

Dear Client,

The third quarter of 2011 is finally over. That's the best thing I can say about it. The S&P 500 was down over 15% making it one of the worst on record and the worst since the financial crisis in 2008.

Despite my optimism over finding excellent long-term investment opportunities in stocks, which I wrote about last quarter, the market swooned. It was risk off.... big time. I strongly believe over the long term that the fundamentals of businesses will win out over shorter-term fears and liquidity concerns; however, when the tide goes out all the boats go down.

Stocks are stuck in a trading range of about 20%. Emotions are running high as seemingly minor news whips the averages around this channel. Our belief is that this chop can remain for a while as we await resolution of the southern European debt crisis and the disgusting political theater here at home.

In the mean time the economy is muddling along at a pace that is not high enough to bring down the unemployment rate. Economic data is coming in mixed to negative. The Federal Reserve has commenced operation twist, which will most likely keep interest rates low for an extended period of time. Congress has committed to bringing down the budget deficit and reforming tax policy and entitlements.

Our indicators show stocks are incredibly cheap relative to the fixed income markets. With so many stocks yielding more than 10-year treasuries and with earnings growth potential it is hard to be bearish. But headwinds are strong. Global growth is slowing and at the margin this can cause problems for more cyclically oriented companies. The lack of coherent economic policy here in the US is raising anxiety.

In this seemingly toxic environment it is very important to take emotion out of the equation. We will continue to follow our discipline and find companies who are trading at significant discounts to their intrinsic values, who have sustainable business models, and whose managements are focused on creating shareholder value. Earnings season is here again and this could provide rational support for stocks. We expect business at the corporate level is better than the macro economic pundits would have us believe.

Capital preservation and income generation is key to surviving this malaise. As we look for opportunities and review existing holdings these principles will be in the forefront of our minds.

This is as tough a market. We have the experience to navigate these shark-infested waters and promise to be ever diligent and focused on your needs. Psychology is negative and valuations are quite attractive. That is a good environment to stay invested and focused on the long term.

Sincerely,

William D. Hutchens Jr, CFA  
President