David L. Berkowitz
Investment Advisor

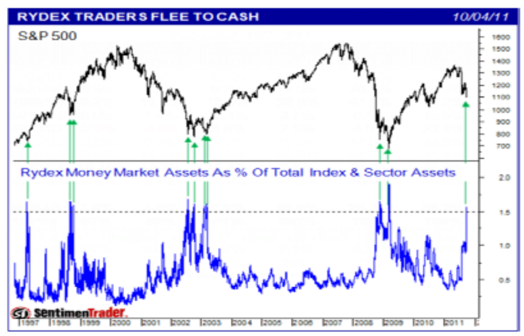
VALUEALIGNED® PORTFOLIO THIRD QUARTER 2011

Dear Friend,

For the 3rd quarter of 2011, our ValueAligned® Portfolio (VAP) of stocks of great companies went down -15.3%, net of fees and expenses.[1] The VAP is now down -3.7% for the year and up +7.6% for the trailing 12 months. The S&P 500 Index including dividends reinvested ended down -13.9% for the quarter and is now down -8.7% for the year, and is up +1.1% for the last year (see endnote for performance disclosures)[1].

Sentiment Is Super Bearish, So We're Bullish

As September ended, measures of *sentiment* registered record breaking fear. Cash is spilling over everywhere we look. For example, the traders in the Rydex family of mutual funds had about $980 million invested in the money market funds at Rydex in early August.



But by early September, in one month, cash increased by 94% to $1.9 billion. As Jason Goepfert at Sentimentrader.com sums it up, "Rydex traders have nearly $1.60 invested in cash for every $1 that they have in stocks." Wow!

Cash is earning near 0%, nothing, nada. That's the very definition of *regime uncertainty—the widespread inability to form confident expectations about future private property rights in all of their dimensions (taxes & regulation).*

Forget the politics for a minute (oh how I wish we could). Here's the fact: investors' time horizons—the length of time they are willing to wait for payback and their expected return—is directly correlated with their confidence in that expected return. In turn, that expected return is directly correlated with the imagined state of economic liberalization (less regime uncertainty) over the investment horizon. The more it looks like the government will intervene through regulating, subsidizing, spending, taxing, borrowing, manipulating interest rates and protecting favored constituencies, the less time investors are willing to wait. Investing in cash at near zero interest rates equates to a near zero investment horizon. Low P/E (Stock Price/Earnings per Share) multiples also equate to near zero investment horizons as the low valuation is subsumed by the value of current earnings only—*there is no future growth of earnings factored into today's price.*

Regardless of what the high economic priests in Washington *think* is the reason for all this cash, *reality* is that investors everywhere are hunkered down in fear of **what's next**. We are at the extreme edge of that fear right now—you can't get any less confident than demanding cash earning near zero and earning a negative return after inflation.

I believe the period defined by this Summer and early Fall is the point of maximum pessimism that the great investors use to buy the stocks of great companies. That's what we are doing.

[1] Please note that the return reported here is net fees and expenses including a *performance allocation* which beginning 2011 is 10% of the extra-profits once you receive a preferred +5% return.

Our Stocks of Great Companies

When volatility increases and individual investors flee the stock market, the remaining participants trade all stocks as one big index. Correlation between stocks go to highs as individual stocks of great companies zig and zag in unison—company differentiation within sectors and countries is non-existent. That's what we saw in the third quarter. The Financial Times reported on September 8 that:

> *The correlation between the movement of big US stocks is at the highest level since Black Monday in 1987, with price moves increasingly driven by the ebb and flow of investors' fears over the economic environment.*
>
> *Stocks, in theory, should move in individual directions based on company fundamentals. But markets of late have been characterised by mass selling alternating with waves of buying, as investors upgrade or downgrade the risk of the US slipping into recession, or a financial crisis sparked by a European sovereign default.*

Of our stocks, the five in Table 1 contributed the most positively for the quarter. All but Bristol-Myers Squibb Co (BMY, $31.38, +18%), the global biopharmaceutical company, are consumer discretionary stocks. While Apple (AAPL, $381.32, +18%) is formerly classified as a "technology" stock, since so many of its sales come from selling iPods, iPhones, iPads and iMacs to consumers, I'll lump it in with the other consumer stocks.

