

QUARTERLY UPDATE

CWS CAPITAL PARTNERS LLC

CWS Capital Partners LLC

CWS

CALENDAR OF EVENTS

November 22 & 23, 2018

Thanksgiving Holiday and Day After
CWS Offices Closed

December 2018

CWS Capital Partners
Semi-Annual Conference Call

December 24 & 25, 2018

Christmas Eve and Day
CWS Offices Closed

January 1, 2019

New Year's Day
CWS Offices Closed

January 15, 2019

4th Quarter 2018 Est. Tax Payment Due

January 25, 2019

4th Quarter 2018
Quarterly Distributions Mailed

March 15, 2019

Year 2018 K-1's Mailed by Date

April 15, 2019

2018 Federal & State Tax Filing Deadline
1st Quarter 2019 Est. Tax Payments Due

April 16, 2019

CWS Annual Partners Meeting
New Location
Irvine Marriott (Irvine, CA)

April 26, 2019

1st Quarter 2019
Quarterly Distributions Mailed



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IN THE KINGDOM OF THE BLIND, THE 25 "I" INVESTOR IS KING



By Gary Carmell

Bill Williams is fond of quoting Erasmus when he says "In the kingdom of the blind, the one-eyed man is king." Of course this means that very few people have a clear vision of the future so those that have a well thought out idea of how the dominoes may fall should still have an advantage even though they don't have 20-20 vision out of both eyes.

As I was pondering what to write for this quarter's article and our 50th year in business approaching, I decided to think about some of the things that CWS needs to do well in order to continue to deliver a satisfactory investor experience. What were those things that we do well or need to improve upon to give us a little more clarity than others? This reminds me of the following joke:

Two men were camping when they spotted a bear coming towards them.

One of the men was a lawyer. He immediately sat down and put on his running shoes.

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"Why are you doing that?" asked the other. "You can't outrun a bear".

"That's right", responded the lawyer. "I'm going to outrun you".

As the list began to take shape, I noticed that the words were beginning with the letter "I". I decided to keep the game going since I liked the pattern that was developing.

Compounding one's capital at attractive rates of return for long periods of time is no simple feat. For this reason I will have to expand upon Erasmus' insight and say that to have a somewhat clear vision in one's good eye, requires doing many "I's" well if one is to run a successful investment management firm over the long term. And in this case, there are 25 of them. I'm sure there are others I missed but I thought 25 was a good place to stop and get my point across.

1. **Ideas** - The only constant is change. New ideas are vital to ensure an organization is growing, evolving, and meeting the ever changing needs of its customers. It's also important to be cognizant of where the puck is headed to capture investment opportunities and to avoid becoming obsolete and being invested in assets with declining value. Breakthrough ideas can be utilized organization-wide and change the growth trajectory of a firm.
2. **Insights** - Insights can be thought of as the deepest level of knowing. I have experienced them as epiphanies that are powerful enough to dramatically shift my thinking and the actions I take. An example of this was a former belief, a long time ago, that at CWS we don't get paid to predict interest rates. After being stuck in non-prepayable loans with fixed rates in an environment in which rents were dropping, interest rates were falling, and we were not able to refinance, the insight for me was that we actually do get paid to predict interest rates. This led us to seeking loans with much more flexible prepayment terms and lower costs. These were floating-rate loans and after doing a lot of research we came to the conclusion that variable-rate loans offered a very compelling risk-reward relationship because of the flexible prepayment and the lower cost of funds that were typically offered to investors because of a relatively steep yield curve. This is an example of a powerful and very lucrative insight that has saved CWS investors a great deal of money via lower interest costs and higher value attained through much smaller prepayment penalties that enabled us to sell properties without requiring buyers to assume our loans.
3. **Invert** - This leverages off of one of Charlie Munger's favorite pieces of advice. This is a very helpful tool for better decision-making and avoiding bad situations by using the algebraic tool of inversion. As Munger likes to say, if you want to know how to live a good life, you should first ask what are the characteristics of a bad life, and avoid those. The byproduct of this avoidance is that one may end up with a pretty good life and then

take the next step of doing some more soul-searching about what really brings one joy and satisfaction. Munger's advice is useful since self-harm, egotistical living, and addiction can contribute to diminishing one's well-being and sap one's sense of satisfaction and joy which can negatively compound into a downward spiral. It's as important to know what not to do as it is what to do.

