The Perspective

Rational, independent thinking™

"Investment-First"
The Untold Truth

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Silver Heights Capital Management Inc. is a discretionary investment counsellor.

We manage money for affluent families, foundations, and select institutions. We are focused on preserving our clients' capital and growing it over time.

We utilize a rational and rigorous process to find, analyze, and select investments for our clients.

Silver Heights
Capital Management

www.SilverHeights.com

Looking Back

Shortly after Silver Heights opened its doors, we introduced our newsletter, *The Perspective*, whose goal was to give people deeper insights into how we think about risk and investing. Our debut piece was titled “Investment-First” – so titled because investing excellence is the core principle at our firm.

As we celebrate our 10th anniversary this year and reflect upon what we wrote in that first *Perspective*, we are pleased to report that those principles have served us well. Our “Investment-First” focus has resulted in rewarding risk-adjusted returns, and it has also been instrumental in attracting a like-minded client base who have been a critical part of our success. We are proud to say that since inception, we have never had a client leave Silver Heights and move their assets to another firm.

We look forward to continuing to operate with our “Investment-First” mindset in the coming decades, just as we have for the first. We invite you to read our first *Perspective* and hope that it resonates with you.

"Investment-First" – *The Untold Truth*

One of our core purposes in creating Silver Heights Capital Management was to build a firm that would always maintain an "Investment-First" focus. It may seem odd to you that we would even bother to make such a seemingly obvious statement.

> *Are there really investment firms that aren't "Investment-First"? Unfortunately for the investing public, there are.*

Because an investment company's revenues are tied to the amount of assets that are being managed, firms are focused on retaining and growing their asset bases. The two main methods of growing the firm's asset base (and hence, revenues) are through the addition of new clients and positive investment performance.

Once an investment management firm has reached profitability, it is very tempting to "coast" and lose the desire to strive for investment excellence. Back in the 1980's, a common saying in the investment business was, "You could never lose your job losing your client's money in IBM". At that time, IBM was a high-profile and well-regarded company. Clients had heard about it, read about it, and seen it on TV and the general consensus on IBM was overwhelmingly positive. These types of high-profile names are less risky for the investment manager *from the perspective of their own business* because if they perform poorly as investments, clients are more likely to say, "What's wrong with the company?" rather than, "What's wrong with you?".

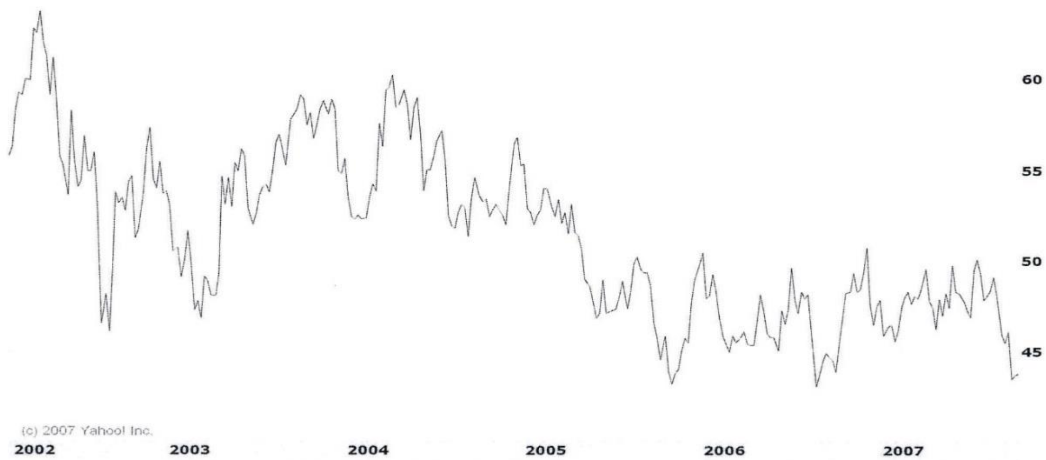
Regardless of the era, there are always stocks that are regarded as "Blue Chip" and perceived to be very low-risk. Today, for example, a portfolio consisting of high-quality, well-recognized companies like Wal-Mart, General Electric, Loblaw, and Thomson Corporation is unlikely to cause clients to raise their eyebrows. The reality is that if you'd have owned these companies over the last five years, you would have realized poor returns.

Even the best companies can be poor investments if purchased at the wrong price. Take Wal-Mart for example:

	Jan 2002	Jan 2003	Jan 2004	Jan 2005	Jan 2006	Jan 2007
Revenues ($billions)	$206	$232	$259	$284	$312	$349
Earnings per share	$1.44	$1.76	$2.03	$2.46	$2.72	$2.92

Since 2002, Wal-Mart has grown its revenues by over 11% per annum and its per share earnings by over 15% per annum on a compounded basis. How would you have done as a shareholder during this period of more-than-admirable corporate performance?

Wal-Mart Stock Price History



As you can see from the previous chart, Wal-Mart's *stock* has lost over 25% of its value from its peak in 2002 even though the underlying business has performed well. You'd still be in a significant loss position *over 5 years later.*

> *It's important to differentiate between the quality of the underlying company and the attractiveness of its stock as an investment.*

Great companies like the ones listed earlier are our preferred choice of investments, but ***only*** at prices that are likely to yield a handsome, risk-adjusted return for our clients and provide an adequate margin of safety.

The unfortunate reality is that if a money manager loses a client's money by investing in a company that the client is unfamiliar with, the negative ramifications for the manager's reputation are likely *much* greater than if they'd lost the exact same amount of money in a so-called "Blue Chip" company. This discourages managers from straying from the crowd and applying an independent thought process to find truly undiscovered investment opportunities.

A shining example of this groupthink mentality is the bubble in technology stocks that started in the late 1990s. Many investment managers at the time would have – in private– admitted that the stocks they were buying for their clients were tremendously overvalued. In their professional lives, however, they were unwilling to stand apart from their peers.

Rational, independent thinking

We at Silver Heights tend not to assess risk levels according to the name itself, but from the fundamentals. This is ***not*** to say that well-known companies can't be great investments. They *can* be – at the right price – but sadly, these types of companies are often purchased for their lower business-risk attributes (from the investment manager's perspective) rather than for their investment merits.

We feel that too many investment managers take the easy path and buy well-known companies for their clients without proper regard for the price they pay in order to minimize risk to their own jobs and businesses. Clients are the ones that end up paying for this lack of independent thinking with lower risk-adjusted returns.

The aforementioned example is but one of many ways in which an investment company may not be as "Investment-First" as one would expect. There are others, but this is one of the most common sins in our industry: "My business takes precedence over *your* financial well-being."

With our "Investment-First" principle firmly in mind, we went about building Silver Heights in late 2006 and into 2007. This touchstone was a key consideration in virtually every decision we made when we were setting up Silver Heights. Whenever possible, we chose the option that allowed us to devote the most time, energy and focus to our rational and unique investment process. These included decisions on everything from our office's location to how we structured our administrative back office.

Our focus on achieving excellent risk-adjusted returns for our clients can be compared to a rational business owner's approach to allocating their company's capital. When a rational-minded business manager allocates a firm's capital, they think about the level of risk they are taking, and compare it to the expected return from that investment. Their goal is to make sure that they are being adequately compensated for the level of risk they are contemplating. In a nutshell, this is how we think when we invest our clients' assets.

Sincerely,

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