February 2014

Dear Client,

Enclosed are the 2013 return calculations for your account(s). Where applicable, three, five, ten year and returns since account inception are included as well.

The S&P 500 returned 32.44% including dividends in 2013. Our composite returned 25.84% in 2013 (individual results may vary). Since inception on 01/01/2000, our composite has returned 204.35% vs. 63.95% for the S&P 500 with dividends. That represents a compound annual return of 8.94% for the composite vs. 3.88% for the S&P 500 with dividends.

Last year's impressive returns continue a string of positive annual returns since the financial crisis in 2008. Indeed, with the exception of 2011 which featured a low single-digit return – +2.11% - four of the five years since 2008 have experienced strong double-digit returns. The net result of the impressive performance for stocks has left them, in our opinion and in the aggregate, fully-priced. Our response to this run-up has meant more sales than purchases and an increase in cash levels in our managed accounts. This does not mean that stocks will decline or that a "crash" is imminent; we have no special insights in that regard. The increased cash levels reflect a difficulty in finding undervalued securities that possess, in the words of Benjamin Graham, a *margin of safety*. We come to work every day looking for undervalued securities to buy and would prefer to be more fully-invested, however when we are temporarily unable to identify any securities that meet our requirements, we will hold cash rather than speculate on securities we are uncertain about.

Our discussion in last year's letter of portfolio activities highlighted some of our purchases and sales. Specifically, we discussed our sale of most securities relating to the homebuilding industry due to the uniformly large price gains. It pays however to be open-minded. In March of 2013 an opportunity directly tied to the domestic housing recovery presented itself. One of the lesser known casualties (at least as far as the headlines were concerned) of the housing bust was the mortgage insurance industry. Under the mistaken impression that house prices had nowhere to go but up, these once careful and prudent underwriters of insurance against mortgage default began insuring anything mortgage related including low-doc loans and bulk issuances of mortgage backed securities (MBS). The results were predictable; large losses. Some of the mortgage insurers went broke and out of business, others teetered on the edge. Although the quality and profitability of loans unwritten since the crisis was impeccable- due to extremely thorough due diligence- the crippling losses from the 2005-2008 period continued to threaten their financial viability. Because of their weakened financial condition, most of the surviving large mortgage insurers needed capital waivers from state insurance commissioners to continue underwriting. If they could just hang-on long enough, the 2005-2008 vintage loans would pass through- like a pig through a python- and profitability would return. Like several other mortgage insurers, MGIC

Corporation underwent a significant capital raise last spring. The company raised over one billion in capital through a combination of stock and convertible debt. After initially surging +20% following the offering, the shares slumped and dropped well below the offering price of the capital raise. That was an opportunity; the capital raise virtually assured their financial viability and the high-quality mortgages underwritten from 2009-2013 were almost certain to be very profitable. While the story has yet to play out completely, MGIC Corp. along with investments in another mortgage insurer, Genworth Financial, were among the largest positive contributors to our performance.

Other positive contributors that have been sold or reduced were Vodaphone Group PLC, Nicholas Financial and Cintas Corp.

Among the other larger positions in our managed accounts, little has changed since last year other than a general increase in the value of the shares. While we no longer consider them to be dramatically undervalued, we continue to own significant stakes in Berkshire Hathaway, Republic Services, Nestle S.A. and the Bank of New York. In addition to reasonable valuations, we like the capital allocation decisions of management, the strength of the business franchises and the durability of their underlying businesses.

We enter the New Year with a laundry list of potential macro concerns. Among the more problematic are the possibility for an abrupt slow-down in China stemming from loan defaults on LGTV's (Local Government Financing Vehicles), a return of the European Sovereign crisis and/or a stalemate over raising the U.S. debt limit. There are many other possible destabilizing macro factors and they would be less of a worry if stock prices were not elevated. But they are, and this leaves them vulnerable to a correction.

We are not in the business of forecasting markets or the future.  We would welcome a correction as that would enable us to purchase bargain securities. In looking back over the past fourteen years of results for the account composite, we have generally fared well with a head wind. Our managed accounts have the cash on hand to buy and we have plenty of securities that have been thoroughly researched and pre-identified for purchase should prices become attractive.

Please feel free to contact us with any questions or comments. As always, we thank you for your trust and patience.

Very truly yours,

Eckart A. Weeck
Senior Managing Director