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Stacking the Odds?

Dear Shareholder:

In over thirty years of being in the investment business, we have seen a phenomena repeated in the 2nd quarter of 2010 that we have seen many times in the past. A popular investment sector or asset class has continued to perform relatively well despite offering poor odds of long-term success. At the same time, a sector or asset class which has offered attractive valuation and higher odds of success adds another dismal quarter to a multi-year period of purgatory. This time it is the small to mid-capitalization stocks which have had a ten-year run of success relative to their large cap brethren. The Smead Value Fund is dominated by what we believe are outstanding large-cap companies which fit our eight criteria.

Performance *Investor Class SMVLX*
Average Annual Total Returns as of 6/30/2010

	Second Qtr 2010	1 Year	Annualized Since Inception 1/2/2008
Smead Value Fund	-13.85%	14.95%	-13.62%
S&P 500	*-11.43%*	*14.43%*	*-10.69%*
Russell 1000 Value	*-11.15%*	*16.92%*	*-12.00%*

Gross Expense Ratio: 1.92%
Net Expense Ratio: 1.41%*
*The Adviser has contractually agreed to waive its fees and/or absorb expenses of the Fund to ensure that Total Annual Operating Expenses do not exceed 1.40% of the Fund's average net assets, through 3/31/11.

Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling 1-877-807-4122. Investment performance reflects fee waivers. In the absence of such waivers, total returns would be reduced.

Instead of bucking the sharp correction in stocks in the second quarter, the companies in our portfolio fell more than the S&P 500 and Russell 1000 Value Indexes. Many of our favorite holdings like Ebay, Nordstrom and Walgreen declined significantly during the quarter. There was plenty of liquidation on the part of investors overall which kept our other holdings from making up any of the difference. This happened despite our portfolio being more attractively priced relative to the market based on price-to-earnings, historical earnings growth, free cash flow, return on equity and a variety of other measures. It is also despite predominantly shareholder friendly actions being taken by the management

of our companies and most of them making wise asset allocation decisions with our free cash flows. Take heart though, because we have seen this before. (Although there is no guarantee that history or past performance will repeat itself). At the beginning of the year 2000, it was obvious that the technology stocks were ridiculously overpriced and non-tech shares were undervalued. By the 10th of March in 2000, the tech dominated S&P 500 Index was up 5% and the Russell 1000 Value was down 9.34%. Value managers started the year with the odds stacked heavily in their favor and were getting beat by the index by 15%!

Thank God that time was the ally of the patient investor during that period. The tech stocks did hit the wall on March 10th of 2000 and lost 80% of their value in the next two years and seven months (as measured by the tech heavy NASDAQ Index through 10/04/2002). We believe that markets always revert to the mean even though they can defy the odds for an extended period of time (to the short-run satisfaction of momentum investors). Below we provide you with the history of how we got to this point and why we believe the next three to five years and normal mean reversion could potentially stack the odds in our favor.

What are the Odds?

A number of years ago we wrote a piece about two very similar state of the Union speeches. Calvin Coolidge gave his last State of the Union address in December of 1928 and President William Clinton gave his last one in early 2000. Here are the opening statements of these speeches:

"No Congress of the United States ever assembled, on surveying the state of the Union, has met with a more pleasing prospect than that which appears at the present time." Coolidge, December 1928

"We are fortunate to be alive at this moment in history. Never before has our nation enjoyed, at once, so much prosperity and social progress with so little internal crisis and so few external threats." Clinton, January 2000

Our country was at peace, had enjoyed an amazing run of prosperity, sat on booming stock markets and the US government had its financial house in order in both cases. These speeches represented inflection points of legendary magnitude. These were the worst two times to invest in common stocks in the last 100 years. What were the odds of that happening?

At Smead Capital Management (SCM), we see a great deal of consternation in the marketplace about the opposite circumstances we see today. The US government and many individual states are running huge budget deficits. We are fighting a worldwide war on terrorism and a number of hotspots are flaring up all over the world. The economy has suffered the deepest recession on record since 1981-82 and the biggest financial panic since the 1930's. Lastly, the S&P 500 Index is well below where it was at the time of President Clinton's speech after more than ten years. (Measured from 1/28/2000 at 1360.16 to 1/28/2010 at 1084.53.) Which decade had worse stock market performance than the one we just finished? You guessed it, the one following Coolidge's speech in 1928.

What are the odds that this is a good time to invest in the US stock market for the next ten years? At SCM, we think high! Tough times impose a discipline on consumers, financial institutions, governments, companies and politicians which have the potential to lay the groundwork for years of future success. It is exactly the opposite of the sloppy, unethical and undisciplined participants who dominated the markets after years of prosperity and booming stock prices.

Most market commentators were talking about stocks rising to the sky and the elimination of business cycles in the late 1920's and the late 1990's. Today, all we hear about is how much hell we have to pay for the sins of the past ten years. Some call it the "New Normal". Any number of respected market pundits will tell you how low we have to go to make things right in stocks. We strongly disagree and count ourselves as realistic optimists.

