A Vision for Silverado Investment Partners

"Life is like a snowball. The important thing is finding wet snow and a really long hill." – Warren Buffett

History

In September of 2002, I gathered a few of my closest friends and started an investment club with two lofty goals:

1. Learn to understand how the complicated world of investing works
2. And to beat investment professionals at their own game

Each of the partners started with a $200 investment and a commitment to both meet and contribute an additional $50 each month. In our first five years, we grew to $250,000 in assets while successfully learning and beating the pros – returning an annualized compounded 15.35% per year over those five years.

Purpose – Alignment of Interests

Investment professionals have two main ways of making money, both of which come with significant conflicts of interest as they pit client and adviser objectives against each other:

1. Commissions – In a commission arrangement, the adviser is paid by the transaction. It doesn't matter how well your investments do: The more activity, the better!
2. Asset based management fees – In an asset based fee arrangement, the adviser's incentive is to maximize the assets under management. This means managing your portfolio takes a back seat to prospecting for new clientele since new money is the only real way your adviser gets a raise.

Silverado Investment Partners charges no commissions and no management fees. In fact, investors pay nothing until we earn 6% per year. Once 6% is earned, investors and management split profits 75/25.

In much the same way Mr. Buffett began his 1950's partnerships; Silverado Investment Partners aligns the interests of its management and partners. Why should I be paid if I'm not doing the one thing you hired me to do – make money? I have the overwhelming majority of my net worth invested in our partnership. Your money will be invested exactly the same as mine and I don't make anything unless you make money too. Our interests are completely aligned.

These inherent conflicts of interest in money management are costing individual investors dearly. According to a study by Vanguard founder Jack Bogle; in an average year, 80% of mutual funds underperform the S&P 500 Index. This underperformance, in large part, can be attributed to fees charged by these funds no matter how well they perform. So while the S&P 500 returns 12.2% on average, the average mutual fund only returns 9.6%. And because investors plow

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more money into stocks at the top of the market, and sell near the bottom, the average mutual fund investor returns only 2.7%.[1] On top of that, most amateur investors employ an adviser who undoubtedly earns a fee regardless of whether their investor makes money or losses money.

Studies show the number one cause of stress in the lives of Americans is money. People work to earn money and then use it to buy goods in the future. In between earning and spending, we are all tricked into thinking we can get better than 12.2% when in reality we'd be lucky to get 3%.

Process

With the help of my investment club partners and the resources and dedicated years of study at Chamberlain Group, I think I have learned what it will take to change the reality outlined above. While in the short run stock prices are driven by fear and greed, in the long run they reflect the fundamentals of the underlying business. Thus, the market is often inefficient in assigning a price to the true value of a company. It is, in effect, possible to buy dollar bills for fifty cents in the marketplace due to this inefficiency. While these situations can be rare at times, all I have to do is have the patience to stand there, with the bat on my shoulder, until I get the pitch I'm looking for. Fortunately for me, there are no called strikes.

I don't need many of these bargains to be successful. Another one of the investing myths relates to diversification. A study by Burton Malkiel in A Random Walk Down Wall Street suggests a portfolio of 10 stocks can achieve 80% of market diversification. Most mutual funds own several hundred. Most people own several mutual funds. How can you expect to beat the market when you *are* the market? I'm sure the manager of that mutual fund cannot possibly like all 200 of the stocks it owns the same. And since there is only a marginal amount of risk removed for every stock over 10, why drag down the performance of the fund by adding another 190?

Much like Mr. Buffett and his teacher, Ben Graham, before him; I will seek value in companies trading below their intrinsic value in one of two ways:

1. Liquidation Value – When the assets the company owns are worth more than the market value of the entire company
2. Present Value of Future Cash Flows – How much am I willing to pay today for $10 a year from now? How much for $20 two years from now?

Expectations

My experience working for an advisory firm has taught me that investment relationships are either good for both parties or bad for both parties with few situations falling in between. To ensure we foster the former, an ideal partner would be someone who is business-minded and has a long term investment horizon. Good partners can afford to be patient and trusting.

[1] Bogle, John C. Bogle Financial Markets Research. The Wall Street Journal. July 8, 2003.

In exchange, a partner can expect a quarterly letter from me that will explain the past performance of our investments and my thought process. I will always be as candid and honest as possible when explaining my philosophy and answering your questions. I will not speak directly about our holdings in specific companies to keep my thinking completely independent.

I will judge myself, and partners should judge me, on my ability to outperform the best of the major market indices over the long term. While I believe I can produce market beating returns, only the top ½ of 1 percent of money managers consistently beat the best performing market index by 3%. Being able to place myself in that group would exceed my expectations.

There will inevitably be times when the snow is dry and will not stick. However, more often than not, we will find snow that is sticky. Nothing is more exciting to me than standing atop this enormous mountain about to send my freshly made snowball rolling down. I consider myself one of the lucky few that get to work every day on fulfilling such a worthwhile and important cause. I owe my most sincere thanks to each of my partners for believing in me and making my dream a reality.