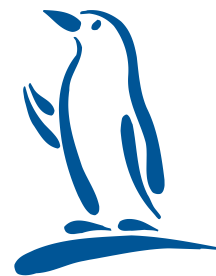


Excess Returns

Monthly insights for investment marketing and sales professionals



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“Dear Investor” letters are perhaps the most vital communication between a portfolio manager and his or her clients. The best such letters generate excitement and instill confidence. The worst are dull, complacent and filled with generalities, clichés and jargon. This month’s issue of *Excess Returns* explores best practices in letters to investors.

With best wishes,

Liz Hecht

Founder, Principal and Director of Research

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Alpha Partners is an investment marketing firm specializing in research and presentation strategy. Our goal is to create alpha (excess returns) by helping investment firms win, keep and diversify assets under management.

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Dear Investor

A while back one of my clients, a portfolio manager who runs his own firm, asked me to review a quarterly letter to investors penned by a member of his staff. I agreed to help and opened the letter as soon as it landed in my in-box. The letter was sloppily written, devoid of specificity and larded with the standard, self-satisfied clichés that often characterize such communications: “we are long-term investors” ... “we don’t practice market timing” ... “fundamental research is our guiding light” ... yadayadayada.

I honestly did not know what advice I could give to improve the letter. “Look,” I said when he called me, “You know this letter is dreadful. I know this letter is dreadful. There is absolutely no point in editing it. You just need to rewrite it yourself from scratch, and then you need to write the letters to investors yourself from now on. You write well and, most important, *you know the portfolio.*”

The advice to write it yourself, I learned later, is a best practice endorsed and lived to the letter (pun intended) by none other than the king of investor communications, Warren Buffett. As most readers of this newsletter will know, Mr. Buffett himself writes the now-legendary annual [Berkshire Hathaway letters to shareholders](#).

What you may not know, and what I learned only recently through [*Investing Between The Lines*](#), is that Mr. Buffett grades a company higher if the CEO writes his or her own shareholder letter. When asked why by *Investing Between the Lines* author L.J. Rittenhouse, Mr. Buffett explained: “I look for someone who talks to me frankly and honestly about the business, the way a partner would. If the CEO doesn’t write the letter, it’s a black mark against them for one reason — they may not know their business very well.”

Best Practices in Letters to Investors

In addition to “write it yourself” (as the portfolio manager, CIO or CEO), the following best practices also may be helpful to you and your firm in writing effective letters to investors.

Bring the Portfolio to Life. The portfolio is not made up of sectors and statistics. It consists of companies and the people who run them. Who can ever forget Rose Blumkin, founder of the Nebraska Furniture Mart, a company that joined the Berkshire Hathaway fold in 1983? Mrs. B, we learn in Mr. Buffett’s 2013 letter to shareholders, emigrated to the United States from Russia. She never spent a day in school and she worked at the company she founded until the age of 103. Investor letters need more such information about the companies in the portfolio and the people behind them.

Provide Historical Context. In 2008, the per-share book value of Berkshire Hathaway declined 9.6% while the S&P 500 declined 37%. In the opening paragraphs of the 2008 letter to shareholders, Mr. Buffett soothes investors with the balm of historical context:

Amid this bad news ... never forget that our country has faced far worse travails in the past. In the 20th Century alone, we dealt with two great wars (one of which we initially appeared to be losing); a dozen or so panics and recessions; virulent inflation that led to a 21 1/2% prime rate in 1980; and the Great Depression of the 1930s, when unemployment ranged between 15% and 25% for many years. America has had no shortage of challenges.

Without fail, however, we’ve overcome them. In the face of those obstacles — and many others — the real standard of living for Americans improved nearly *seven-fold* during the 1900s, while the Dow Jones Industrials rose from 66 to 11,497. Compare the record of this period with the dozens of centuries during which humans secured only tiny gains, if any, in how they lived. Though the path has not been smooth, our economic system has worked extraordinarily well over time. It has unleashed human potential as no other system has, and it will continue to do so. America’s best days lie ahead.

Investor letters can thus instill confidence even when the world seems to be coming to an end.

