October 11, 2012

Disciplined advisors naturally believe in repetition, or so we like to think, but some of you have politely asked for a little variety in the format of our quarterly letter. As we aim to please and do occasionally have things besides our investment results we want to communicate, we are taking this opportunity to talk in broad terms about our relationship with you. An abbreviated investment report will follow.

Although our relationship is often described one of "client" and "advisor", and although the SEC refers to you as a "customer," we really prefer to think of you as a "partner." That has become an overused feel-good word, but we think it is accurate in this case.

Our partnership operates on several levels. On a primary level, you contribute capital and we contribute our work, knowledge and experience in the form of advice. But beyond that level, we also contribute our own capital to invest with yours. Except for personal use assets, our firm's principals and employees have almost 100% of our funds invested alongside yours.

Furthermore, just as we contribute capital, you provide your own knowledge and experience to the partnership. Our interactions provide us with another research opportunity. Through your endeavors, you have developed "zones of competence" that have often been of great help in carrying out our common enterprise. We are not thinking here of meteorological, political or religious opinion, nor of insider information, hot tips or anything of that sort. Rather, we listen closely to your experiences and observations in the marketplace, particularly as they relate to the companies and industries that we follow.

As an example, before the implosion of the U.S. real estate markets, we began hearing from you about strange goings on in those markets, including excessive real estate valuations and other loose lending practices. Word of widespread practices of this kind came not only from those of you with specialist knowledge about real estate, but also from those who were just buying, selling or financing a home, and it led us to rethink and then to sell our holdings in Fannie Mae and Freddie Mac before it was too late. You, our partners, proved far better indicators of the real state of health of the real estate markets and those companies than any computer analytics or company financial statements.

Partnerships work best when the partners share a similar outlook, as well as a collaborative tradition, and ours does. After years of following a consistent investment philosophy, we are in the very fortunate position of having investors who think as we do. We think more about the long-run prospects of individual companies than short-term market movements. Our partners tolerate our tendency to zig when the markets zag, such as when we invest in strong companies in essential industries that the market is viewing with disfavor. Recent investments in the banking and for-profit education industries come to mind. Many other good advisors have investors who do not give them the same freedom and are therefore constrained to focus on short-term results to the detriment of the long-term.

One important reason for our consistency of outlook is that we have grown mostly by word of mouth and referrals, including referrals from other advisors who understand our outlook and can judge which of their clients are most likely to share it. We are unusual in our industry in not having a PR, marketing or sales department. We do not attempt to fit into institutional "style boxes" for the satisfaction of consultants. We have seen too many times what happens when "hot money" flows into a firm enjoying a moment of fame--disillusion and disappointment all around. The firm's exhilaration over its own fast growth leads to a loss of focus on the growth and protection of the investments it is charged with managing. These quarterly letters are about as close as we get to self-advertisement, and so far they have not attracted any "hot money." Au contraire!

In line with this thinking, we do not set growth goals or profitability objectives. We view our firm as a profession, not as a business. Our profession is about using our investment disciplines to care for your wealth, not as a business to generate more wealth for ourselves. Although this distinction is increasingly blurry, we have all reacted negatively when we saw, for example, a "professional" increase his business at the expense of his profession. (Do you remember when you started seeing large ads for lawyers or doctors in the Yellow Pages?) We are even more careful about that trap because we study businesses and think about profitability as a profession!

For this reason, we no longer field discussions about selling our firm. Early in our careers, we did, but we finally saw that the arguments made by prospective purchasers about strengthening our firm by combining it with theirs were nonsense. The first step would be to increase "efficiency" by "streamlining" (read, firing everyone). The second step would be to "standardize" (read, automate all decisions). While such an approach makes sense in many business contexts, it is radically unsuited to being a profession built on a partnership with each other and with you our investors.

As an example on this topic, we would point out that we view the calamities of 2008 and 2009 were much more driven by the dissolution of Wall Street partnerships into publicly traded businesses than any factor in banking or rating agencies.

For the quarter, fixed income investors saw total returns of 0.14% for the 1-year Treasury Index, 0.85% for the 5-year Treasury Index, and 0.91% for the 10-year Treasury Index. The 10-year BB- corporate bonds had total returns of 3.84%. In a quarter reminiscent of many others in a "risk on, risk off" world, a slowing economy and investor anxiety triggered central bankers around the world to provides assurances and actions of easy money. The result was strong investor response, particularly providing demand for riskier securities in the form of European bonds, high yield U.S. bonds and high dividend-paying stocks.

We hope this letter helps you increase your understanding of our approach. We want you to stay informed and feel comfortable about our investing discipline. If you're new to Academy, past quarterly letters may be useful and may be obtained through your financial advisor or Sue Carter at our office. In addition, our website (at

www.academycapitalmgmt.com) has our investment reports on the individual holdings in your portfolio.

On a final note, we wish to let you know that we are pleased for Sue Clark on her recent decision to retire at the end of the year. For many years, she has been the lovely "voice of Academy" when you have called in. She has played many roles, including the firm's emotional CEO. Please let her know how much you appreciate her and, if you are so inclined, share with her that it is not too late to change her mind. We are doing the same!

As always, we appreciate the stewardship responsibilities you entrust to us and your patience with our investment process.

Academy Capital Management