	Ticker	3rd Qtr Return	YTD Return
1	AAPL	13.6%	18.2%
2	VFC	12.5%	41.0%
3	BMY	8.4%	18.5%
4	AZO	8.3%	17.1%
5	DECK	5.7%	16.8%

Table 1. Five Best to 3rd Qtr Performers

Two apparel companies make the list: VF Corp (VFC, $121.52, +41%), the maker of Lee and Wrangler jeans, Nautica and The North Face branded clothing, and newly acquired Timberland footwear; and Deckers Outdoors (DECK, $93.16, +17%) which designs, markets, and produces athletic and high-end casual footwear. Its primary brands consist of the UGG (88% of sales in 2009) and Teva (10%) brands, while secondary brands (3%) include the Simple, TSUBO and Ahnu brands. **It closed the quarter in the 87th percentile of 6 month relative performance and only in the 79th percentile of shrinking shares outstanding.** Last week we sold all our DECK to take profits after its peer, Crocs (CROX), reported weak funky footwear sales.

AutoZone (AZO) – The Top ValueAligned® Company

What is ValueAligned® Investing? It is the owning of companies that manage for intrinsic value per share. Notice it does not mean managing for share price in the stock market. Companies care for their stock *price* best when they ignore it, and concentrate on the intrinsic *value* of their shares. I think Warren Buffett explains it best:

> *When managers are making decisions it's vital that they act in ways that increase per-share intrinsic value and avoid moves that decrease it. This principle may seem obvious but we constantly see it violated.*
>
> **—Warren Buffett, 1998 Berkshire Annual Report**

One of our favorite ValueAligned® companies is top positive contributor for the quarter AutoZone (AZO, $319.19, 17%) the auto parts retailer.

AutoZone has been doing a great business since the start of the Great Recesssion, serving new demand from cost conscious customers looking to maintain their own car. The stock price has responded as well. It's up +20% year to date and +41% over the last 12 months.
In general, people are becoming more comfortable doing maintenance on their cars, as they look to save money. Also, the average age of a vehicle is now over 9 years. Cars over 7 years old are in the "sweet spot" for AZO since these cars are typically off warranties, and may be on their 2nd owner. Here's how CEO Bill Rhodes talked about it on the quarterly earning's call on September 20th:

There is no doubt we have benefited from the macro economy. However, it's important to highlight that we are increasing market share in this environment. As new and used car prices, gas prices, and unemployment have all remained high, consumers have been looking for ways to save money while using their cars and trucks as an integral part of their daily lives.

AZO believes it is in a good position in terms of inventory coverage, having invested over $300 million in parts over the past few years. On the commercial side of the business, the so called “do-it-for-me” (DIFM) sales, AZO now has over 2,600 programs, and continues to focus on growing this side of the business. Management feels that its enhanced parts coverage, its hub programs, and its increased sales force position the company to increase penetration. DIFM sales grew +22.3% in its 2011 fiscal year just ended. Why does this company "act in ways that increase per-share intrinsic value and avoid moves that decrease it?" Let's consider what drives up per share intrinsic value.

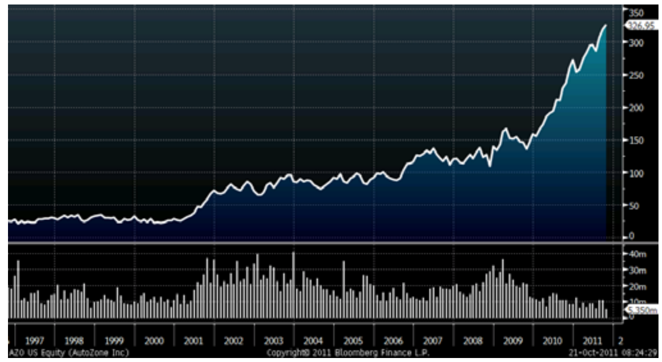


Figure 1. 15 years of AZO Monthly Share Prices. Source: Bloomberg

Intrinsic Value = Present Value (PV) of Future Cash Flows

PV of Future Cash Flows = Capital (debt + equity) + PV of Future Economic Value Added (EVA)

EVA = (Return on Invest Capital (ROIC) – Cost of Capital) * Capital

ROIC = Net Operating after Taxes (NOPAT)/Capital = NOPAT/Sales x Sales/Capital

That's the math! Simple for accounting and number geeks like me but its also simple for non accounting types because it all boils down to managing short-term and long-term profit margins and sales growth per cash spent to increase the dollar amounts of EVA.

