Gaia Capital Management Inc.

Saturdays with Jim: A Most Inspiring Retirement Income Program

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I know I promised a discussion of the role that trust plays in keeping civilization together but I am so wired by reading The Snowball, a well written biography of Warren Buffet's life, that I want to lay out to you the inspiration which led to a really good return last year and which has the potential to unfold even more gains in the months and years to come.

Buffet developed compounding to an almost mystical art. He recognized that insurance companies generated a lot of premium money that would not be spent, in all probability, for years. He bought an insurance company and scored another coup when he created a reinsurance company to in effect increase his float even more (float is excess premium). Reinsurance is insurance for insurance companies which do not want to carry all of a particular risk. Buffet was smart enough to do solid underwriting so that the model would not blow up in a year of unexpectedly large losses. And so his Berkshire Hathaway grew and grew. Berkshire bought whole businesses, which in themselves had huge and compelling cash flows. Buffet used the incoming cash to buy more businesses and more stock in others. You can see why his bio is called The Snowball.

We are doing much the same on your behalf, in a far more humble way than did Buffet. We like high yield, high quality securities and reinvest the income that you do not take as cash. By reinvesting, we can continually grow the capital, providing ample money for inflation protection.

Our version of compounding involves both the growth of income and, over time, growth of capital. But we did not arrive at this model overnight.

When we began a few years ago, we were smitten with dividend paying stocks, which tended to growth in price and in the income they threw off. But as we progressed, we noticed that a security with a 10% yield which never grew its payout would throw off more cash than a security paying 6% and growing at 3% a year. And so we sought securities with yields of 8% or more (based on our purchase price, of course). We used a

Buffet trick - buy cheaply. Doing so we amplified the income we could generate even more.

Topping off the action, we even take occasional profits when a security seems overbought (too highly priced due to market enthusiasm) and deploy the cash to something cheaper. In this way we are able to use both compounding and what seems like trading to make your capital and income grow.

We went through another, quite unfortunate, phase in the fall and early winter of 2007-8 when we thought, like Buffet, that holding good businesses through thick and thin was the best and safest way to accumulate income and wealth, despite what the market thought. In January 2008, we realized that our compounding machine did not throw off nearly as much money as Buffet's machine did, so we returned to the process of "scalping" at highs and reinvesting at lows. This practiced allowed us to lower your cost basis (what we pay for a security) and, at the same time, to increase your income - our float, so to speak.

Our process is quite active, quite energizing and so far has been quite profitable for us, once we got clear of the crazy "hold forever" notion. The proof of the pudding is always in future performance, of course, but you can feel assured that your money management team is not asleep at the wheel.

We are constantly on the lookout for good deals which increase both your income and your overall wealth. We are fond of calling this work our passion. We sincerely hope that we can execute the strategy one tenth as well as Buffet did (and does). Can you think of a better model?

Thank you for investing with us!