

## Building Trust

**W**hile it's tempting to rest on our laurels, we recognize those past accomplishments are not nearly so meaningful to newer clients, accordingly I feel compelled to tell you that CUSH had a bad quarter. There it is. I said it. Yuck. I hate saying it, but it's true. I am not going to hide from it like 99% of our competition who go dark during periods of volatility. Our clients who have been with us for years appreciate this distinguishing characteristic and our most astute clients recognize this candor as an opportunity to capitalize on the natural ebb and flow of a process they have come to know and trust. This kind of trust can take years to develop. I write this month's newsletter as part of the process of building and maintaining the trust that is so central to our work.

At CUSH we customize all of our portfolios according to the risk tolerance of the individual. Notwithstanding, because most of our clients have tolerance for some risk, portfolios have a tendency to move together -- directionally speaking. So this month, at a broad level, I am writing to explain some of the volatility inside of the CUSH portfolios over the last few months. My hope is that in doing so I will be able to leave our clients with a greater sense of peace about their future. Something like this:

*"Ah-ha, I get it. I see now how despite recent volatility the strategy CUSH is employing comes together to produce a portfolio that should protect and grow my wealth over time. I feel very comfortable. I will sleep well tonight. I love CUSH Capital, and I can't wait to tell all my friends. Maybe I should send those guys a box of cookies."* -- CUSH Capital Client

OK, so that might be a stretch but we did receive some very encouraging feedback from our last [What's The Big Idea?](#) event, so I am going to give it the old college try here in newsletter format since this is the best way I have to reach all our clients simultaneously

while maintaining focus on our core work. First I encourage all our readers to watch the video (<http://cushcapital.com/videos.php>) of our event last month and read our [December Newsletter](#) as we have put a lot of effort into trying to share our thoughts on the unfolding European Debt crisis which represents the largest risk to the markets in 2012 and beyond. For further insights I would also direct you to John Mauldin's year-end letter: [Collateral Damage](#). It is excellent!

When I saw this cartoon in the most recent edition of [Jim Grant's Interest Rate Observer](#), I knew that I had to include it because it so perfectly tells the story of the last six months. As many of our readers know, we have been growing increasingly risk averse as the aforementioned crisis in Europe continues to look more and more dire; -- again reference our [December Newsletter](#) and [Video](#) of our most recent client event (that's the second time I've mentioned it - wink, wink, nudge, nudge). In the quarter ended 9-30-2011 that conservatism made us look **very smart** in the face of a 20% plus sell-off in the global markets. As markets rebounded on false hopes of a solution to this slow-motion train wreck, the measures we took to insulate our clients from systemic shock (think Lehman Brothers) proved to be a drag on our returns. That's not to be unexpected, frankly, since the emotional turbulence that we so often capitalize on has to swing both ways. Couple this with several of our individual holdings that performed poorly and you have a recipe for some natural second-guessing. So let me try to add some detail:

I'd like to break the story of the last few months into two parts: 1) our natural skepticism and risk aversion for all things Europe, these days and 2) stock-picking at the individual security level. I am not going to use this newsletter as a forum to re-hash all of the evidence we have already put forth

*"We have been growing increasingly risk averse as we try to mitigate the consequences of the slow-motion train wreck that is Europe."*



*"But Daddy, you were so smart yesterday."*

to support our thinking on sovereign risk. Rather I will just link to the prior material: [here](#), and [here](#).

I will also note that in executing our strategy we have chosen to employ an inverse exchange traded fund to modulate the risk we are comfortable assuming on behalf of our clients. This is basically a mutual fund that goes up when the market goes down, creating something of a hedge against a systemic shock. We estimate the likelihood of this at 30%. We have been asked in the past: “*Why wouldn't you just hold cash?*” That is a perfectly reasonable question and we understand how betting against the market can appear counter-productive, but in practice a small allocation to an inverse fund frees up cash for opportunities that (given our research) exhibit every likelihood of out-performing the market in the face of these risks. We have talked about such opportunities many times in the past as we seek to create a portfolio of things people can't do without: utilities, pipelines, oil, gas, hard assets, medicine, etc.

When our stock-picking underperforms in a given quarter, however, the wisdom of this model can look like something less than wisdom. This is the second part of the story as several of our individual holdings declined in price in the last few months. So the conversation turns now to portfolio composition. What is going on at the individual security level? If prices are cheaper, does this represent an error or an opportunity to buy more at better prices? These are the kinds of questions that our intensive research process is built for.

