Investment Management

ADVISOR SERIES

"Put me in coach, I'm ready to play, today."
John Fogerty - Centerfield

October 17, 2012

Dear Fellow Investors,

Sports fans love this time of year. The National Football League and college football teams are well into their seasons, Major League Baseball wraps up with the World Series, and the National Basketball Association gears up for the start of their regular season. Why is our society so fascinated with sports? I believe it is because sports share the same values that our country was founded on. Success can be reached with practice, dedication, teamwork, & the willingness to compete.

Although each sport is unique they all share the same underlying structure. Rules to each game are created. Teams are formed. Coaches are hired to lead the teams and players are there to execute the game plan. Referees ensure the games flow smoothly and enforce any violations of the rules. This structure is no different than how your investments should operate. If we liken the players in finance to the players on the field we have the following:

Sports	***Finances***
Team Owners	Investors
Coaches	Portfolio Managers
Players	Companies
Referees	Government/Regulation
Penalties	Taxes

Good teams are innovative, focused, exceptional at exploiting other team's weaknesses, and have a clear identity. Have you ever watched a baseball game and seen several different pitchers brought in to face different batters? Or seen a football team continually throw the ball to the same wide receiver because the defensive back trying to cover him is too short or too slow? Or heard commentators say, "These guys win games by playing great defense & running the football". Good coaches recognize the strength of their team and have the ability to create mismatches to exploit other's weaknesses. They put their players in the best possible position to be successful. This is exactly what good portfolio managers do.

When we manage money for our clients we think of ourselves as the Coach of your portfolio. In our attempt to give your portfolio the best opportunity to win, we have a rigorous process that we put each of our companies through. To make our team each company must tryout on an annual basis. Last year we had more than 17,000 companies tryout and about 16,700 of them get cut! That leaves us with about 300 companies that make our roster. How do we determine who makes our roster? We've listed some of our common-sense investment criteria below:

- A history of rewarding shareholders with growing dividends
- The ability to continue to raise the dividends paid to shareholders
- Being in solid financial shape and not bloated with too much debt
- Earning adequate returns on the company's capital
- A consistent record of growing sales, earnings & cash flow

Just because a company makes the roster doesn't guarantee they'll get to play. We have some companies that are better suited for different economic environments. If we sense tough economic times ahead we may field a team that specializes in playing defense by having companies that produce essential products and services and in our opinion are in tip-top financial shape. If we anticipate a major growth phase ahead we may field a team that possesses more power by going with companies that have youth on their side and the ability to swing for the fences by creating new products or industries. Our job is to put the best team on the field giving your portfolio the best chance for success.

The S&P 500 Total Return Index is up over 16% year-to-date, 28% for the trailing 1-year, and over 100% since the March 2009 lows. The market has made this move in spite of fears regarding Europe, the Middle East, global recessions, U.S. unemployment, etc. The question we must ask ourselves now is: "What type of companies do we want to put in the game now?" We've seen this market led by quality veterans such as Coca-Cola, Procter & Gamble, Colgate-Palmolive & Johnson & Johnson. Some of these vets now trade near the upper-end of their recent valuation multiples. Do these types of companies deserve a spot on the field going forward?

Looking forward, we still view stocks as attractive on a long-term basis. The earnings yield of the S&P 500 is currently 4 times more than the 10-year U.S. Treasury yield. The P/E multiple of the market is 14 and the dividend yield is just over 2%. However, we do not recommend going out and blindly buying an ETF to track the performance of the market. We believe this market requires a great coach to be successful. As the coach of your portfolio we are asking each of our companies one simple question - How are you growing? If a company responds by saying they've grown earnings by laying off employees, selling off non-core assets, reducing expenses & cutting waste, we're not interested at this time. While this increases the efficiency of the business we know you cannot cut your way to growth. We want to play companies that are experiencing organic growth from strong demand for their products & services.

According to the Book of Odds website, the average professional sports coach in the U.S. can expect to keep their job for 3.3 seasons. Coaching can be a thankless career path with coaches constantly having to answer – What have you done for me lately? However, if you look at coaches who have the longest tenures in their respective sports they generally share the same traits – focus, discipline, patience, and perseverance. We employ these same traits when coaching your financial portfolio. Our goal is to invest in attractive opportunities discovered by utilizing our common-sense investment disciplines. We know our identity and will always stick to it.

As always, we welcome your comments and feedback.

Sincerely,

Blake Todd, AIF®
Portfolio Manager

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Associate Portfolio Manager

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