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TOM QUINN ON "WHAT AM I DOING HERE?"

This article is an exception to our policy over the last 25 years of not identifying the author. Regarding matters of investments, our goal is for everyone in the firm to speak with a single, consistent voice. This article is about how I define my job, so there is no mystery about who is voicing these words. However, I believe that the other professionals in the firm agree with the prioritization of my duties.

> . . . our most significant accomplishment may be the development of a new generation of leaders in the firm.

Before delineating my duties, let me briefly describe the somewhat collegial management structure of the firm. We have three AARP-qualifying members of the firm: Gene Hoots, Jim Carr and me. While our ages qualify us to join the ranks of the retired, none of us has any plans to retire. Each of us enjoys the business of investments, which includes being of service to our loyal and growing client base and developing our talented CornerCap staff. Each of us plans to retire when he believes that his services are no longer of value to our clients and staff.

The vast majority of our clients came to CornerCap through one of the above senior members of the firm. Gene Hoots is the principal connection for most of our North Carolina clients; Jim Carr introduced us to most of our Georgia clients; and I have been fortunate enough to escape the confines of the office periodically and get to know many of our clients. While a little over half of our clients are located in those two states, we now have clients throughout the world.

In addition to growing our performance record and client base, our most significant accomplishment may be the development of a new generation of leaders in the firm.

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THE *CHARACTER* OF AN ECONOMY

As discussed in the above article, it is comforting for us to be able to state clearly where we believe we are going at CornerCap. We would like to be able to express the same level of comfort about where we believe the U.S. economy is going. But, these are unusual and uncertain times. Of course, we have never heard any investor describe any time as anything other than unusual and uncertain.

> . . . nothing lasts forever. Eventually, the U.S. economy will decline relative to other world economies.

Is the economy really all that risky for a <u>long-term</u> investor? Looking at a five-year rolling average of the U.S. real gross domestic product (after inflation) over the last 50 years, it only varied from 1.9% to 5.8% at the extremes. The economy has done consistently well when averaged over these five-year periods. Of course, the stock market can take those modest extremes in the economy and magnify them manyfold, creating excessive fear or jubilation for investors.

We do not believe that we or anyone else can forecast short-term, minor tweaks in the economy. Even if we could, how those economic tweaks would translate into major market gyrations remains a total mystery to us. Contrary to what we think, most investors feel that near-term economic forecasts are important, and they want to hear our views on the matter. It is one of those things you have to do in this business. We are reminded of what Bob Kirby, a former president of Capital Guardian, told us after his portfolio manager finished presenting the firm's position on the economy. Using his usual humor, Bob noted, "But we go on and on about this stuff as though it had anything to do with the stock market."

What if we take a much longer view, say 50 years from now? Is the economy a little more predictable and is that where the real concerns should lie? A historical perspective is probably much more relevant if we can take this longer term view.

Over the last century, we have witnessed the dramatic decline of several economic superpowers. The most dramatic and rapid decline was the British Empire in the first

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We have four portfolio managers who do most of the investment research and client service. We have several professionals in Operations and Systems, and we have a full-time trader. My belief is that if the three senior members of the firm mysteriously disappeared, the firm would continue down the road of investing and servicing without missing a philosophical beat. We may experience a temporary shortage of marketing skills, but, anyway, marketing has never been a major focus of the firm.

With that preamble, exactly what is it that I need to be doing to be of the most value to CornerCap? I believe that my focus should be on the following eight tasks:

1. Culture—Every organization has a unique culture. Since Gene and I first formed our partnership over 25 years ago, we have been evolving a culture about investments, people, business practices, etc. Since forming CornerCap 16 years ago, we have been partnering with others to grow that culture. We are extremely proud of what we have created, and we believe that preserving that culture with future management generations will give CornerCap a permanent competitive advantage. This is a task for which I feel somewhat qualified, given my long tenure and strong passions for the success of the firm.

