July 2008

Price versus Value

In times like these, with the economy and capital markets in seemingly constant states of uncertainty, we are often asked "what do you think is going to happen"? This question is asked about the market's direction, the economy's growth, the presidential election and any number of things. As you well know, we are not in the business of making predictions. However, regarding the markets we certainly believe that it's "not about timing the market, but rather your time in the market" that makes all the difference.

With that as a backdrop, we thought we'd take this opportunity to discuss one aspect of our investment process that specifically addresses the issue of stock price movements. Hopefully these examples will make clear how we use our overall investment philosophy to look beyond the immediate economic clutter, and to tune out the clatter generated by those in the business of simply filling air time, the media.

We make individual investments that, after careful analysis and discussion, we believe offer the greatest chance of achieving a desired return with a tolerable amount of risk for a particular portfolio. To be more concrete about it, we buy stocks that we believe will provide our clients with an appropriate rate of return over a meaningful period of time.

This means that we are just as concerned with the value of a company as we are with the price of its stock. How do we determine the value of a company? It's just like any other analysis; the fair value of any investment is the present value of a future stream of cash flows discounted at an appropriate rate. Don't worry; we have spreadsheets and formulae to help us do the math. Over time, the price of a stock and the value of the underlying company will reach equilibrium. That is the purpose, and nature, of free markets.

However, when the price of a stock and the value of the company are substantially different, that is when we can make the best buy, or sell, decisions for our clients. For example, if company ABC is selling for $50 a share, but we have determined that it's true value is $40 a share; we simply are not interested in buying the stock. Even if a news item comes out and the stock price is down 10%, to $45, we still are not interested in buying the stock. Cheaper does not always mean cheap.

Conversely, if we own a stock at $30 because we believe the value of the company is $50 per share, volatile price movements alone do not compel us to trade the stock. A quick 10% move down, to $27, does not indicate that the company is going out of business, and is certainly not an automatic sell trigger. Or, let's say a news item comes out and sends the stock up 20%, to $36 a share. We are not looking for the quick hit, but rather a sustained move up to the intrinsic value of the company; in this case, at least another 39%, up to $50 per share.

To add icing to the cake, not only do we buy stocks that we think will appreciate up to the value of the company, we buy companies that we believe have an ever-increasing underlying value. So, if the target is $50 today, it might be $60 next year. When we are able to buy companies whose value is increasing at a discount to their current value, then we truly have made the appropriate investment for our clients. That, in a nutshell, is the basis for our investment strategy of Growth At a Reasonable Price (GARP).

We are not always right. Sometimes our inputs, assumptions and analysis are off the mark. When that is the case we attempt to act as objectively, and decisively, as possible. More often than not our analysis is correct and we provide a valuable service to our clients. We believe our track record bears this out.

Of course, there are times when the stock price doesn't reach full valuation as quickly as we or our clients would expect or even moves the opposite direction for a period of time. When that is the case, we step back, re-visit our analysis and confirm the validity of a stock valuation, and practice patience. Again, it is the purpose and nature of markets to make sure that eventually price equals value.

We trust that this helps explain this portion of our stock selection process. If you have any questions, or would like to discuss other portions of the process with us, we would welcome that. Please feel free to get in touch with us at your convenience.

Howard, Ward, Elizabeth, Ethel and Craig

A copy of our SEC Form ADV Part II is available to you at any time. This document describes who we are, what we do, and how we do it. If you would like to have a copy sent to you please contact Connie at the phone number, or e-mail, listed below.

As a Registered Investment Advisor, Paragon Capital Management receives and collects non-public personal information from various activities and statements.

Paragon does not disclose such information unless instructed to do so by the client.

We maintain physical, electronic and procedural safeguards that comply with federal regulations to guard your non-public personal information.

Paragon Capital Management, LLC
9200 Indian Creek Parkway, Suite 230
Overland Park, Kansas 66210
(Located in Corporate Woods, Building 9)

Main line:	913-451-2254
Toll-free:	800-508-4605
Fax:	913-451-2505

Howard Jacobson	913-451-2290	hjacobson@paragoncap.com
Ward Williams	913-451-2291	wwilliams@paragoncap.com
Elizabeth McLeod	913-451-0130	emcleod@paragoncap.com
Ethel Davis	913-451-2296	edavis@paragoncap.com
Craig Novorr	913-451-6330	cnovorr@paragoncap.com
Dorothy Boehr, CCO	913-451-2254	dboehr@paragoncap.com
Maryse Schlenk	913-451-2217	mschlenk@paragoncap.com
Connie Gunter	913-451-2254	cgunter@paragoncap.com