

I WANNA BE LIKE WARREN!

We Americans like to worship our heroes. In sports, it was Michael Jordan in basketball whom we worshipped and the "I Wanna Be Like Mike" ads. More recently, it was Tiger Woods in golf. We even seem to worship our heroes in business, like Jack Welch of GE and, more recently, Donald Trump, probably because of his media exposure and self-promotion. One generally consistent thread for our modern day American heroes is that they all seem to have become exceedingly rich.

At CornerCap, we are in the investment business, and we certainly have our heroes. In our newsletters, we frequently attribute basic investment principles that we have learned over the years to investment idols. Unlike sports or business heroes, our heroes do not seem to change over time, even after they move on to that mystical market in the heavens. As many of you know, one of those heroes is Warren Buffett. We must emphasize that this speaks only to his investments and not to his politics, palate, or personal life. We have followed him closely for over 30 years, before he was well known in the investment community, much less a household name in most any community.

We recently attended the Berkshire Hathaway (B-H) annual meeting in Omaha, Nebraska. B-H is the company that Buffett uses to assemble and manage his investment portfolio. In a sense, B-H is like a closed-end mutual fund with a miniscule expense ratio. Once a year, the B-H shareholders gather in Omaha to listen to Warren and his less public, straight man, Charlie

Munger, answer questions, mostly about investment theory and practice. There were 19,500 people at the meeting in May, which is up from a few hundred when we first started attending a little over a decade ago. The event has taken on a carnival atmosphere with the Pied Piper's (Buffett's) leading his merry flock to the treasures of American enterprise.

Most company annual meetings are just formalities attended by a handful of shareholders. What pearls of wisdom attract this many people to come listen to the man who has been dubbed the Oracle of Omaha? The investment lessons are not new and always relatively simple. Moreover, the investment principles have all been well documented, either in the B-H annual management

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letters or in several books written by Buffett's followers (or in our commentaries over the years). No matter how much people in our business try to make it so, successful investing is not complicated. And, as Warren says, anyone with reasonable intelligence, an interest, and the right temperament (realistic about price and value) can be a successful investor. These principles just work!

Why do so many attend the B-H annual meeting? It is because Buffett has become an investment hero. In this article, we want to address certain issues about hero investing, such as buying into or imitating an investment hero and succession planning of an investment hero, whether the hero is Buffett or anyone else.

SEE PAGE 2

SUCCESSFUL SUCCESSION

In the lead article, we discussed the problem of the lack of succession efforts at Berkshire Hathaway, Warren Buffett's investment firm. What about the succession efforts at CornerCap?

as the market realized a significant net decline over the next five years. As Henry Ford said, "Failure is the opportunity to begin again more intelligently." This is what Gene did.

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SEE PAGE 3

It is important to understand where you have been before trying to decide where you are going. Our "firm" started with Gene Hoots' having a passion for investing and starting a small equity fund in 1969 called the Clemmons Investment Group. It was not a good time to start a fund

In the mid- to late '70s, Gene took over managing the R.J. Reynolds pension fund, and he continued and accelerated his learning process. In 1979, Tom Quinn joined Gene in the investment group, and Tom began his investment learning process, much of it from Gene.

I WANNA BE LIKE WARREN! (CONTINUED)

Buying Into Buffett

Why not just buy into Buffett by purchasing the B-H stock? Even though Buffett does not hold technology stocks and has a large concentration in some sectors, such as the insurance sector, the B-H portfolio offers some diversification, plus management brilliance, and a low expense ratio. B-H has been an excellent investment for over 30 years, and there is a good chance that it may continue to be so. However, at the risk of being self-contradicting, it just is not that simple.

With the B-H stock's being publicly available and with the popularity of Buffett's spreading from a few followers to a slew of investors, B-H shares are fully priced. However, while you might expect the high growth performer to be priced at a premium, you must remember that when buying B-H or any stock, you are buying future performance. B-H now has a market capitalization of \$137 billion. As Buffett has often said, he can no longer be as creative and opportunistic as he once was when his company was smaller and he had many more alternatives and strategies available to him. Most of the better return opportunities are not large enough to be material and warrant his attention.

