Antares
INVESTMENT MANAGEMENT
Quarterly Report
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For investors that are as concerned about a return **of** their principal as they are concerned about a return **on** their principal

Lessons from Omaha

There are few better ways of investing than to mimic the approach taken by Warren Buffett. There is no need to create a new way of investing, when such a tried and true method of investing already exists and has been used with such success for so many years. And there is no better place to learn about Buffett's approach than the Berkshire Hathaway annual general meeting.

Now as business meetings go, this one is quite unique. There are no other companies that have over 35,000 shareholders show up for a business meeting. But then, there are no other companies like Berkshire, and no other investors like Buffett and Charlie Munger, Buffett's partner for the better part of 40 years.

"A question and answer session that lasts for close to 6 hours."

The format is the same as in other years...basically a question and answer session that lasts for close to 6 hours. Needless to say, there were more questions than time allowed answers for.

This year I also took in an investing panel discussion hosted by Creighton University which featured various money managers and the author of one of my favorite books on investing, Bruce Greenwald. Greenwald got an endorsement from Buffett back in 2001 for the Security Analysis course he teaches at Columbia University, and it was Greenwald's book that I used while teaching Security Analysis at the University of Manitoba. To be honest, it was only Greenwald that drew me in, but the panel discussion was worthwhile.

"Derivatives...a better way of gambling."

Here are the highlights of the responses from Buffett and Munger, as well my comments on each one.

1) Due to the heavy use of derivatives for speculation rather than insurance purposes, derivatives were described by Munger (in a sarcasm heavy quip) as "a better way of gambling". Derivatives were first used as insurance by farmers, miners, and exporters as a way of protecting them from price and currency swings; which is the way Antares uses them. Rampant speculation with derivatives has far reaching consequences, as the 2008 market meltdown has shown.

"Investors need to be prepared when opportunities present themselves."

2) Buffett said that "Investors need to be prepared when opportunities present themselves." That means holding some cash with which to strike. The dividends that are being paid to you help in this regard.
3) Both Munger and Buffett were not concerned about currency movements. They agreed that all currencies would be devalued over time; meaning that

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inflation would eventually be a tough force to be reckoned with. Companies that are able to pass on higher costs will not be as affected as those companies that do not have any pricing power.

4) Munger said that "People should get used to uninspiring returns over time. Stocks right now, represent the best of a bad lot, of investing options." With interest rates at all time lows it will be difficult to retire on a fixed income in a world with rising inflation (see point above). With time, well run businesses purchased at good prices will alleviate much of that dilemma.

> "Temperament is the greatest predictor of investing success."

5) A question was asked about where to put money now. Buffett replied that short term bonds were the best place. See note #2 on the prior page. You may have noticed that we have followed this approach; even before the Berkshire meeting.
6) Buffett mentioned again that temperament is the greatest predictor of investing success. The ability to not let stock market prices dictate fondness or dislike of a particular company will go a long way to investing in a rational manner. Success comes from making rational decisions.
7) Buffett is not a fan of a company making acquisitions for the sake of making acquisitions. Unless a company is getting something of better value (or at least equal value) in return for something it is giving up, an acquisition does not make much sense. It is for this reason that he was not in favour of Kraft's buyout of Cadbury. In the end he would have kept Kraft's frozen pizza business and not made the Cadbury purchase. As an owner of both companies prior to the deal, he obviously felt that Cadbury was a fine company in it's own right. Simply put, Kraft overpaid.

> "A company that does not earn its' cost of capital should be avoided."

8) A company that does not earn its' cost of capital should be avoided. For many companies there is a high cost to getting the capital, for other companies the capital is almost free. Buffett focuses his efforts primarily on investing in those companies that have a very low cost of capital and are able to consistently generate a return in excess of that cost. Airlines are an example of an industry that consistently DOES NOT generate a positive return on capital, while most large consumer goods companies are able to generate substantial cash amounts in excess of their capital needs.

> "Risk at it's core is not about volatility and variances of stock prices, but the permanent loss of capital."

9) Risk at its' core is not about volatility and variances of stock prices, but the permanent loss of capital. Fluctuating prices can be annoying but pose no real long term risk. If a company is on solid footing the share price can recover. However, the permanent loss of capital can never be regained (Nortel and CanWest come to mind).

As you can see, Buffett's approach to investing is much more based on common sense than on fancy mathematical formulas. Keeping things simple and straight forward is something that is too often overlooked with investing.

