

## Kraemer, Schwab & Co. AG Investment Management

*"We simply attempt to be fearful when others are greedy and greedy only when others are fearful"*  
W. Buffett

After five years of excellent returns, worldwide stock markets seem to have entered a correction phase. Problems in the US sub-prime lending market have started to spread, and some of the excesses that built up over the recent past have started to reverse. We do not know how severe and how long this correction will be, and we do not spend time trying to predict it, as we think it's not possible.

We do know though that we own solid companies, with strong balance sheets and dominant positions in their markets. In tough times, leaders typically gain market share at the expense of smaller, weaker competitors, and probably they will come out of the crisis leaner and more dominant than when they entered it. Home Depot and Lowes, currently facing severe headwinds as the US housing market is under strain, are using their financial muscle to step up investments, improve their stores and open new ones, while several weaker mom and pop competitors will go out of business. Long term demand for housing in the US is underpinned by solid favorable demographic trends, and the future of these companies past this downturn is promising.

Our financial holdings such as HSBC and Citigroup, have solid worldwide franchises, large balance sheets with diversified revenue streams, the lowest valuations seen in many years and dividend yields in the 5% plus range. Our insurance companies have on average lower exposure to stocks and high yield bonds than they used to have, yet they trade very close to book value while delivering double digit returns on their equity.

Many of our healthcare holdings also trade at very low valuations: Johnson & Johnson has been as cheap as now only once in the last 20 years (in 1994), yet its financial muscle is as strong as ever and its diversified businesses hold promises to deliver reasonable growth over the next few years. Past disappointing returns fed the current strong pessimism that seems to dominate the healthcare area: while investors are quick at pointing at current and future potential problems, they seem to ignore any favorable trends such as aging population and new screening and diagnostic technologies that should improve productivity of research. We think the pendulum has swung too far into negativity on pharmaceutical companies.

We have some cash reserves and several of our holdings pay fat dividends: as prices get lower, our task is to stay rational and become increasingly greedy in the face of the market's growing fear. We will therefore opportunistically add to our positions: the lower the prices, the more we'll buy.