

Returning From Retreat

According to *Webster*, a “retreat” is a forced or strategic withdrawal, as into a place of safety, refuge or seclusion. The management of CornerCap returned from a retreat in the North Georgia Mountains just a day before our nation experienced the horrific events of September 11. Those human tragedies were followed by an acceleration of the retreat that many investors were already experiencing in the financial markets. While we Americans are not much into retreating, sometimes it is necessary to keep us focused and to propel us to a higher level.

Renewed Focus – America

Like most Americans, we watched the terrorist assault on our nation on September 11. As we contemplated friends or loved ones whom we knew or thought might be in the World Trade Center, we were overcome with feelings of shock, sadness, despair and anger. How could a group of people who were clever and organized enough to orchestrate this crime so deeply hate our country and for what we stand? What did they expect to accomplish? What did they in fact accomplish?

It is difficult to speak of anything positive when we feel such deep sorrow and compassion for those whose lives were directly touched by these tragic attacks. But what these few radical terrorists were able to accomplish is an amazing awakening in the spiritual and patriotic soul of our citizens. This change is forcing America to refocus on what we value in this country and what needs to be done to preserve those values.

In recent years, there are many who believe that because of our prosperity, both financially and militarily, we had retreated from those basic values. There has been a change. In the financial world, we have noted the need for an awakening for some time (see below). In the world of terrorism, we have now been fully awakened to the dangers that can occur within our own borders – something the rest of the world has lived with for years. With a renewed focus, we will join with others around the globe who are more interested in creating life based on the moral good than on destroying life based on some evil, irrational extreme.

Renewed Focus – The Market

Speaking of retreats, the stock market has made a dramatic and extended reversal from its highs in early 2000. The major market indices – excluding the disaster-prone Nasdaq – were down 15% to 20 % in the third quarter, marking the worst quarterly decline since the market meltdown in October 1987, 14 years ago. While this was a down quarter for our clients, we continue to perform exceptionally well relative to the indices and other investment managers. We are pleased to note that our equity investments have continued to realize good, positive returns since the start of the bear market, March 2000, even though the Dow, S&P 500 and Nasdaq indices have declined 21.5%, 30.7 % and 70.3%, respectively, from their peak.

Have we reached a market bottom? How much lower can it go? What we wrote in our last quarterly report about forecasting is still true: “One of the most important things to know is what you do not know no reliable forecast of the market can be made for the next year, three years, or even five years.” The best recent illustration was the technology-based bubble, which expanded longer and larger than we

professionals could have ever imagined. The peak was characterized by total euphoria and confidence in both the market and the winners of the day.

We cannot predict how long or low this market will go. However, we do know that rather than euphoria and confidence, its turning point will be characterized by nausea and disillusionment. We also know that efforts to predict the turnaround in the economy and correlate that with the turnaround in the market will probably be of little value. Similarly to the effects of the terrorist attacks, while the US economy may be staggered in the near term, it will recover, survive and thrive in the long term. The biggest risk that investors face is not the decline in the market from this point but rather not being in the market at the turn (see March 31, 2001, quarterly commentary about “investor” risk). In other words, our current passion should be for buying and not selling.

The spiritual poem “It’s in the Valleys I Grow” is very applicable to what US investors are currently experiencing. When we are on the top of the mountain, there are few lessons learned. Whether you are talking about financial or human, our values and disciplines oftentimes slip while we are coasting on the top. It is only when we experience pain -- pain from the deep valleys -- that we are able to focus clearly on those things that truly matter.

While we are horrified by the terrorist attacks and we suffer with our clients when investments decline, deep valleys force us to learn and grow. With investments, we have experienced many valleys in our 25+ years of investing for clients and ourselves. Through those depressing times, we have learned that the turnaround in the economy usually is not predicted until it is already turning around. We have learned that the turn in the market usually comes well before the turn in the economy and when investors least expect it. We have learned that the initial upside tends to be rapid, so you have to be there before it happens. And we have learned that if you did not have the courage to walk through the valley, the mountaintop will not be nearly as high and clear.

Renewed Focus – CornerCap

The “valley” for CornerCap was at the peak of the technology bubble in early 2000. We knew how to keep the investment side on track, but we had less control over the human side. It was a growing, learning experience, even for our more senior people. We are very proud of how few clients we lost during that period; all of our investment professionals stayed with the firm, and we kept our investment philosophy intact.

The purpose of our firm retreat was to make sure that CornerCap was clearly focused on our objectives and future direction and that everyone in the firm agreed. Now that we have reconfirmed our focus, we will share them with the people whom we consider to be the “boss” of the firm, our valued clients.

- Investment Management - Research and portfolio management will continue to be the primary focus of the firm. We also intend to continue to deliver quality client service, administration, and business development, but we have built the firm’s foundation on investment knowledge and implementation.
- Succession Planning – The cofounders of the firm committed to continue transitioning ownership of the firm through the Performance Valuation Share Plan beyond the original 10-year commitment, with no planned termination date. The cofounders also expressed their commitment to continue working full time for the firm for the long term.
- Growth – Continue growing the assets under management to an intermediate target size of approximately \$1 billion. We believe that this target size will provide the greatest benefits to the clients, owners and employees of the firm.