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Fourth Quarter 2010

Intro

The market roared through Q4 2010, gaining 10.7%, and the momentum carried into Q1 of 2011. Tidd Capital portfolios turned in a respectable 8.3%, but lagged the S&P. Financial markets worldwide are generally bottoming or stabilizing, and business is nearly returning to normal for many companies. There are of course things to worry about, such as instability in the Middle East, but markets are relatively stable.

Healthy banks, now the majority, are lending again, which provides the capital that businesses need. Unemployment is very slowly decreasing, and improved unemployment news will be necessary to solidify the recovery.

Portfolio Updates

In mid-2010 fear was still rampant in the markets, and many were calling for a double-dip recession and sitting on the sidelines. As I mentioned in prior newsletters, my feeling was that the recovery was taking hold and I thus positioned our portfolios for economic recovery. This meant remaining relatively fully invested in companies in some of the more depressed areas of the market, such as finance, real estate, infrastructure and commodities. These companies include Leucadia National, Brookfield Asset Management and its sister company Brookfield Infrastructure Partners and ATP Oil & Gas. This decision panned out, as these companies have been solid outperformers, as shown in the table below:

Company	Q3 2010 Performance	Q4 2010 Performance
Leucadia National Company	21.0%	24.6%
Brookfield Asset Management	26.0%	17.9%
Brookfield Infrastructure Partners	24.3%	9.9%
ATP Oil & Gas	28.9%	22.6%
S&P 500	*11.2%*	*10.8%*

We have, however, had some performance laggards. The share price of Fairfax Financial, still a major investment of ours, has been flat for about 5 quarters. After brilliantly predicting and profiting from the meltdown in 2008, Prem Watsa and his team took a strongly defensive posture and locked down their business with strong hedges. Their thought was to make 100% sure that they locked in their gains from 2008 even if that meant missing out on positive performance in 2010. This "overabundance of prudence" has caused the company to miss out on the market recovery during 2010, though they are still strong operationally. I am monitoring our investment in Fairfax as a possible place to take gains.

Access National Corporation, a small regional bank based in Reston, VA, successfully avoided the crisis and never stopped growing book value or earnings. This growth, however, seems to have stalled over the past 6 quarters. They have begun to take steps to revitalize the company including entering other lines of business and shaking up the board, and I am monitoring their progress.

St. Joe has become a battleground stock, which I'll talk more about in a moment, and the share price there has also been flat over the past year or so. St. Joe and a smaller position in USG were intended as a way to play a recovery in the housing market, which has yet to transpire.

We continue to hold a sizable investment in Berkshire Hathaway, which surprisingly has been left out of the recent market rally, as the stock is trading about where it was a year ago. Berkshire stands to gain significantly from an improving economy and stock market. Berkshire's stock has significantly underperformed the stocks of its largest investments (Wells Fargo, Coca-Cola, Proctor & Gamble and American Express) over the past 6-12 months, whereas gains in those stocks increase Berkshire's book value. The gains in the S&P will lead to a reversal of the mark-to-market losses Berkshire was required to report for its large and misunderstood derivatives position, which will further increase book value. Finally, Burlington Northern is now the largest driver of Berkshire's operating results and revenues there increased 22% from 2009 to 2010 and US rail businesses are doing well. These things add up to significant improvements for Berkshire, yet the stock trades at historically low multiples. I have been significantly increasing our position in Berkshire during Q4 2010.

While our recent performance against the S&P has been somewhat disappointing, overall I am satisfied with our portfolios and their positioning going forward. The recent strong performance has allowed me to trim positions and raise cash, and our cash levels are the highest they have been in quite some time. I feel that we are well positioned to make new investments as 2011 unfolds.

St. Joe, USG, and the Housing Market

The US housing market has had its longest and weakest period in history and still does not show solid signs of recovery. Housing oversupply is still prevalent in many markets and construction levels are low. However, now that the worst of the financial crisis has passed, I have been looking for investments in this distressed area.

One of our current investments in this industry is actually a holdover from a mistake made in the pre-meltdown period. USG is one of the country's largest producers of gypsum wallboard, the primary driver of which is residential home construction. I was buying USG in 2007, which unfortunately, though I certainly didn't realize it at the time, was the peak of the housing market. When the crisis hit, the stock fell from around $45 to the single digits during the nadir of the crisis, and was one of my costliest mistakes leading into the financial crisis.

However, even as the stock fell lower and lower, I did not feel that it should be sold, as the prices were certainly well below even a pessimistic assessment for the company. As a result, I continued to hold the stock, despite miserable performance in 2008. Once the smoke cleared, the stock nearly doubled in 2009, was up around 35% in 2010, and is up again in 2011. The stock is now around $16-18, certainly an unacceptable return from the original cost, but a lot better than the lows of about $5. Buying the stock in 2007 was a mistake; however, selling the stock at its depths in early 2009 would have been a worse mistake. At this point, the position is not huge but is attractive in that USG will benefit disproportionately from a recovering housing market, and I'll be monitoring it.

