



Sometimes it takes a lot of guts to become an investor, and maybe even more to stick to it. Today we are seemingly faced with all sorts of obstacles to staying with a well conceived and disciplined investment philosophy.

The world is so often filled with bad news. Can anyone remember when everything was going well? The last time when the world looked pretty okay was back in 2000. The US economy had completed eight years of uninterrupted growth. Corporate profits were at records. We had survived the dreaded “Y2K” event. Tech stocks were sailing to the moon, whether they had earnings or not. The ‘evil empire’ of the Soviet Union had fallen apart and we were left with a plethora of new nations casting-off communism and embracing capitalism.

It’s odd to say this, but good times to be an investor seem to be bad times for everyone else. At the market bottoms in both 1974 and 1982 the world seemed to be spinning out of control. We had big problems, inflation, recession, New York City was going bust in 1974, and the whole US government looked to go bust in 1982. These were wonderful times to be an investor simply because things were poised to get a lot better and as that happened those improvements were reflected in the capital markets.

The stock market likes to climb a “wall of worry.” That has been true for a long, long time. Today we have a long list of things to worry about but oddly, the capital markets continue to show gains. Markets, over the short term, seesaw between greed and fear. History shows us again and again that when everyone is bullish, when the seesaw is weighted toward greed, results tend to be poor. Conversely when the scale tips toward fear we quite often have good results.

Over the longer term stock prices are simply a reflection of corporate earnings growth. Companies make more money, economies continue to grow and stocks become higher in price. Those higher prices are a reflection of the natural growth in the economy, in GDP. That is why it makes sense to invest in stocks, why it makes sense to be part owner of the great companies of the world. You, of course, know this already but it’s helpful to be reminded of this when times seem to be troubled and when the headlines are dominated by worrisome news.

With this in mind let’s look at some of the specific worries we’re faced with today. The Greek debt crisis has been very much on folks minds over the last few months. The immediate concern about this situation is moving to the background even as we write this but nonetheless it’s worth a brief recap. We talked about this in our letter to you almost exactly one year ago. And we bet we’ll hear more about this in the future. The austerity measure recently adopted by the Greek government won’t fix this problem, but they will buy more time for the Euro nations to come to grips with the situation. It’s in no one’s interest to see the Greeks default and for now that situation has been defused. There will be losses for the holders of Greek debt, but they won’t be total losses. The Greek economy doesn’t have a significant affect on the world’s economic outlook. Eventually the situation will resolve itself as the EU works to address the problems of its debtor nations. Time is what was needed for this to sort itself out and now all concerned have more of that to work on a solution that spreads the pain and averts panic.



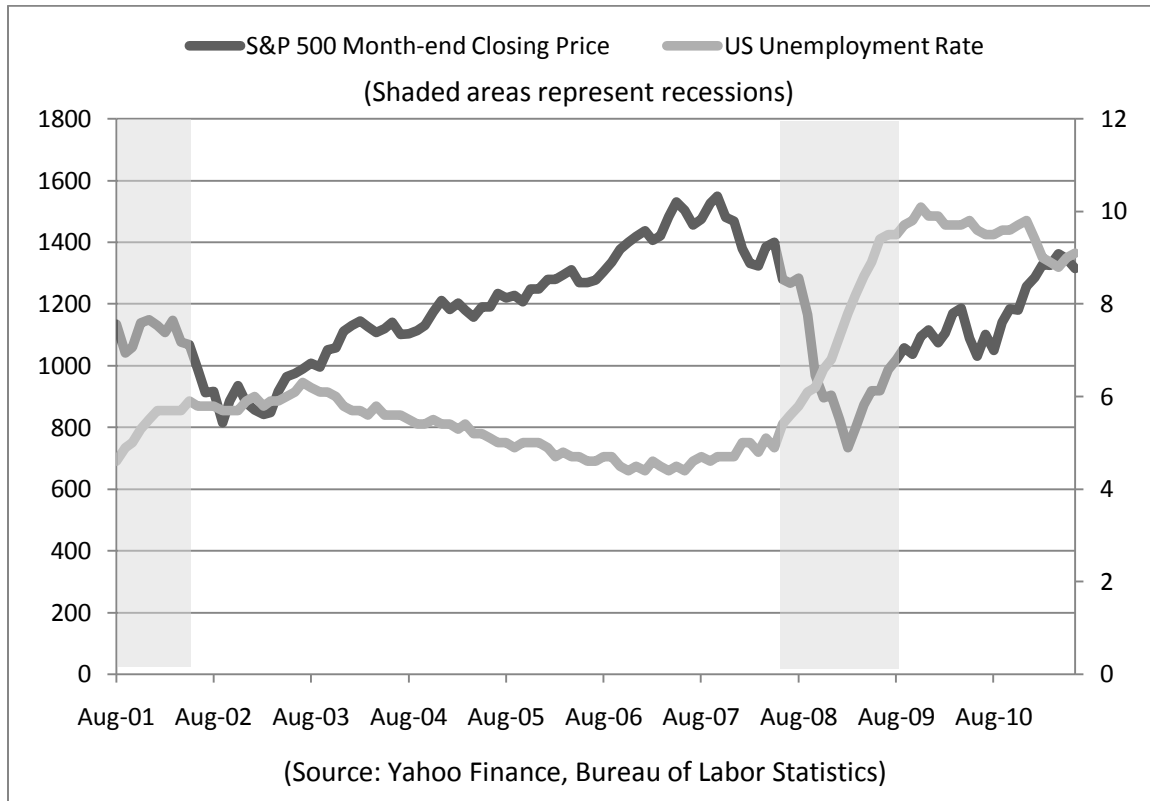
We have a similar issue right now in our own nation. Our government owes a lot of people a lot of money. As a means of trying to keep a lid on just how much money we can borrow, we have put a limit on our borrowings, the so-called debt ceiling. Since the debt ceiling has been in place, we have raised it something like 80 times. We fully expect that we will raise it again in the next few weeks but until we do, the chance that we could default on our debt has become a media focus. But we expect to see the debt ceiling raised since a failure to do so would be catastrophic for our economy and for the world's economy and markets.

