2018 Annual Report Letter

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Philosophy

CWS is celebrating its 50th anniversary in 2019. This is a pretty remarkable feat as only approximately 50% of businesses are still around after five years and this number drops to a little less than 12% after 25 years. So what is CWS' success attributable to? I think it goes back to our first investors being family and friends and the tremendous responsibility Jim Clayton and Bill Williams felt to not lose their money. This commitment only grew when Steve Sherwood joined CWS and convinced some of his family and friends to invest as well. And while they were very fortunate for having done so, this was only known in hindsight. Regardless of the track record, each time someone they knew wrote a check for a new investment, the pressure to preserve investor capital increased.

Since I joined CWS in 1987, it has been quite evident to me that we have made a concerted effort to build our company around preserving wealth. The pressure initially felt by Steve, Bill, and Jim has been filtered down to Mike Engels, me, and the team here at CWS. Only after focusing first on preservation of capital do we then set our sights on the potential upside of an investment. One of the best ways of increasing the probability of protecting investor capital is to deploy that capital in a growing business with pricing power (apartments) in dynamic, growing areas that are a magnet for the best and the brightest. We have subscribed to the following maxim laid out by Warren Buffett:

"When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact."

One cannot overestimate the importance of buying quality real estate in outstanding locations to produce durable growing cash flows. Bill Williams will be discussing this in his annual report letter.

And while we would like to think all of our investments will turn out as planned, the results produced often vary materially from what was quantified in the pro forma. And while many have done better than projected, we have inevitably had our share of ones that have underperformed. We have owned hundreds of properties over our long history and it's just not possible to get it right each and every time.

While it may be fun – and gratifying for the ego- to focus on the ones that have done well, the real challenge of protecting investor capital begins when things do not go according to plan. I recently heard Alex Rodriguez speak at a conference and one of the audience members was commending him on being the youngest person to reach 600 home runs. He then asked this person rhetorically if he knew which statistic ranked him as #5 of all-time. After a brief pause he revealed that it was strikeouts. He said he had a Masters degree in failure and a PhD in getting back on his feet. He focused more on his failures to learn from them and to make him better. This is something that has served CWS well over the years. To quote Warren Buffett's partner Charlie Munger:

"Most of Berkshire's success grew from stupidity and failure that we learned from. I hope that makes you feel better about your own life...I like people admitting they were complete stupid horses' asses. I know I'll perform better if I rub my nose in my mistakes. This is a wonderful trick to learn."

What do you do when your assumptions turned out to be off and/or the economy goes into a recession and negatively impacts your performance? This is where the risk of capital loss is quite acute. In order to battle through such challenges and right the ship, we have found that it is critical to have great people organized into highly effective teams and the ability to engage in metaphorical hand-to-hand combat as this is often necessary to effect a turnaround. Steve Sherwood will be discussing the importance of people and supporting their growth as part of fostering a very unique culture to position us to compete and win, particularly in difficult times.

Our people need to have the support and resources to be successful. Mike Engels will be focusing his discussion on the importance of a very deep platform and effective processes as outcomes are often a byproduct of processes. Poor process oftentimes leads to poor outcomes. If results disappoint, then the first thing to do is to review one's process and not assign blame. It's possible that individuals may be contributing factors, but when buying a property there are too many people involved with too many processes to fall on the shoulders of one individual. Due diligence, operations, marketing, capital projects, legal, finance, etc. all have involvement so processes are vitally important, especially aggregating all of the pertinent findings to determine if our projections have a reasonable probability of being met.

If we have an overriding goal of preservation of capital, then we will always have to be evolving and have the openness to study the landscape to ascertain where the risk-reward relationship is in our favor. To do this requires a curious and connected group of people who are always thinking ahead and bringing to the surface compelling ideas that are debated to make sure that we are not operating on autopilot or deluding ourselves that what we are doing is the right strategy because it’s what we’ve always been doing or the effort and cost of change is perceived to be too difficult or too high. It is vitally important that we come up with actionable insights within our core competency that we can execute on. And that core competency must be sufficiently diverse so we don’t fall under the spell of a “man with a hammer” fallacy in which every problem looks like a nail because we only have one tool in our toolbox. That is why we made the decision long ago to have a fully-integrated investment and management platform to have more control over our own destiny. It has enabled us to put our ideas into action with people we have helped grow and train who are organized into highly effective teams who adhere to our values, contribute positively to our culture, and have the deep commitment to our investors and CWS’ reputation to carry on the tenacious fight to do what it takes to try to protect our investors’ capital when times get tough.

Oftentimes in life, and in the investment arena, you can win just by not losing. This has served CWS well for 50 years and we believe it will continue to do so over the next 50 years.