4. **Investigate** - It's important for us when we are determining where to allocate our capital that we do a lot of research and investigate what markets to be in, which ones have compelling long-term demand fundamentals, and which ones may be out of sync in terms of supply and demand and may offer a good opportunity to invest. It's also important to investigate our different hypotheses when contemplating making investments. In addition, we also have to do thorough due diligence on the properties that we have under contract and be constantly investigating whether our people and processes and procedures are optimized for delivering the best service at a compelling value.
5. **Invest** - Of course this is what we do by investing our capital into new properties that we purchase and develop. But we also invest in our technology systems and talent via training and new hires. We are very focused on continuously making sure that the firm's capital is growing and productive to stay competitive and relevant.
6. **Integrate** - It is very difficult to do acquisitions. In fact, most companies that are publicly traded that are acquirers often underperform those businesses that stick to their own businesses and grow organically. It's difficult to merge one's culture and systems while often times sellers of properties have lost their focus or have been undercapitalized and have let their properties slip in terms of resident quality, rules enforcement, maintenance, and on-site talent. As a result, when we takeover a property we often find that it can be more challenging than initially thought to bring it up to the quality of CWS' standards. We have to hire new people, train them, and hold our residents accountable to follow the rules and pay on time. But after awhile, everyone is better off due to the community being better managed. The residents are happier, and over time, the investment should perform better.
7. **Ignorance Removal** - This is one word that unfortunately includes a non-"I" word (Removal). I often say that at the end of the day, we are hypotheses testers. We have certain beliefs about cause-and-effect and how things will unfold. As such, it's incumbent upon us to test whether our hypotheses are reasonably accurate or not. We course correct when our hypotheses are incorrect and do more when they seem to be working. It is just as important to know that one of the ways of becoming wise is, as Charlie Munger says, by not being stupid. So if we can eliminate stupidity (ignorance removal) and catastrophic

error that can take us off the field then that's half the battle. One has to stay in the game and do no harm. So when we make mistakes, we need to be able to process them, learn from them, and adjust accordingly so that our body of wisdom grows and we become a smarter organization with better judgment and improve our decision-making skills.

8. **Inform** - It is critical that we keep all of our key constituents informed, particularly our investors. We want people to know why we are doing what we are doing to offer insight into our thought process and judgment. We want to be able to minimize surprises by telegraphing good or bad news relatively early, especially bad news. We follow the golden rule when it comes to communicating with our investors. We want to communicate in ways that we would want to be communicated to if we were the recipient of that information.
9. **Instruct** - It is vital that we have a learning mindset and are always doing our best to convey to our CWS associates critical knowledge and ways of doing things. It is becoming increasingly more complex to manage apartment communities as well as a growing organization given the technological needs to interface with residents, investors, and employees. This requires a lot of training and continuous instruction.
10. **Inspire** - A compelling vision and infectious enthusiasm are great motivators to explain the "why" of what we do so our people can feel like they are playing a much bigger game and understand their role in contributing to our success and theirs individually.
11. **Improve** - We must always be focused on improving our talent, systems, and our way of doing business. A mindset of continuous improvement is very healthy. It's important not to rest on our laurels and to realize that the world is always evolving and changing, and that we need to have a commitment to prudently do so as well. It's not just change for the sake of change, but to change appropriately to add value and improve the customer experience and value proposition.
12. **Impact** - Businesses that succeed for the long run make a difference in the lives of their investors, employees, suppliers, and customers. Our community service program we call "BRIDGE" is one of the most powerful ways that CWS and our employees give back by making a huge impact for causes that move them and something for which we are immensely proud. We strive to enhance the lives of our residents, investors, and employees and we hope that they will have been positively impacted by their relationship with CWS.
13. **Initiate** - Ideas are not enough. They also need to be put into action if they are compelling and fit within the core competency of the firm. It's important to have scorers who can make things happen and take the initiative to bring ideas and new initiatives to fruition.