People have decried this political process in regards to the seeming stalemate on this issue. But we find great hope in the whole spectacle, as messy as it seems to be. Democracy IS messy and thankfully much of the time we're spared the details of the political process that happens every day in the halls of government. But we find this debate incredibly hopeful; precisely because there is debate. Up until recently our government was dominated by one or the other party and there wasn't really the opportunity for meaningful debate. The party in power simply decided what they wanted to do and did just that. Now neither side has that luxury. The Republicans are insisting on financial prudence, controls on spending and putting our financial house in order. The Democrats are holding the line on cuts to many of the programs that have made this country such a great place to live and work. Neither side can have everything they want and that's probably a good thing. Compromise is a necessity and we think that compromise will help us solve our debt issue as the debate continues.

Of course in the meantime we (and the rest of the world) sit on the edge of our proverbial seats to see what the outcome will be. And we're presented with another foothold in our "wall of worry" for the market to use in its ascent.

Looking at our country's economy we're seeing just what we thought would happen. As we moved out of the recession a couple years ago the mainstream economic view was that our recovery would be slow and somewhat uneven. That's precisely what we've been seeing. We have modest growth in consumer spending (that's you and me), there is growth in investments like plant and equipment, as well as technology and structures and there is growth in exports. We aren't doing all that badly, but neither are we growing as fast as we'd like. This allows all sorts of folks to argue that we will have another recession right away. Maybe we will, but we doubt it. Most recessions are caused by major policy errors or built-up imbalances that need to be corrected. The last recession was largely caused by excess housing construction over years and years along with the financial crisis which was linked to housing as well. We can quibble about whether the current fiscal and monetary policy is appropriate for the situation, but Washington is trying to foster growth, not fight it.

One key area where just about everyone would like to see more growth is in employment. Now, more than two years into an economic recovery our unemployment rate is still very high, 9.1% in the May report. Unemployment peaked after the recovery had already begun, but unemployment is often a lagging indicator for economic health. As the chart below shows, stock prices and the unemployment rate do not match.



We worry more about some of the topics that don't make it into the headlines very often, the ones that will matter a lot to investors over years and years. We worry about inflation, the almost inevitable result of the stimulus that has been applied during and after the last recession. We worry about rising interest rates because at zero percent for money market assets and historically low interest rates in general, there is really only one direction rates can go in the future. But we look out at stock valuations and improving fundamentals and see more opportunity than risk right now.

We've made some changes to your portfolios to help ease the risks associated with rising interest rates and inflation. We've shortened the maturities on many of your bond holdings to reduce that interest rate risk. And with those changes in place we feel quite positive about the balance of our current positions both in stocks and bonds. Your portfolio is behaving precisely as we thought it would across the various asset classes. You have exposure to developing markets in your international equity holdings and we've emphasized high quality growth oriented firms in your domestic stock positions. And of course we continue to monitor valuations, risks and opportunities across all the asset classes and individual investments in your portfolio.

Thinking yet again of the "wall of worry," we'd like to remind you that the markets don't move in straight lines. There will be advances and retreats as the market works its way forward. And truth be told, this will all happen whether you pay attention each day or not.



We do hope that you'll enjoy some of this glorious summer weather free from the worries posted each day in the news. And in this spirit we wish you the very best sort of summer fun and good times with family and friends.

Optimistically yours,

A handwritten signature in black ink that reads 'Scot Thigpen'.

Scot A. Thigpen

A handwritten signature in black ink that reads 'Travis Woods'.

Travis B. Woods

A handwritten signature in black ink that reads 'Theresa J. McMullin'.

Theresa J. McMullin