Pardon a short digression, but my partner Mike Curran is fond of sharing the story of how he came to join CUSH Capital. You can read the whole story in our [January 2011 Newsletter](#), but as part of the abbreviated version Mike will tell you that he first had CUSH Capital manage his own personal funds so that he could get a feel for how we do things. During that process, one of the securities we held experienced some rather

extreme volatility (down over 30%). Coming to understand our conviction and contrarian viewpoint played a big part in Mike's decision to join our team. We were able to provide the proper perspective on the long-term dynamics of the business and industry, and ultimately shine some light on how the market's myopic focus on short-term performance was creating opportunity for our clients.

This same market myopia has recently affected several of our investments: an oil & gas company (ATPG), a telecom company (IDT), and a bio-defense company (SIGA). We still hold them because we still believe in the long-term prospects. One indication of the market's short-sightedness for ATPG and SIGA is the recent insider buying activity. It is always a positive sign when the management team is ponying up their own money to buy more of a company's stock. If I had the time and the space this month I would take a deep dive into each one of these companies to share in more detail some of the work we have done. But proving ourselves in that regard is not really the purpose of this newsletter -- that has been the purpose of many past newsletters and all of our client events and is evidenced by our [Morningstar Rating](#) and acknowledgement from the [Kansas City Business Journal](#) last year -- No, as I already mentioned the purpose of this newsletter is to build trust by pointing out the method to our madness (so to speak).

Inherent in our process is the recognition that in any given period one or two or three holdings will experience volatility. The fact that these three disparate companies (bio-defense, telecom, oil & natural gas) as well as our macro hedge (inverse exchange traded fund) all worked against us in the preceding months is sheer coincidence (aka bad luck). Over time, we know (as professional investors) that we will see just as many periods, probably more, where the inverse is true. Savvy investing is not gambling, yet the fact is that no one can predict the future. Ultimately we make decisions in an uncertain environment (called reality) and we have to

*“It's incumbent upon us as financial advisors to make people comfortable with what they are not comfortable with.”*

let ourselves be guided by our core values. At CUSH that means we are always questioning ourselves, revisiting our investment theses, double-checking our work, going back through the portfolio to ask ourselves if we have missed something or if there is something we need to be doing differently. We challenge ourselves to do a better job on a daily basis. Learning from your mistakes is critical for a portfolio manager and post-mortems are a natural part of an ongoing improvement process. Lest our poor readers get too downtrodden, we have not been without successes. Some of which have been recent and sizeable. Alas, our regulators prevent me from sharing them here for fear I would cherry-pick only the work which shows us in the best light (who me? Never! ☺)

I see a tendency among investors to look at their portfolio and extrapolate a straight line through two or more data points: e.g. if a retail investor loses 3% in each of the last three months or 10% for the quarter, he/she might surmise that they will be bankrupt in another nine quarters. This is obviously irrational and runs contrary to everything we know about the cyclical nature of the markets. Nevertheless, this is the way the human brain works. **It's incumbent upon us as financial advisors to make people comfortable with what they are not comfortable with.** Successful investors have to re-program themselves to make decisions contrary to millions of years of evolution. While *'fight or flight'* might suggest: *'take the money and run'*, a more rational investor recognizes the underlying value in the businesses and assets that back the flickering quotations on their computer screen. When the market presents an opportunity to buy more of a great asset (utility, pipeline, food, timberland, gold, oil) at a better price, the correct response becomes: yes please! This is what Warren Buffett is referring to when he says: *"Be greedy when others are fearful and fearful when others are greedy."*

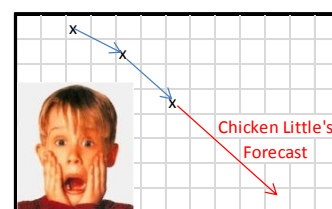
I never like to see a down quarter, but unless you are Bernie Madoff it's going to

happen. What really bothers investors is the not knowing . . . the silence. This is where CUSH has an advantage. Our due diligence allows us to tell a story and provide insights that most financial advisors can't provide on account of outsourcing that very part of the process to some mutual fund manager in New York or Chicago or San Francisco. We don't have to rely on the catchphrases that become crutches for less knowledgeable advisors like *'markets always come back,' 'the market fluctuates,' 'stay the course,' 'it'll be OK,'* or *'trust us.'*

At CUSH we view these newsletters as a part of our fiduciary duty to keep clients informed. We never want our clients to have anxiety. We have the best clients in the world. We love our clients, and we know that if we will just take the time to reach out via this newsletter, client events, investor's club, and individual conversations we actually benefit from their wisdom. We get great ideas from our clients, and they in turn make us better at what we do.