Communicate a Point of View. When asked to provide the confidence-inspiring historical context and future perspective noted above, however, many portfolio managers are unable to do so. They hide behind the assertion that their investment orientation is exclusively bottom up and long term. They protest that they never address what's going on in the larger market as this would smack of market timing. A consistent theme in Mr. Buffett's writing is investing in stocks as if they were "small portions of businesses" and then holding them for the long term. Reading his letters, however, it strikes me that his bottom-up, long-term focus has often been misinterpreted by those who glibly disavow the importance of big-picture perspective. If I were a Berkshire Hathaway investor who met Mr. Buffett in a coffee shop and asked him what was going on in the portfolio, he would provide (just as he does in his letters) an in-depth, thoughtful description rich with detail about the companies, the industries where they operate and the larger world that supports them. He would offer, in other words, a point of view. He would not scold me for invoking the evil of market timing.

Put Performance in Perspective. When it comes to the business of investing and communications about investing, any form of excess should be avoided — excessive pride or excessive penitence. The tone of investor letters should be factual, forthright, and humble, neither overdramatizing weak numbers nor aggrandizing strong numbers. When the numbers are fantastic, remind investors when and why they are likely to be less fantastic. When the numbers are disappointing, admit mistakes and do not make excuses. The explanatory detail and modest tone of earlier letters will serve you well when your numbers are down.

Circle Back Often. In this same vein, remind your investors what you wrote in past letters and how it turned out. Were you right or wrong and why? What did you miss? As I have written [in the past](#), one of the best ways to understand how a portfolio manager works is to understand past mistakes and how the manager learned from his or her mistakes.

There are many reasons why portfolio managers and CIOs do not write their own letters to investors. They may simply not write well enough or they may be unwilling to make the time to communicate with their investors. In his 2013 letter to shareholders, Mr. Buffett writes, "[We] like your company's prospects. We feel fortunate to be entrusted with its management." In other words, "This is *your company* and we are the faithful, hard-working servants of *your money*." Such language has permeated his communications with investors over the years, and is likely well received precisely because it is rare. After all, Mr. Buffett operates in a world where some believe that communicating effectively with investors is not sufficiently important to merit their time.

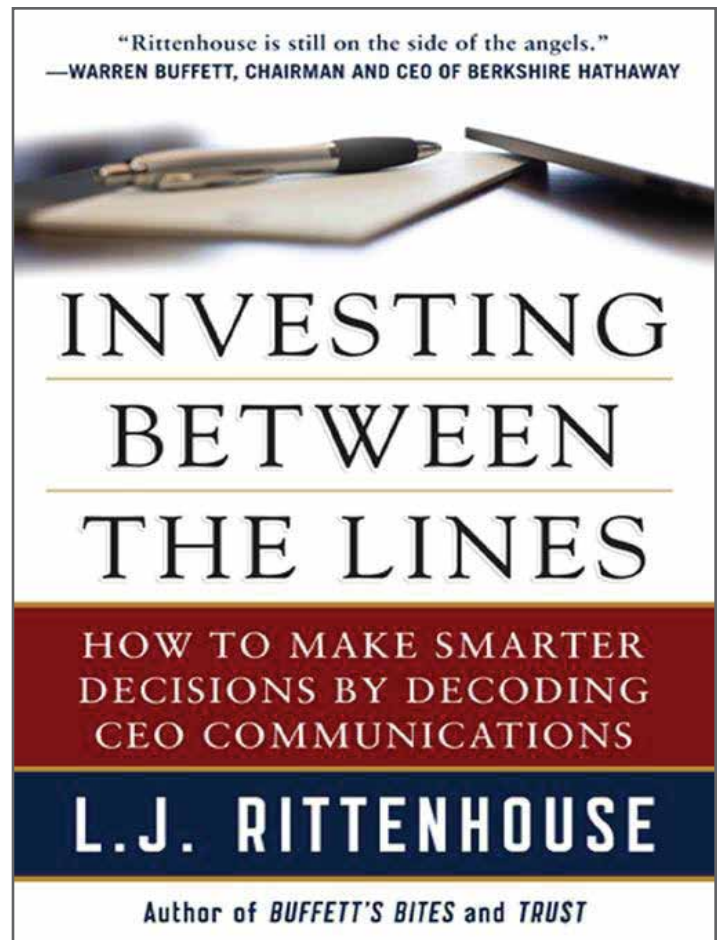


Between the Lines

Investing Between The Lines: How to Make Smarter Decisions by Decoding CEO Communications is

a fascinating, necessary, eye-opener of a book.

