Remove the emotion. Think. Be patient. **May 11, 2012**

"We live in an investment world populated not by those who must be logically persuaded to believe, but by the hopeful, credulous and greedy, grasping for an excuse to believe."

Warren Buffett wrote this in 1968 during the peak of the "Nifty 50" bull market when a select group of stocks drove the stock market and reached sky-high valuations that could not be sustained. Investors poured money into those "hot" stocks with no regard to their valuations but simply because *"they keep going up".* It ended very badly.

Similarly in early 2000 at the pinnacle of the dot-com bubble, Buffett was labeled a "dinosaur" because he was not participating in the mania. He said then, *"I'm not worried in the least. I know how this will end. What I cannot know is when it will end."*

Another great investor we follow, Seth Klarman said in his highly acclaimed book (*reading it now*) **Margin of Safety** – *"Individual and institutional investors alike frequently demonstrate an inability to make long-term investment decisions based on business fundamentals….focused on short-term returns, (they) are frequently attracted to the latest market fads as a source of superior relative performance. The temptation of making the fast buck is great and many will find it hard to fight the crowd. Greed leads investors to make high-risk bets based upon optimistic predictions and to focus on return while ignoring risk."*

Back to the first quote – Greatmark strives to invest your hard-earned life savings in a way where we **must** be *logically persuaded to believe* before we invest. We look very hard at valuations. A client called this week about a tech stock. It had risen from $25 to $85 in three years and trades for 30x next year's earnings. Enough said for us….not interested. We've been asked about Amazon.com – we love the company but the stock is now $225 up from $75 three years ago and trades for 52x 2014's earnings!

We just cannot "bet" your savings on a company – *no matter how good a company it is* – trading at nearly 100x this year's earnings, 75x next year's and 50x the following year's. Valuations matter. They matter in buying a car, buying a home, buying timber land and they matter in buying stocks. To buy stocks at these valuations could only be driven by "hopeful, credulous" thinking "grasping for an excuse to believe" the run can continue. And while the "hot" stock may stay hot, that is a bet Greatmark is never willing to make. There is way too much downside if it doesn't pan out.

We take much greater comfort buying a stock like Intel or Microsoft at 10x earnings with strong dividends and fortress balance sheets than we would in chasing a hot idea on the *hopes* it can keep hitting homeruns. We think we can win a lot of ball games hitting singles and doubles and making fewer unforced errors.

Facebook

Facebook is coming public next week and we've talked about it with a few of you this week. Facebook is coming public in the range of 20x sales and 100x earnings. Google – *by comparison* – today trades for around 5x sales and 14x next year's earnings. Now Google is a more mature business and Facebook is growing faster but that is a very rich entry point. The expected market cap of Facebook will be about $105 billion. That means Facebook is worth more than McDonalds, Amazon or Disney. It is supposedly worth more than Nike and Starbucks *combined* and almost as much as Target and Home Depot *combined*. On top of that, Facebook is run by a 28-year old entrepreneur. He's brilliant and driven but at 28 does he have the skills and temperament to run a company worth $100+ billion? Perhaps he does but consider this from their S-1 filing, Mark Zuckerberg says this…

"Facebook was not originally created to be a company. It was built to accomplish a social mission."
"It is important that everyone who invests in Facebook understands what this mission means to us."
"We do not wake up in the morning with the primary goal of making money."
"We are going public for our employees and our (existing) investors."

An analyst said this about the filing, *"He cares about his product, not you (the new investor) or "returns." He views you (the new buyers of his stock) as a source of liquidity for his employees wanting to sell some of their stock and his existing shareholders. He is only taking it public because he has to. Zuckerberg holds a 57% voting control meaning shareholders are not legally entitled to tell him what to do."*

Facebook is a remarkable invention. No question. We have concerns about the usage (*we believe many users are tiring of the product*) and the transition to mobile usage (*Facebook can't get as many ads on your phone as they can your laptop*) which is rising sharply. Most of all, we won't pay 100x earnings for it no matter how attractive it is.

We also readily admit going in that we'll probably be wrong….at least for a while. Our way of investing isn't the only way. Facebook will probably become the next Google or Apple and be a huge home run. We just can't pay the price of entry. We can't invest your money that way. We must be logically persuaded to believe. With your other holdings, we are. We cannot invest on a hope, a dream or a *"what might be".* You've worked way too hard for your money and we take our stewardship role way too seriously to take that kind of risk.

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