Succeeding Buffett

Another potential problem with future performance is that Buffett turns 74 in August, and Munger is several years older. Buffett will continue to invest the assets of B-H as long as he is alive and physically able. In fact, Buffett humorously stated that he plans to continue managing B-H for the rest of his life and at least five years posthumously!

Recently, under pressure from large shareholders, Buffet has tried to make comforting statements about who might be his successor and the continuation of his investment approach at B-H. We find these statements woefully lacking. His passion is in his life's work with little concern about the hereafter, to include what happens to B-H in his absence. In our opinion, at Buffett's passing, the premium paid for the stock will almost immediately dissipate, and the investment prowess at B-H will begin a long, slow, downward slide. We witnessed this with the departure of Peter Lynch at the Magellan Fund and John Neff at the Windsor Fund. Indeed, because of no succession planning, Buffett at B-H should be even worse.

It is interesting that a reporter asked 15-plus shareholders exiting the annual meeting if they had any concerns about the post-Buffett company. None did. Extraordinary, successful management such as this is difficult to succeed, especially when there is essentially no preparation. As Buffett himself said at this year's meeting, "What we learn from history is that people don't learn much from history." Following Buffett's own advice, people who buy B-H are disregarding current valuations and future risks.

Imitating Buffett

If we are correct that B-H shares are fully priced and should be avoided as a long-term investment, then what about simply buying the same stocks that Buffett buys? This is more difficult and dangerous than it sounds.

Buffett's strong preference is to own controlling interest in companies, and, of course, these companies are typically not available for purchase by other investors. To a limited extent, Buffett also buys a minority interest in some stocks, and other investors can purchase these holdings. However, imitators will not know when to buy or sell until well after Buffett has made and implemented his decision. Imitators will get in and out at a different price than Buffett, and, typically, the right starting/ending point determines the ultimate success of an investment.

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Over the years, many investors, products, and firms have been built and marketed based on this copycat approach. One of these products was a mutual fund started in 1987 in Missouri called Wealth Monitors. The managers of the fund promised to purchase the same securities that were bought and owned by the most respected investors of the day, to include Buffett. This mutual fund performed so poorly over the next five years that the eventual owners decided to close down the fund. Coincidentally, CornerCap was searching for an inexpensive means to enter the mutual fund business, so it took over the fund for essentially no startup costs and converted it to the CornerCap Small Cap Value Fund. If you view the performance of the fund before and after 1992, i.e., the date CornerCap assumed management, you will note the dramatic performance turnaround. In doing so, CornerCap imitated no investment heroes!

Whenever you see an investment imitator or copycat product, keep in mind that the seller's primary objective is to be business-successful (with your money) and not investment-successful. By this we mean that his primary passion lies with selling and not investing. This can be an excellent short-term business plan for the sellers of the product. Their plan is often appealing because, "We all wanna be like our heroes."

I Wanna Be Like CornerCap!

We believe that we have done well managing client assets over the last 25 years. However, since Buffett is worth \$40 billion and we are not, we assume that his talents have historically exceeded ours. No shame there. But for reasons stated above (B-H valuation, size, age, no succession, etc.), going forward, our own personal investments will continue to be managed at CornerCap.

I WANNA BE LIKE WARREN! (CONTINUED)

While we are not much on imitating any hero's investments, we do believe in imitating quality investment philosophies. At CornerCap, Buffett is just one of a mosaic of our investment heroes. We have always learned by following great mentors. We have had some of the best. We spent our first decade managing the RJR Nabisco pension plan. We learned greatly from our outside advisers who included top professionals such as Bob Kirby (Capital Guardian), Dean LeBaron (Batterymarch), Bob Hoerle (Reich & Tang), Bill Gross (PIMCO), etc.

