



February 17, 2012

For the first half of Q1 2012 (Jan. 1 through Feb. 15) the Arquitos Value portfolio has returned 10.4% after fees. Three holdings have been big winners: Bank of America gained 40%, First Marblehead gained 23%, and Clearwire gained 22%. Clearwire has been a particularly strong performer, returning 54% since our purchase in October.

In my last letter I talked about the high degree of volatility in the markets in 2011. That high volatility also caused a high level of correlation among stocks. Josh Brown at [The Reformed Broker blog](#) noted that “[i]n October of 2011 84% of S&P 500 stocks were moving in the same direction as the index itself.” That makes it difficult for bottom-up stock pickers to outperform. Since the beginning of this year we’ve seen a reversal of this and a few weeks ago only 30% of stocks were moving in the same direction as the index.

Only a few of our holdings are in the S&P 500, but that high level of correlation had been the trend for other indexes and across asset classes last year as well. I’m glad to see it go. The fact is that the problems in Greece, for example, shouldn’t affect First Marblehead’s cash level and their prospects to get their Monogram private student loan program into more banks. However, when investors are scared and pull money out of the markets, funds must liquidate some of their holdings.

This phenomenon was highlighted in the stock of a company named Blackboard last August. The company was being bought out for \$45 cash per share by Providence Equity Partners. The spread between the buy-out price and what shares were trading at was around 2% from the end of June until August. So, basically the stock was trading around \$44. When the overall markets sunk after the debt ceiling debate and downgrade of the U.S.’s credit rating, Blackboard’s stock dropped to about \$41 for a few days. This didn’t reflect any change in the circumstances of the merger. Investment funds were simply trying to raise cash and sold out of a stock which had been more stable than others. Smart and nimble buyers were able to capture a nearly 10% gain in the course of a month in a very low risk situation. We didn’t quite catch that large of a gain, but I was able to buy into Blackboard under \$43 during that time period.

We’re currently participating in two low risk mergers, the buy-out of Goodrich by United Technologies, and Google’s purchase of Motorola Mobility. I’m on the lookout for other low risk investments like this that we can opportunistically take advantage of.

In the near term, I’m taking a cautious view on the markets. While I’m agnostic about which direction the overall markets will go, and I generally believe short term predictions are nonsense and unknowable, I also am cognizant of some potentially large market disruptions that could occur over the next six months. Two in particular have my attention: Iran’s intransigence will most likely be dealt with by June, and the situation in Greece is reaching an untenable point. We currently hold a small position in

a hedging ETF to offer some protections. I also would like to increase our cash position slightly over the next few months. If there is a market disruption, we'll be buyers.

Our largest current positions are in First Marblehead, Biglari Holdings, Berkshire Hathaway, and Valeant Pharmaceuticals.

Arquitos Capital is expanding and we are launching a hedge fund on April 1 to complement our two Spoke Funds®. If you are an accredited investor and would like to learn more, please contact me to set up an appointment. As always, thank you for following along.

Best regards,

Steven L. Kiel  
Arquitos Capital Management

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