February 2011

Dear Client,

Enclosed are the 2010 return calculations for your account(s). Where applicable, three, five and ten year returns are included as well.

The S&P 500 returned 15.10% in 2010 including dividends. Our composite account also returned 15.10% for the year (individual results may vary). Results for our composite since inception on 01/01/2000 and through 12/31/2010, were +107.16% vs. +4.56% for the S&P 500 with dividends. Annually, that works out to +6.85% for the composite and +.41% for the S&P 500.

With the financial panic and market lows of March 2009 receding into history, it is helpful to remember that equity prices- as measured by the S&P 500- have rallied over 100% off their lows. Unfortunately, judging by equity fund inflows over the last few years, many investors who sold at the market depths are still waiting for the “all clear” signal to sound. This may turn out to be a very long wait. As we have witnessed and continue to witness, there is always something on the investment horizon that creates concern. As an investor, one winds up paying a very high price- both in opportunity cost and in the aggregate- for a cloudless sky and perfectly calm waters.

Almost as if on cue, and just as the waters in the commercial financial markets have calmed, concerns have shifted from corporate to sovereign and municipal debt. This is a justifiable concern; the financial liabilities of quite a few governments and political sub-divisions may exceed their ability to honor those commitments. Those commitments come in various forms, but the primary problem areas for most governments are interest on debt, pensions and health care. The concerns have become so acute, that absent an explicit guarantee by certain member countries of the European Union, Greece and Ireland would have been unable to “roll” their debt and refund themselves at reasonable interest rates; they would have effectively defaulted on their debt. An interest rate risk-premium has also become evident in the U.S. municipal bond market where many issues are trading at yields well in excess of similarly maturing treasury securities, even though their interest payments are tax-exempt. While this phenomenon is not unheard of, the interest rate premium is historically large and extends to a large number of state and local issues.

Our performance last year was helped by a variety of stocks. Among the more meaningful contributors were Nicholas Financial (+49%), El Paso Corp. (+40%), Dover Corp. (+40%) and Berkshire Hathaway (+22%). The list highlights our “go anywhere” approach as Nicholas Financial is classified as a micro-cap with a market capitalization of approximately $150 million, and Berkshire Hathaway is at the other end of the spectrum with a market cap in excess of $200 billion. We are not restricted by size, and will buy in any market where we can identify undervalued securities. The larger the universe of available securities, the better it is for us.

Our recent activity has involved a little more selling than buying of equities. This is in part due to the aforementioned strong rally in prices, and the concomitant conclusion that some of our holding are no longer significantly undervalued. The net effect has been an increase in cash. For us, having cash on hand plays a vital role in portfolio management. As a tool, it represents opportunity money. From time to time, price dislocations occur-either with individual securities or collectively (market crash) - and there is no substitute for having cash on hand with which to buy. Since one can never predict with any precision when these price disruptions will occur, it makes sense to us to sell some securities when they are fully priced with the expectation that better priced opportunities will emerge.

Earlier we alluded to the developments in the sovereign and municipal bond markets. U.S. treasury securities have thus far been immune to credit concerns. Despite running a budget deficit of close to ten-percent of GDP, the Treasury is able to effortlessly sell bills, notes and bonds of all maturities at exceptionally low yields. To mistake this benign environment as something permanent brings to mind a quote from the late economist Herb Stein, who famously stated “If something can’t go on forever, it won’t.” At some point, the unprecedented monetary stimulus will end and yields will rise. If no progress is made on the budget deficit, the rise in yields and corresponding drop in bond prices could be material. Paradoxically, the securities often billed as being the safest instruments may turn out to be among the riskiest.

In closing, we will continue to invest the way we always have; by identifying and purchasing securities that are safe, easy to understand and undervalued. We can’t promise that future results will continue to out-perform in the same way as they have in the past, but we can promise to do our homework. When it comes to analysis and judgment, you can be sure we’ll be motivated by what is best for the client and not by what happens to be popular or trendy on Wall Street.

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