

## Third Quarter Commentary

### Market Factors

The end of the 3<sup>rd</sup> quarter marks a difficult and maybe historical time for the structure of global financial markets, leaving open the question of fiscal and economic viability for the European Community. Global equity markets have attempted to price in the default of Greek sovereign debt with the carryover of discounting prices in the commodities market anticipating a global recession. Frenzy rather than factual evidence or sound thinking has driven the process.

To be certain, the fiscal state of affairs in Greece is grim; however, a sovereign default within the Community is not a viable solution. Contagion could spread to Spain, Portugal, Italy and possibly Ireland. The results would affect the entire European financial structure and its economies, with the prospect of reaching into Asia and the Americas as well.

The Euro Community has an acute understanding of the potential consequences of the Greek debt problem. While the issue has roiled markets, without resolution the consequences are apparent. How these problems are resolved and the timeliness of the decisions will have long term and far reaching impact on the global financial markets.

So where are we, really? The Euro Community, IMF and key Central Banks are working to employ pragmatic solutions recognizing the problems must be resolved by independent states each of different political, social and economic makeup.

While similar to the financial turmoil of 2008, Europe's problems differ. The US "bubble" occurred in the private sector (primarily real-estate) while the EC's revolve around excessive deficit spending. Comparable to the US recovery following 2008, we expect a drag on the European GDP over the near term.

While not totally immune from Europe's problems, US growth is positive, though housing remains depressed and un-employment high. The consumer, representing roughly two thirds of US GDP, is alive and well. Key economic data like retail sales which show 7.9% growth since this time last year, coupled with an upbeat outlook by retailers for the holiday season suggests that confidence is improving. Third quarter corporate earnings are expected to remain strong with an optimistic forecast for the balance of 2011. These trends reflect healthy prospects for growth not a "double dip" recession.

China also weighs into the global economic equation. Market concerns that recent government actions to tighten bank lending and curb inflation have not materialized. Through the three quarters of 2011 China GDP grew at an annualized rate of 9.1% (the average annual rate of growth for the last 22 years is 9.32%), while inflation fell .3% in August from 6.5% in the previous month.

Financial and economic events outside the US are not as dire as equity markets reflect though challenges remain.

### Portfolio Review

The equity markets sold off sharply this past quarter extending loses in the major stock indices. The S&P 500 index return was minus 13.87% for the 3<sup>rd</sup> quarter and the Russell 3000 Value index return was minus 16.63%. Few sectors had positive returns. In the portfolio, the return for a defensive utility position in American Electric Power was positive, and an improving outlook for Visa resulted in a positive return as well. This global credit card company was recognized finally for its tremendous growth potential. When the negative implications of proposed banking regulations resulted in a more

favorable outcome, our continued positive outlook for Visa was vindicated. Other positions contributing to better investment performance relative to the stock market include the pharmaceutical company Johnson & Johnson, the telecoms AT&T and Windstream, and the mortgage REIT positions Capstead Mortgage Corp. and American Capital Agency Corp. These mortgage REITs generate very attractive yields as well as offer excellent risk/return profiles.

Detracting from our performance during the quarter were the shippers Nordic American Tanker and Diana Shipping, the commodity/material companies Pengrowth Energy, DuPont and Freeport-McMoRan Copper & Gold and the consumer positions Best Buy and Safeway. While their long term values remain intact, their stock performance suffered from the decline in the outlook for global growth and domestic spending.

In particular, Freeport has been a victim of reactionary selling in this risk adverse environment. In fact, Freeport is actually benefiting from the increased demand of worldwide economic growth, led by China, and a shrinking supply of copper ore. Fear of slowing worldwide growth, and strikes at Freeport's Peru and Indonesia mines have depressed the stock price. We believe Freeport's valuation will return to prior levels as confidence in global growth is restored and the strike issues are resolved.

Also suffering this last quarter was our position in Goldman Sachs, one of the better capitalized

investment banks in the world. Goldman has declined to a valuation only seen during the 2008/2009 financial crisis. We are confident that Goldman's business is solid and will emerge as an even stronger company as the financial sector recovers.

We sold our holding in Hewlett-Packard after an unexpected announcement to change their core business. About a year ago their board fired the CEO and the newly appointed successor took a very different strategic path with adverse results. It's hard to recall a time when a board of directors' actions eroded shareholder and customer confidence in such a legendary company to such a degree.

### **Outlook**

Our outlook for the balance of the year remains constructive. The Euro and China stories will eventually be displaced from front page news. We continue to believe the needs of nearly 7 billion people on earth must be met by providing food, housing and medical care supported by new means of communications, technology, education, and social infrastructure. These economic advances will need to be supported by productive partnerships between capitalism and government.

With a very attractive dividend yield around 4.8%, the portfolio is well positioned to participate in our future economic growth.

As always we encourage you to call to review your portfolio and our investment strategy.