TWO OAKS
Investment Management
ADVISOR SERIES

"Buy when there is blood in the streets,
even if the blood is your own" – Baron Rothchild

5 August 2011

Dear Fellow Investors,

There are moments in time when we think a mid-quarter update is warranted. With the markets in a correction phase (the Standard & Poor's 500 average is off over 10% from its recent highs) we thought it would be good to touch base and give a brief update.

As many of you know, we believe that the financial media can at times be the long-term investor's worst enemy. Their focus on the very short term, ability to change their minds at a moment's notice, and sensationalism of the emotional aspects of the markets does a disservice to many investors. Perhaps it is as fundamental as what we perceive the time frame of an investor to be (years) and what the media's time frame appears to be (minutes and days).

This current short-term change of emotion in pricing the markets seemed to start with fears that our own government couldn't reach a deal on how to fund our continuing spending spree. As our gracious leaders successfully inked an agreement, the fear switched to "the impending collapse of Europe". Sprinkle in some anemic growth from the US economy and you have a recipe for the media to fan the flames of bearishness. Never mind that corporate profits are strong, the companies have been able to refinance their balance sheets at historically low interest rate levels and are sitting on record amounts of cash, that dividends are greater than treasury yields, and corporations are buying back tremendous amounts of their own stock. The financial media needs emotion and volatility to stay relevant.

Sadly, we think they are driving the uneducated investors out of higher cash flow generating investments into the one asset class that looks most vulnerable to us – US Government Bonds. With our federal deficit now at 100% of GDP and constant talk of a ratings downgrade, why would investors find safety in US Treasury bonds? We believe the coveted AAA credit rating shouldn't apply to most major governments these days. The yield on the 10yr US Treasury has recently been less than 2.5%. We contend that 2.5% is an unacceptably low yield for long-term investors. We also believe lending money to the US government for 10 years at 2.5%, with no hope of an increase in that cash flow for those ten years, is far less attractive than investing in a company like McDonalds that yields 2.9% on its dividend. McDonalds has increased its dividend each year for the past 35 years and we feel they will likely increase it more in the future – thereby increasing the yield over the next ten years. In addition, McDonalds generates more than half of its business outside of the U.S., and has plans to continue building out its footprint in emerging markets such as China & India. We feel McDonalds makes more common sense to us than does a 10 Year treasury bond when you have an investor's time frame that is measured in years and not days. We use McDonalds as an example in this letter, but there are many other companies we could have used as an example and feel that a portfolio of this type of company is the best approach.

We want to reiterate our belief that markets reflect the true value of a business over the **long-term**. During periods such as this, there can be extreme disconnects. If we look at the market as a whole currently, the market is trading at about 13 times our projected earnings for 2012, has a dividend yield of approximately 2% & an earnings yield of almost 8%. This earnings yield is over 3 times more than the yield on the 10 year US Treasury. The last time the earnings yield of the market was 3 times greater than the 10yr US Treasury was during The Financial Collapse of late 2008 to early 2009. According to this one measure, we are priced at Crisis levels and we would draw your attention to the quote at the top of the letter.

A few final thoughts before we close this letter. Trying to keep a level head and stick to long-term disciplines has become a lost art form in today's instant and constant information world. Long-term investors do their homework, value businesses, invest at attractive prices and patiently wait for the market to realize the true worth of the business. We believe this pricing mechanism is not broken, but often forgotten. While we don't see spectacular economic growth from the US economy, we do see the continued rise of emerging markets as providing the catalyst for continued corporate profit growth. We also note that economic statistics are a matter of perspective. Remember, 9 out of 10 Americans has a job. That is a 90% employment rate! Oil has pulled back from its recent highs of over $110/barrel to prices now in the

$80's. In our car loving country this can mean big dollars in individual's wallets to save or spend as they see fit. The entrepreneurial spirit of this country is still in tact. New industries such as the use of Natural Gas are starting to develop. It just takes time and patience. Time and patience seem to be the two greatest assets "investors" have left behind.

A line from a poem by Rudyard Kipling comes to mind – "If you can keep your head when all about you are losing their's…" – to help bring into focus our bottom line to this letter. We do not want to lose sight of our common sense long term investment disciplines of diversification, discipline, and attention to cash flow that have proven themselves in past times of turbulence. Continue to collect our increasing dividends and welcome a market's decline as an opportunity to acquire shares of great companies at lower prices.

We are sorry for the length of this mid quarter update, but felt it was important to reach out and contact everyone with our thoughts. We invite you to call us and talk some more about all this and more.

Warmest Regards,

Blake Todd
Portfolio Manager

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Associate Portfolio Manager

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