All we ask in return is the appropriate amount of time to demonstrate the efficacy of our model. That means a full market cycle including both a bull market and a bear market over a period that encompasses an economic recession and expansion. That is a minimum of three years. Many investors today have conditioned themselves to take meaning from time periods much shorter; sometimes monthly or weekly. For an investor trying to build wealth over a lifetime this is akin to going on a diet and weighing yourself every 15 minutes! It makes no sense, and yet investors continually assign meaning to meaningless fluctuations. It's not that we don't want our clients to be alert, because we do. But with that alertness we'd like to add the perspective that comes with the years of experience that CUSH offers. What we do is not sexy, but it is effective when your priorities are managing risk, preserving capital and building trust. •

*"There is a natural (yet irrational) tendency for investors to forecast by extrapolating recent data points."*



## Our Mission

CUSH Capital seeks to educate our clients about the market and serve as trusted advisor. By customizing and tailoring financial plans to each client, we strive to create a shared vision of your future. CUSH Capital provides our clients the tools and resources to implement this future. This is only made possible by our independence, which eliminates conflicts of interest and allows us to act as a fiduciary in all matters. We recognize the great depth of our responsibility with regard to our clients' financial future, and we don't take that lightly. Ultimately, our goal is to assist our clients in creating the most secure, comfortable and meaningful lives for themselves and for their families. In every way, in all that we do, we are committed to serving our clients with discretion, honesty, and integrity.

## The Strategy

At our core we are value investors, but in truth our philosophy so clearly differs from that of the herd. We have little difficulty distinguishing ourselves from the frenetic hyperactive trading strategies profiled on the financial news channels and common to so many other advisors. We offer a better alternative by selecting high quality stocks and bonds for the long-run. This low turnover, tax efficient approach is considered one of the most successful techniques for compounding wealth ever created. The key points are:

- 1) Targeting businesses with long-term sustainable competitive advantages.** This allows investors to compound gains and avoid excessive transaction costs. (Short-term selling and reinvesting can substantially eat up profits due to trading costs and tax consequences compounded over time).
- 2) Recognizing that stocks are businesses with an intrinsic value that correlates to success in the longer-term.** This intrinsic value CAN be measured, but it takes serious work to do that well.
- 3) Knowing that it is rare to find a great company with a sustainable competitive advantage trading at a discount to its intrinsic value.** When these opportunities present themselves you have to be prepared to invest with conviction.

## Vern Cushenbery, CFA, CPA Owner / Portfolio Manager

I founded CUSH Capital to deliver my clients the kind of trusted financial advice and portfolio management that is so rare in the financial community.

My years of experience in consulting allowed me to audit the portfolio strategies used by the very best. There is no substitute for hard work in this business -- no secret sauce. The only way to succeed in the long-run is to do your own research and think for yourself because if you follow the crowd or get caught up in the confusion of the financial press, then you are certain to fail.

CUSH Capital pioneered the concept of **wholesale investing**. We do our own research; we don't outsource, we **in-source**. Not only does this keep us independent, but it also lowers your fees. I publish this newsletter to keep clients involved and informed. I invite you to become a part of our team. Visit our website to subscribe to this newsletter today, or call me. I will be happy to answer any questions about your financial future.



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Sincerely,

A handwritten signature in blue ink that reads "Vern".

Vern Cushenbery, CFA, CPA

Mr. Cushenbery has more than 13 years of experience in portfolio management and research. He was formerly Chief Investment Officer with Legacy Investment Management, and prior to that he was with Kornitzer Capital, sub-advisor to the Buffalo Funds. He holds an MBA and a Masters of Accountancy degree from the University of Missouri at Kansas City, and a BS in Finance from Kansas State University. As a CFA Charterholder and Certified Public Accountant, Vern is uniquely qualified as an investment advisor.

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