



“Remember that there are no called strikes in investing, so don’t swing at the marginally attractive pitches. Wait for the slow pitches right down the middle before taking a swing.”

Paul Larson, Equity Strategist and Editor of Morningstar Stock Investor

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Dear Valued Client,

The quote above is a refreshing reminder of the value of patience as it relates to investing. Given the market’s steady rise, we feel there are fewer compelling “fat pitches” in the market for investors to swing at, or purchase. Some may argue being patient is an implicit form of market timing. We would disagree. Instead, it’s primarily a form of risk management, which only allocates capital when there is a significant gap between the price of a security and its intrinsic value, conservatively calculated. Value investors oftentimes run into trouble when they compromise their valuation discipline and justify purchasing marginally attractive securities for the satisfaction of participating in the market’s positive momentum. Although we believe Wall Street is mostly built upon a community of active investors with misaligned incentives, the best investors who create lasting long-term wealth are those that have the emotional fortitude to be patient when markets do not offer compelling opportunities. Fortunately, we live in a world where investors overreact to news and information fairly predictably, so we’re confident that volatility will create opportunities in individual securities no matter how attractive or unattractive the market may be at the time.

Year-to-date, the S&P 500, Dow Jones Industrials, & NASDAQ are up, 7.05%, 6.42%, & 9.39%, respectively, as of the end of April. Small cap companies have outperformed large caps significantly so far this year, with the Russell 2000 Small Cap Index up 15.01% through April. Analyzing performance within industries, industrials (up 17.05%), consumer discretionary (up 16.67%), and financials (up 12.26%) are among the best performing industry groups. All of these industry groups have in common a high degree of leverage and/or cyclicity within their business models, which is often associated with a low quality business. It’s not surprising the best performance has come from this low quality group of stocks, as these low quality stocks were exactly the ones that were crushed in price in early 2009. We believe that in order for the market to sustain its advance, market leadership will need to shift from low quality to high quality stocks, particularly those in the large cap space. Quality is often defined by the eyes of the beholder, but we view high quality companies as those with high returns on invested capital, minimal leverage, and enduring competitive advantages.

As you can imagine, we are currently prospecting for high quality investments within some of the industries that haven’t fully participated in this year’s advance, specifically in healthcare (down 1.13%), utilities (down 2.29%), and telecom services (down 6.98%). For example, last month we purchased Pfizer (PFE) in a few accounts where we have discretion to make individual stock purchases. Last year, Pfizer was only up 7.2% and YTD through April, it was down 7.1%. We



believe that the acquisition of Wyeth will help Pfizer dilute the negative impact of Lipitor going off patent in 2011. Although we don't expect any near term price appreciation, we do believe that the market will make an upward adjustment how it values Pfizer once the challenges of Pfizer's "patent cliff" are behind them. At the price we purchased Pfizer, we believe most of the negative news surrounding Pfizer is already known and discounted into the price of the stock. Aside from its attractive valuation, our investment in Pfizer was based on the following factors: 1) Positive secular growth dynamics from an aging population, 2) World class distribution system in higher growth emerging markets, 3) Visible areas to achieve synergies and cut costs from its Wyeth acquisition, & 4) Strong commitment to stable earnings, where no individual drug should make up more than 10% of their revenues, according to company management. Pfizer serves as a good example of an undervalued, high quality business that was acquired amidst a market environment that is not producing many compelling buying opportunities.

Finally, we thank you for your patience and assistance in completing the TD Ameritrade paperwork over the past month. An undertaking of this size could not have been done without your help and your promptness in returning the forms made our jobs much easier, so we thank you for helping us make the transition to TD Ameritrade a success. As always, we are grateful for the trust you've placed in us, and we assure you we're working hard to keep it.

The S&P 500 consists of 500 stocks chosen for market size, liquidity and industry group representation. Each stocks weight in the index is proportionate to its market value. The S&P 500 is one of the most widely used benchmarks of US equity performance.

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Diversification can be thought of as spreading your investment dollars into various asset classes to add balance to your portfolio. Although it doesn't guarantee a profit, it may be able to reduce the volatility of your portfolio.