Author Laura Rittenhouse, President of [Rittenhouse Rankings](#), has made a formal study of the “linguistic clues” embedded in letters to shareholders. This 2013 book shows how companies that communicate with candor outperform their peers and how investors can learn to identify lack of candor in companies such as Enron before they declare bankruptcy.



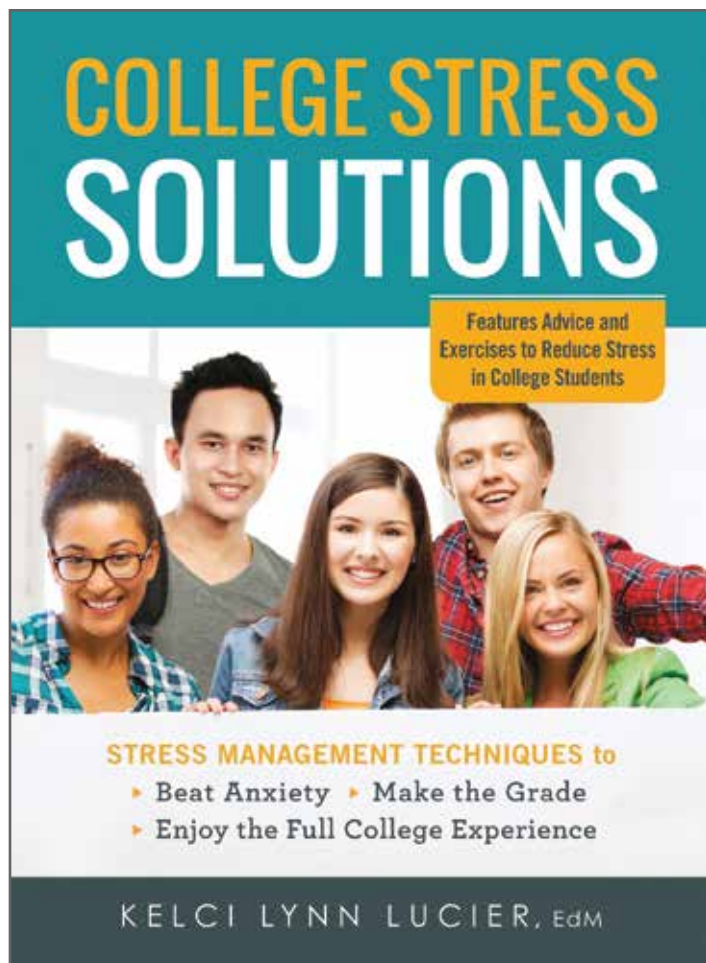
Investing Between the Lines documents how words can be just as important as numbers in understanding a company's long-term investment potential.



College Stress Solutions

Alpha Partners' Strategic Partner [Kelci Lynn Lucier](#) has written a book, [College Stress Solutions](#). As soon as I heard about her new book, I and apparently many other people said, "Wow! I wish I had a book like that while in college!" If you have children, grandchildren or siblings in college now, you might want to make them aware of Kelci's new book. *College Stress Solutions* considers different sources of stress for students — academic, financial, social and family, among others — and then proposes commonsense solutions. The book can be read cover to cover or kept on a shelf and referred to as needed.

Kelci Lynn has assisted Alpha Partners for many years with a variety of editorial projects, and we have come to rely on her expertise as an editor. We are delighted that she has written such an important book. Congratulations, Kelci!



College pressures can be daunting, especially in a difficult job market. This book is filled with practical advice for students who want to combine academic success with enjoyment of all college has to offer.