For us to be effective in managing your portfolio we need to be sure of the goals you have for your money. If things have changed in your life, it may mean a change in what you need your money to do for you. We suggest a review of your situation at least annually to ensure we are managing your portfolio in the manner that is needed for you to achieve your financial goals. If your situation has recently changed, we will need to meet with you, to review your portfolio. This will provide you with the comfort of knowing that your portfolio is working for you.

Looking Ahead

This last quarter has certainly been an interesting one. Between the oil crisis in the Gulf of Mexico, the bond crisis in Greece, the bank crisis in Spain, and the state budget crisis in the U.S., there have been few weeks without some kind of drama.

"There have been few weeks without some kind of drama."

There are certainly things to be optimist about. The unemployment rate in the U.S. is below 10%, housing starts have climbed from last years lows, China's enormous stimulus spending has kept it out of a recession, and the Baltic Dry Index (a measure of global shipping prices) has also risen. Also, there has been discussion as to whether the U.S. government should start additional stimulus spending to spur the recovery on. While a recovery usually starts out slowly just like now, it gathers steam as rising stock prices and housing prices provide the confidence for people to start spending money again. As the money gets spent, factories and stores hire more people to meet the extra demand and unemployment decreases. Yes, it is all unfolding as it should, though much slower than hoped.

So what's wrong with this picture?

"The problem is that now that the money is spent, it cannot be spent again."

For starters, major government stimulus spending is being cut. Programs such as the U.S. "Cash for Clunkers" and "First Time Homebuyers", and Canada's "Home Renovation Tax Credit" offered government incentives to increase spending during a period that suffered from a lack of it. So all that has really happened is that money that might have been spent in November of this year, got spent in February of this year (that is precisely what happened in our own family). The problem is that now that the money is spent, it cannot be spent again in November.

Governments have also enacted measures to tax more and spend less. Greece and Ireland have been among the first, but now the G20 group of countries have agreed to reduce their budget deficits significantly. This will be a further damper on overall spending. Combine that with balanced budget legislation for U.S. states and the ability for further government spending is diminished.

"Prices in many areas have not gone back to what they were before."

While U.S. housing prices have rebounded somewhat, prices in many areas have not gone back to what they were before. People are still living in houses with mortgages that are higher than the value of the property. There are many reports now of people living in their houses for free because the banks do not want to foreclose. After allowing for the property damage that is usually caused by people in foreclosure situations, the cost of continued surveillance and insurance while it stands empty, banks would be forced to take a hit on their balance sheets. Because of new rules, banks will now have to carry more

Looking Ahead

continued

capital, so they are reluctant to take write-downs. This situation is unlikely to give people confidence to continue to spend money, particularly when job growth is slow at best and many are still worried about their work situation.

China's economy has been growing but there are signs of trouble there as well. Real estate prices have been driven up and entire high-rises are sitting mostly vacant as developers took the government stimulus money and put it to work to house the millions of people that would be leaving the farm each year to join the workforces in the industrialized cities. In fact, Business Week reported that there is an entire town, complete with roads, apartment buildings, factories, and shops that is sitting empty. It was a project taken on by a government official, but now stands empty as the migrating workers have not shown up. The government is now calling on banks to reel in their lending. Write-downs are almost certain.

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So what does this mean for you? While this means that caution is definitely warranted, in the broader sense all of this should not have much impact at all.

"It is unlikely that purchases of these things will be put off until things look better."

No matter what happens in the economy, people are very likely to continue to eat, to communicate with each other, to use cosmetics and wash their hair, and seek medical attention when needed. We have focused on these companies because it is unlikely that purchases of these things will be put off until things look better, so sales will continue to roll on.

For example, L'Oreal just announced a 12% increase in sales in this last quarter, Kraft had a sales increase of 3.4% in the prior quarter, and Vodafone increased its' revenue by 8.4% in the last year (it now has over 340 million subscribers worldwide). In Canada, Loblaws sales have held steady in a difficult 2009, as have sales at BCE and Telus, the two largest communications companies in Canada. As a bonus, each of these companies pays a dividend; so we get regular cash flow.

"You can rest easy knowing that your friends, neighbours, and thousands of others across the ocean will continue to buy products from your company."

Companies like these are safe places to invest because they are profitable today and do not have excessive debt. We know that the companies are stable, so even if the economy goes off the rails in Canada, you can rest easy knowing that your friends, neighbours, and thousands of others across the ocean will continue to buy products from your company.

Also, in keeping with #2 on the list, each of your portfolios has an adequate supply of ready cash which can be deployed to buy the stock of other well run companies, similar to those above. Buying safe companies and holding cash should allow us to weather any economic storm and prosper in spite of them. The cautious approach should allow you to sleep well. I trust that it does.