Price-to-earning (PE) ratios told you quite a bit about what was coming for the stock market in 1929 and 1999. In 1929, the Dow Jones Industrial Average (DJIA) peaked at around 28 PE. This means that the after-tax profit of the businesses were equal to less than 4% of the company's combined stock market capitalization. High quality bonds were offering around 5% at the time. It was a poor risk reward ratio begging for uninterrupted growth in the economy and in corporate earnings.

The same thing could be said in 1999. The DJIA peaked at around 27 PE with high quality bonds somewhere around 7%. Each one of these instances saw investors rabidly excited about new technology. In 1929 it was automobiles, airplanes and uses of electricity. In 1999 it was the internet and how it was going to change our lives. The 1999 episode was especially damaging because it caused investors to congregate in the 50 largest tech stocks. Most of those were specifically a US stock market phenomena. The tech stocks were most likely to be owned by large cap growth money managers and in large-cap growth mutual funds. Therefore, large cap growth funds got drowned in billions of dollars of new money. In an effort to reduce portfolio risk, these managers used the money to diversify away from tech into consumer staple and pharmaceutical company shares. Unfortunately, this drove PE multiples to 30 to 50 on those sector share prices dooming them to a decade of dismal stock price performance.

Today the DJIA trades at a trailing PE multiple of 14.5 and 13 times the consensus estimate for 2010. This means that 7 to 8% of the share prices are expected to be made in after-tax profits this year. Five year AA-rated Corporate Bonds yield 2.8% and ten-year Treasury bonds yield around 3.15%. When the gap between lower risk bonds has tilted away from stocks, beware. When stocks offer significant upside potential to bonds, we at SCM are very comfortable owning stocks which meet our eight criteria.

Based on PE ratios, we think that the story for our portfolio may be even more compelling than the overall stock market. In the process we are potentially given better odds. Our companies have been trading at a dollar-weighted average PE of 13.2x on a trailing basis and 12.1x on a 2010 consensus estimate basis. We think that's a commandingly attractive position in relation to earning interest in high quality bonds. Our story appears even stronger on a market relative basis when you consider our companies strong balance sheets, high average returns on equity, history of ten-year revenue and profit growth, historical earnings stability and high free cash flow generation.

Here is the great irony of where we are today and how the odds stack up. Our portfolio is dominated by companies which were in favor in 1999. These companies traded at those 30-50 PE multiples and based on our strategy, you pay us to stay away from that kind of popularity. The list includes MSFT, EBAY, MRK, BMY, JNJ, ABT, WMT and DIS among many others. These companies were "priced for perfection" back in 1999 and in most cases trade for a lower PE ratio today than the average stock in the DJIA or S&P 500 Index. The most ironic part of all is that they have been beaten down lately by heavy mutual fund liquidation as investors flee large cap money managers and the large cap mutual funds that own these stocks. It seems like the last major punishment for all the misguided affection of the late 1990's. Major sector bottoms come when there is no one else to sell. At SCM, we believe that investors with a three to five-year outlook who are invested in large cap stocks have the odds stacked more heavily in their favor. Thank you for your ongoing confidence and patience as we wait to see if these odds play out.

Warm Regards,

William Smead
Portfolio Manager

Tony Scherrer, CFA
Co-Portfolio Manager

The information contained herein represents the opinion of Smead Capital Management and is not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

The Smead Value Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and it may be obtained by calling 1- 877-807-4122, or visiting www.smeadfunds.com. Read it carefully before investing.

Mutual fund investing involves risk. Principal loss is possible. The Fund is non-diversified, meaning it may concentrate its assets in fewer individual holdings than a diversified fund. Therefore, the Fund is more exposed to individual stock volatility than a diversified fund.

As of 6/30/10 the fund held 4.9% of Ebay, 3.6% of Nordstrom, 3.1% of Walgreen, 3.8% of Microsoft, 4.5% of Merck, 3.5% of Bristol-Myers, 3.1% of Johnson & Johnson, 3.2% of Abbott Laboratories, 3.5% of WalMart and 4.5% of Disney. Fund holdings are subject to change at any time and should not be considered recommendations to buy or sell any security.

The S&P 500 Index is a broad based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. The Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. The NASDAQ Composite Index is a market capitalization-weighted index that is designed to represent the performance of the National Market System which includes over 5,000 stocks traded only over-the-counter and not on an exchange. The Dow Jones Industrial Average is an unmanaged index of common stocks comprised of major industrial companies and assumes reinvestment of dividends. You cannot invest directly in an index.

The Price to Earnings (P/E) Ratio is calculated by dividing current price of the stock by the company's trailing 12 months' earnings per share. Free cash flow is revenue less operating expenses including interest expenses and maintenance capital spending. It is the discretionary cash that a company has after all expenses and is available for purposes such as dividend payments, investing back into the business or share repurchases. Earnings Growth is the measure of growth of a company's net income over a specific period, often one year. Return on Equity (ROE) is a measure of a corporation's profitability. Represents average return on equity on the securities in the portfolio, not the actual return on equity on the portfolio.

P/E and Earnings Growth Rates are not a forecast of the funds future performance.

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