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Of course, our greater understanding came from putting the investment principles that we were learning from our mentors into practice with the in-house portfolios at RJR. To quote an old Chinese proverb, "I hear and I forget. I see and I remember. I do and I understand." We learn by doing, and what we do must be consistent with our basic beliefs. With investments, fully acknowledged heroes tend to be fully priced in the marketplace, so they are expensive to "buy." However, the principles they promote are frequently free for those who can hear and see. ▲

SUCCESSFUL SUCCESSION (CONTINUED)

Gene and Tom changed the name of the Clemmons Investment Group to the Carolina Equity Fund (CEF) and added a number of new shareholders. That fund continues to this day and has an exceptional 25-year performance history. Most of its original investors are still with us.

Of immense importance was the fact that Gene and Tom were philosophically compatible. Of course, as they hired outside investment advisers (see lead article) at RJR, they were frequently attracted to those who were also philosophically compatible. In 1982, the management at R.J. Reynolds decided to move assets in house and chose Gene and Tom to invest them. RJR chose them primarily because of their performance with the CEF. They formed RJR Investment Management, Inc. and began investing \$100 million. That \$100 million grew to \$600 million by 1989 when Kohlberg Kravis acquired RJR Nabisco. In 1989, Gene and Tom grabbed their hats and coats and started CornerCap. It now has 15 employees and almost \$500 million under management. Gene continues to work full time for the firm out of the Charlotte office. Tom manages the firm out of the headquarters in Atlanta where all other employees are located.

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How is CornerCap managing the firm for succession to a newer, younger generation? First, CornerCap focuses the hiring of new investment professionals on talented people who have little or no experience managing portfolios for other investment firms. As Dean LeBaron at Batterymarch advised us, it is difficult to rewire investment professionals who have matured under mentors of the "wrong" philosophical persuasion (i.e., who are not compatible with CornerCap). Once hired, these professionals must naturally buy into the CornerCap philosophy and process. There is more than one "right" way to succeed with investments, but inconsistency is the most consistent way to fail.

Assuming sufficient mentoring has taken place, succession requires that each senior generation be willing to pass decision-making control down to the next succeeding generation. This is an ongoing process that requires a willingness, maybe even a desire, to give others the opportunity to grow on their own merits. Succeeding generations cannot be successful just on the prior generation's merits, at least not over time. The money and economics must always be approximately equitable, but, not unlike a marriage, success will be driven more by both generations' attitude toward giving and sharing.

This giving and sharing is supplemented at CornerCap through the passing down of equity ownership to key professionals at the firm. Each year, CornerCap grants no less than 5% of the shares outstanding to these professionals. The grant is in the form of new shares and is granted to those in the firm who appear most capable of leading it in the future. In this way, these professionals will grow as the firm grows, and the actual vesting of the shares is based on the percentage growth of the firm during the three-year period following the grant. These professionals pay for this ownership with their time, talent, and attitude. CornerCap intends to continue this share distribution process for the foreseeable future.

Successful succession requires that the senior generation be willing to pass authority and ownership to others. Gene and Tom are like Buffett in the sense that they very much enjoy the work at CornerCap and have no plans to ever retire. However, unlike Buffett, they are committed to a multi-generational approach to building a firm and managing the assets of CornerCap's clients (who include family and friends) using the same approach to successful investing. ▲

CORNERCAP HIGHLIGHTS



*Many of our clients and friends
have enjoyed getting to
know Patrice Smith,
our Director of First Impressions.*

CORNERCAP'S PRIVACY DISCLOSURE

In the course of client relationships, we gather and maintain personal, nonpublic information regarding our clients' financial circumstances and investment objectives. We are committed to maintaining the privacy and confidentiality of this client information. Accordingly, we have adopted a privacy policy in accordance with Securities and Exchange Commission and Federal Trade Commission privacy regulations that require us to determine and disclose how they treat nonpublic information to our clients and potential clients.

We collect nonpublic personal information about clients from the following sources: Information we receive from clients on applications and other forms; information about clients' transactions with us, our affiliates, or others; and information we may receive from a consumer-reporting agency.

We do not disclose any nonpublic personal information about our clients or former clients to anyone, except as permitted by law. We restrict access to nonpublic personal information about clients to those employees who need to know that information to provide products or services to clients. We maintain physical, electronic, and procedural safeguards that comply with federal standards to guard clients' nonpublic personal information.



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