2. Investments—Investment management is a very complicated business, but investments are probably one of our simpler tasks. As Warren Buffett said, "Investing is simple, but not easy." There are investment practices that we know should be done and some that we know should be avoided. Investing is just a formula, and the successful investors whom we have admired over the years all had one. The "not easy" part is being able to apply that formula consistently over time, even when clients, logic and the market vibes tell you to do otherwise. As the chief investment officer of CornerCap, I must ensure that our investment philosophy and process is sound and consistently applied.

3. Growth—It is important that we continue growing the firm at a measured pace. Working to grow at an appropriate pace enables CornerCap to fund our growing investment research and to hire and retain quality professionals. However, overly rapid growth can be as damaging as no or negative growth. While part of our job is to ensure that the firm continues to grow, we must also recognize that there will be times, probably relatively brief, when the firm will not grow. We experienced this during the tech bubble. It is important that we simply ride through these periodic extremes caused by unsustainable events and make no compromises to our proven process.

4. Ethics—As a service-based business, we have few hard assets on our balance sheet. Our most significant asset is our reputation. Lose that and we not only lose the business but also many of the purposes that drive us through life. It is important to remember that the Ebbers, Kozlowskis and Scrushys in the world did not wake up one day and decide to do something really unethical. It always starts with very small, barely noticeable actions. Ethical standards can never be a matter of materiality.

5. Employees—As noted above, our largest asset is our reputation, and it is our employees who mold that reputation. Investment management is a high level, competitive business. It is not easy to survive at CornerCap. Everyone must be bright and hard working in his position. We enjoy each of our differing personalities and characteristics, but investment and business philosophies cannot differ. With the help of our successful employees, we are committed to finding and holding on to new successful employees over time.

6. Ownership—Equity participation by all key professionals is essential. Moving from employees to owners elevates passions, skills and attitudes. Simply stated, owners care more. As new owners are created at CornerCap, old owners are diluted. This process of changing equity ownership must be equitable. Using "sweat equity" over the past nine years, we have used a Performance Valuation Share Plan to begin transitioning ownership from the more senior majority owners to the more junior employee owners. We currently have nine employee owners (and no outside shareholders). As the majority shareholder, I have stated my commitment to continue indefinitely our efforts to transition ownership to future generations of management of CornerCap.

7. Independence—While the priority of "independence" may be listed here as seventh, the reality may be first. What do you think when you hear that XYZ Investment Management was acquired by BBB Bank or MMM Mega Manager? Are any of your concerns allayed when XYZ tells you that all the professionals are staying with the combined firm and that nothing is going to change? The drill is to explain that the new owners not only will have no affect on the firm's independence but will also make everything better with the additional resources of the combined firm.

Bigger, no question. Better, no way. In general, owners of successful investment firms sell their firms for one reason—cash. There may be estate planning concerns, health problems, and retirement or other financial needs, or, more likely, just some garden-variety greed. So, let me be perfectly clear about this issue of independence. Should we owners of the firm decide to sell CornerCap to a bank or some larger firm, we cannot guarantee how these big barbarians might behave after they pass through our clients' gates. However, we can guarantee that we ex-owners would have been well paid and would probably be saying things to help our clients feel better about the new ownership.

When you are no longer independent, you are dependent. Being dependent on owners with divided loyalties can create compromising conflicts of interest. Currently, our loyalties are solely to our CornerCap investment clients. We will work to keep it that way.

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8. Stewardship—The competitive nature of business tends to foster a certain amount of greed. As Jack Bogel, the founder of Vanguard, has noted about the investment business, it has replaced an historic attitude of stewardship with one of salesmanship. As we work to attract and serve clients of the firm, we must always feel that their business with us is not as important as finding the best means for accomplishing their goals and objectives. Our perspective must be sufficiently long-term to appreciate that if we always put the client's needs first, our business will ultimately be rewarded. This attitude of stewardship or giving to our clients must also extend to the communities in which we serve by always giving back our fair share.

I feel a tremendous responsibility as I contemplate the eight important challenges listed above. I feel great comfort as I consider the talents of our professionals and the quality of our current clients. We must show excellence in those things that we have been given to do. As we meander through this mortal journey of professional, personal and *pro bono* tasks and accomplishments, our ultimate goal should only be to feel that our job was well done. Other recognition is probably better saved for the hereafter than for the here and now.

