February 2013

Dear Client,

Enclosed are the 2012 return calculations for your account(s). Where applicable, three, five, ten year and returns since inception are included as well.

The S&P 500 returned 15.95% including dividends in 2012. Our composite returned 13.89% in 2012 (individual results may vary). Since inception on 01/01/2000, our composite has returned 141.85% vs. 23.79% for the S&P 500 including dividends. That represents a compound annual rate of 7.03% for the composite vs. 1.66% for the S&P 500 with dividends.

Equity returns were quite good in 2012 due to a combination of factors. From our perspective, the primary factors were a continuing improvement in earnings and cash flows for most businesses and the attractive valuations of equities relative to competing investment alternatives; principally bonds. The new-year as well has gotten off to a good start with the with broad stock market averages up close to five percent in January alone. In response to the early run-up in prices, we have taken several actions that seem prudent in light of the current circumstances. Among those actions are the sale of most securities directly tied to the homebuilding industry. These stocks have almost uniformly had large price increases, which seems to discount all of the earnings recovery likely through the much-improved housing situation. Additionally, for those accounts with high-yield fixed income exposure, we have sold some positions. In a desperate search for yield, investors have bid-up prices on these securities whereby yields are now in the low single-digits for intermediate term (5-10 years) bonds. Current prices and yields do not, in our opinion, accurately reflect credit or potential inflation risk. We may be wrong, but a three percent yield on an intermediate term “B” rated bond doesn’t look like a formula for wealth creation to us.

It has been said that investing is easy but not simple. Identifying securities with attractive appreciation potential doesn’t require any penetrating insights or clairvoyance regarding future events. With a fairly basic understanding of security analysis and by employing relatively conservative projections about the likely course of commerce, one can generally determine if a security is priced at a level where it is reasonable to expect a satisfactory return through an investment in that security. Investing is not an exercise for determining at what price a particular security will trade the next day, next week or next month. Yet this is precisely what many individual investors and Wall Street analysts attempt to do. Securities often trade at prices that reflect not their *intrinsic value*, but rather the tenor of the recent news flow emanating from the corporation. Thus, unfavorable news begets lower prices and favorable news, higher prices. At first glance this may seem perfectly reasonable, however the price moves often ignore the actual asset value or long-term earnings potential of the business. Investing in response to short-term news flow can identify popular securities, not necessarily undervalued ones.

In addition to the portfolio activity discussed earlier in this letter, we trimmed some fully valued positions including Diageo PLC and Yum Brands, increased positions in the Bank of New York and Republic Services, Inc., and initiated new positions in Hospira Inc. and Spectra Energy. We continue to hold large positions in Berkshire Hathaway, Nestle S.A., PepsiCo Inc. and several other large cap multinational firms, as well as a handful of mid and small cap companies. At current prices, the securities we hold likely offer good but not outstanding return potential. The actions we have taken with respect to sales provide us with the necessary "dry powder" to take advantage of bargain securities when they present themselves. While we are unable to provide an exact timeline for the emergence of bargain securities, experience suggests that patience will likely reward us with compelling opportunities.

One final observation; we have commented over the last several years about the abnormally low level of interest rates in general and U.S. Treasury securities in particular. Although rates have moved up slightly recently (the 30 year Treasury has risen above three percent), almost the entire bond market (corporate, government & municipal) is comprised of issues with miniscule yields. While this environment has been wonderful for borrowers (corporate and household), it has forced investors seeking yield into longer dated bonds. As we noted last year, this strategy is at a minimum likely to result in a loss of purchasing power over time and may possibly result in large losses if rates move up abruptly. We would limit any purchases of bonds to shorter dated ones and special situations.

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