14. **Intelligence** - We need both intellectual horsepower to come up with game changing ideas and also people scanning our competitive environment to gather intelligence about what others are doing that we are not and should strongly consider adopting. We then have to have a system to allow that important information to flow to the top to make it actionable if that is the optimal course of action.
15. **Integrity** - This goes without saying. It's vitally important that we act ethically and are transparent so that people know when they invest money with us or live in one of our communities that we are a trustworthy, honorable organization. We are custodians of people's wealth, responsible for providing our residents with safe communities, and providing a safe and challenging work environment. This responsibility is something we take very seriously and make them our highest priority and it starts with having an ethical culture and organization.
16. **Intuition** - A sense that something is not right or, conversely, feels particularly right, partially rooted in the intellect, but not entirely. Great investors have a powerful intuition to guide them to make decisions even when the numbers don't obviously point to it being the right course of action. As Charlie Munger says, "People calculate too much and think too little."
17. **Instinct** - This is akin to a gut feel that bypasses the intellect and should lead to action if they are strong enough.
18. **Insee** - This is a word used by the poet Rilke and speaks to the importance of empathy and looking very deeply within situations and identifying emotionally with them. This deep caring helps create a strong service orientation. It also has the connotation of visualizing where things will be in terms of the operating environment, economy, customer needs, competitor behavior, etc. This is not easy to do as we all suffer from recency bias in which we weigh our most recent experience the heaviest but it helps the firm and individuals who are self-reflective to counter inertia and transform a body at rest to one in motion.
19. **Innovate** - We cannot rest on our laurels. We have to be open minded to doing things differently, discarding those we have been doing that no longer add value, or doing new things that will keep us moving forward and relevant.
20. **Incentivize** - It's important that we create the right incentives for the outcomes we want to achieve. The wrong incentives can lead to terribly destructive behavior that can derail a business. The right incentives have the added benefit of attracting and retaining

people who share your values and are additive to the culture and contribute to the long-term sustainability of the firm.

21. **Independence** - Needing external validation is a recipe for poor results. Ego and fear become the drivers versus drowning out the noise and distraction of what others might think. It's imperative to focus on your own internal analysis, experience, intuition, instinct, and gathering the best minds to determine the best course of action given the organization's constraints, capabilities, and assumptions about the operating environment. Independence also comes from having the financial resources to lessen the need to take actions that benefit the firm at the expense of one's investors due to short-term financial gain.
22. **Ingenuity** - Using creativity and moxy to solve problems. A good example of this is a niece of mine who, when in high school, had a party while her parents were out of town. One of the guys there punched a hole in the wall. Rather than fessing up as to what happened, she went on the internet and taught herself how to patch a hole using drywall. Her parents never found out until years later when she confessed. Now that is ingenuity in my book.
23. **Imitate** - If one concludes that others are doing important functions better, then one should subordinate one's ego and pride to what is necessary and imitate, adopt, or adapt if necessary.
24. **Improvise** - As John Lennon said, "Life is what happens when you're busy making other plans." In a similar vein, no battle plan survives first contact with the enemy. There is how you think things will turn out when you buy a property or make an investment and then there is the real world which can often be quite different. As a result, the willingness and ability to improvise is necessary to deal with setbacks and to take advantage of unanticipated opportunities.
25. **Inquire** - Curiosity is one of the most important characteristics for investment success. This is reiterated by famed investor Ray Dalio who says that curiosity, along with character, is one of the most important attributes to be successful. This curiosity should not only be applied to the big picture but also should drill down to the most important details as well.

So there you have it. My list of 25 important attributes that firms like CWS should possess if we are to continue to be successful beyond our 50-year milestone.