I have mentioned The St. Joe Company in previous newsletters. The company owns over 500,000 acres of land in and near the Florida panhandle, the most valuable of which are miles of beachfront property on the Gulf of Mexico. Land values tend to move dramatically when housing markets improve, and also provide some hedge against inflation. "Land bank" companies as St. Joe is known tend to be very long term investments since value is unlocked over years or decades. In mid-2009, the stock was available at prices that seemed to completely discount the value of their best land assets, which had yet to be fully developed. On these notions, the investment was made as real estate investment with an unusually long term view.

To my surprise, St. Joe became a high profile battleground stock as two famous investors took an interest in the company, one long, and one short. David Einhorn is a hedge fund manager famous for his high profile short position against Lehman Brothers and other companies, and he declared that St. Joe was at least 3x overvalued and that he had shorted the company. He also gave a scathing 100+ page presentation describing everything he thought was wrong with the company. On the other side of the net is Bruce Berkowitz from the Fairholme Fund, one of the top performing mutual funds of the past 10 years, who now owns about 30% of St. Joe and is trying to restructure the company, including a hostile attempt to replace the board and management. Berkowitz believes that “tremendous value” can be unlocked by changing how St. Joe monetizes its land assets and that the stock is significantly undervalued.

Bill Miller famously said, “One hundred percent of a company's information reflects its past while one hundred percent of its value reflects its future.” This quote may summarize how two astute investors can have such opposite views of the same company. Einhorn is focusing only on the past, while Berkowitz is focusing only on the future. I obviously side with Berkowitz in this situation, and look at the probable trends over the next 5 years that may affect St. Joe’s value. Land and real estate values are certainly at multi-decade lows, especially in Florida, and can only go up. A new international airport was opened in the middle of St. Joe’s land during 2010, which should be a significant economic catalyst to the area. St. Joe has no debt and there are no negative catalysts that could force them into trouble. It is true that St. Joe’s management has not acted as quickly or aggressively as shareholders may like, and generally have a lack of urgency around delivering value. Berkowitz is in a very good position to change that, owning 30% of the company and with just 6 other institutions owning another 60%. He only needs 1 or 2 other investors to cooperate with him in order to take whatever actions he feels are necessary, which makes for a relatively simple shake-up scenario.

It is important to remember that shareholders own companies, shareholders choose board members, and the board chooses executives. It is unfortunately often the case that the boards and management teams at public companies don’t seem to fully realize or appreciate this, and instead expect shareholders to allow the board and management to act in their own self-interest even when it does not serve shareholders. As with any kind of protest, good organization with a clear set of demands is the best way to enact change, and Berkowitz is following this formula.

Biglari Holdings / Steak’n Shake

I mentioned in previous newsletters that we owned debt of Biglari Holdings (formerly known as Steak’n Shake). While I have absolutely no interest in being a shareholder of the company for reasons I outlined earlier, I am happy to be a debt holder.

The debt paid a coupon of 14%, a rate that you typically only see with junk bonds or other insecure debt. However, I felt that this debt was extremely secure, given the capital structure of the company and my assessment of the motivations of insiders. I thought the 14% coupon was more an artifact of the terms of the restructuring than the security of the debt.

We obtained the debt in April 2010, and the company has recently announced the intention to redeem this debt. We are entitled to receive full principal plus interest in cash, so this represents a successful outcome to this investment. My only regret is not being able to buy more of this security.

This will add to our cash holdings during Q1 2011.

Administrative

As I'm sure you are aware, tax time is rapidly approaching. Our broker (TD Ameritrade) provides 1099 reports for each account, which include dividend and interest income. These are available for download from the TD Ameritrade web site. If you have any trouble getting yours, let me know and I can provide it via email or fax.

You may also need the schedule K distributed by Brookfield Infrastructure Partners. You should have received this in the mail by now. This form as well as other helpful tax information about this investment can be found here:

https://www.taxpackagesupport.com/brookfield

A crucial piece of information required to file your taxes is the capital gains and losses for positions sold during the year. This information cannot be gleaned from the TD Ameritrade 1099 forms, since it requires cost basis information that they do not track. Unusual transactions such as mergers and spin-offs also affect capital gains, and these are also not tracked by TD Ameritrade.

To fill this gap, each year I prepare capital gains and losses reports for clients with taxable accounts under management. You should have already received those via email. I am not a CPA and Tidd Capital does not provide tax advice. However, as the active manager of these accounts, I am in a unique position to determine the cost basis and tax consequences of transactions within the accounts. As a courtesy, I provide clients with an estimate of these tax consequences that can be a useful input to your taxes. If you or your tax advisor has any questions about these reports, please don't hesitate to contact me.

Starting in 2011, at long last, brokers are beginning to be required to better track cost basis information, though it might be a year or two more before they provide the full set of information required to file taxes.

I am currently in the process of changing phone service providers, and email continues to be the best way to get in touch with me.

Closing

I hope that this letter has given you a better understanding of my investment process. As always, if you have any questions or concerns, please feel free to contact me by phone or e-mail at any time.

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