THE *CHARACTER* OF AN ECONOMY (CONTINUED)

half of the 20th century. Financing two world wars over such a short period deprived its economy of any new, productive investments and brought on more debt than any economy could survive. With Russia, its decline derived from a similar imbalance in military spending, but this was from financing an extended cold war rather than two quick hot wars. Russia's planned socialistic economy was simply unable to support its entry in the arms race. With the Japanese, their rise and eventual failed bid to surpass the U.S. economy may have been caused by an imbalance at the other extreme, no military spending and consequently no military muscle.

As Paul Kennedy wrote in his book, *The Rise and Fall of the Great Powers*, "Without a rough balance between these competing demands of defense, consumption and investment, a Great Power is unlikely to preserve its status for long." Kennedy noted that, throughout history, the imbalance resulted in each super power's eventual decline.

Over the last half century, the U.S. has risen to become the undisputed world leader in terms of commerce, politics and military might. One lesson in life that investors frequently tend to forget is that nothing lasts forever. Eventually, the U.S. economy will decline relative to other world economies. Will the new leader be some Asian country, like China, the current odds-on favorite, or could there be resurgence by Japan? More importantly, will the relative decline of the U.S. economy take five years or 500 years? Are our leaders making the best, well balanced decisions about military conflicts, Social Security, global commerce, education, etc. so that we can preserve the American Empire for as long as possible? Of course, we all share the same concerns as we monitor, question and work to influence the actions of our leaders.

It is easy to relate to the balancing forces that Paul Kennedy points to: defense, consumption and investments. These forces are close corollaries to the ingredients we must keep in balance in our personal lives: physical activity, social interaction and savings. Is there a critical ingredient, neglected by others, which we Americans have thrown into the brew to create a better and longer lasting taste? We believe there may be a couple that are not on Kennedy's list.

> An important uniqueness of American culture is that it is a melting pot of other cultures.

An important uniqueness of American culture is that it is a melting pot of other cultures. This is not true of the countries mentioned above or any other developed country. Our diversity in business is far from perfect. However, some of us can remember how restrictive the business world was just 50 years ago for blacks, Jews, women and other non-white males (such as Asians and Hispanics who were not even registering on the map). Today, we have all of the above cultural "flavors" leading major enterprises that would not have granted them an interview 50 years ago. In the U.S., we are persistent about equality of opportunity, and this results in American business being more open to all of the talents available in our blended culture.

We believe that another important ingredient in the success of a nation is its spirituality. No one ever wins the spirituality debate, so we will avoid any country comparisons. However, in an absolute sense, a very large percentage of our citizens consider themselves religious people, who worship a loving God, and who accept people of other faiths.

> "Ability may get you to the top, but it takes character to keep you there."

As Paul Kennedy documented, being able to balance our fiscal resources properly for defense, consumption and investment were probably the driving forces that enabled the U.S. to pass all other nations of the world. However, to stay there, to avoid the peak and eventual decline as long as possible, the driving forces for the future may be as much our human resources as our fiscal resources, i.e., our pursuit of broader diversity and deeper spirituality. John Wooden, the UCLA basketball coach who stayed on top in his profession more consistently than anyone, stated this very well. He said, "Ability may get you to the top, but it takes character to keep you there."

CornerCap Highlights

CornerCap's Sponsorship of the Georgia Shakespeare Festival

Please be our guest! CornerCap is a proud sponsor of Georgia Shakespeare' 20th anniversary season. This is our eight consecutive year of sponsoring this impressive program presented at Oglethorpe University's Conant Performing Arts Center. We extend a special invitation to our clients to attend a *Streetcar Named Desire* by Tennessee Williams. The performance will be directed by Karen Robinson and is being performed from June 23 to August 6 (see www.gashakespeare.org).

We are sorry to report that *Judith S. Hoots*, the wife of CornerCap's co-founder and Chairman Emeritus, Gene Hoots, died recently following a long battle with cancer. Judy's support and commitment to the firm have been an important element of its success, and she will be truly missed.

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