1. Profit margin (NOPAT/Sales)
2. Capital (asset) Turnover (Sales/Capital)
3. Capital Growth (aka Capex and Investments)
4. Use of excess cash—debt pay-down, stock buyback and/or dividend.

To manage for value, companies need to take actions that maximize the amount of EVA dollars in the present and the future. Notice they cannot simply maximize profit margins by minimizing costs or raising prices. They cannot minimize investments or capital expenditures only to maximize return on invested capital because that might not maximize EVA dollars or intrinsic value.

Instead, the best business models and management teams optimize each driver of intrinsic value to maximize it in the present and in the future.

But remember Mr. Buffett implores managers to act to increase **per share intrinsic value**. After all, unlike him, we only own shares or parts of these companies. Ideally, for the long-term I would want a board of directors that monitors increases in intrinsic value (or EVA), but also uses earned cash to buy back stock and shrink the number of shares outstanding, thereby increasing our ownership percentage of a growing pie. That's the formula for excess returns over the long-term and is at the heart of our process.

Let's look at the drivers of performance for Autozone. First, let's look at past and expected economic performance for the last 15 years.

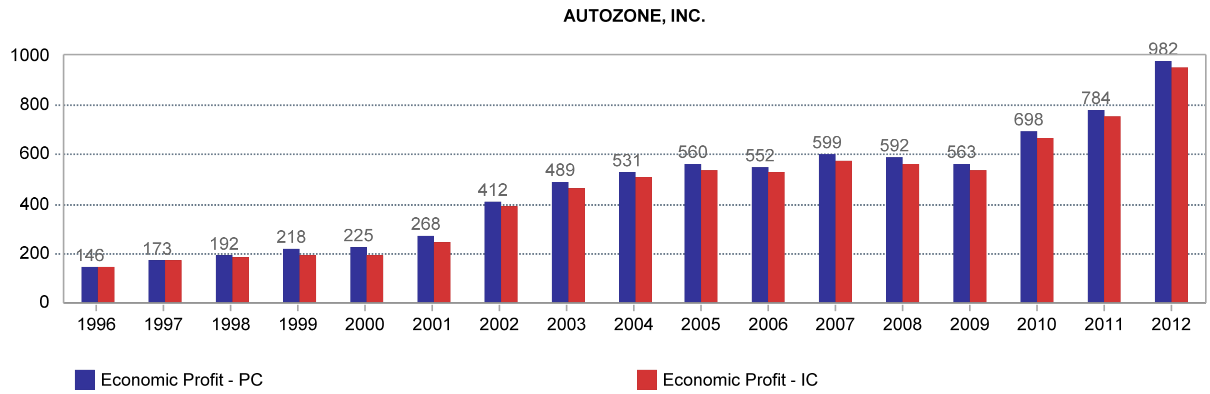


Figure 2. Economic Profit (EVA) on Productive and Invested Capital 1996-2012f
Source: AfgView.com

The first thing that strikes us is that the economic profit (same as EVA in dollars) has been positive for the last 15 years. Next, we understand that the EVA has grown for most of the period except during the financial meltdown period 2007–2009.

Finally, look at how EVA growth accelerated to unprecedented highs after 2001. This was the period when value investor and Warren Buffett acolyte, Eddie Lampert, took a large stake in AZO. He instituted a ValueAligned® program where only cash expenditures that had a high probability of earning a +15% pre-tax return on capital would be made. This discipline is exactly the discipline that Buffett has said he sees violated everyday. Basically, growth, investing and spending are good, but only when they are expected to generate returns well above the cost of its capital—which leads to high and increasing EVA. How did AZO do it—look at the profit margins and asset turnover below.

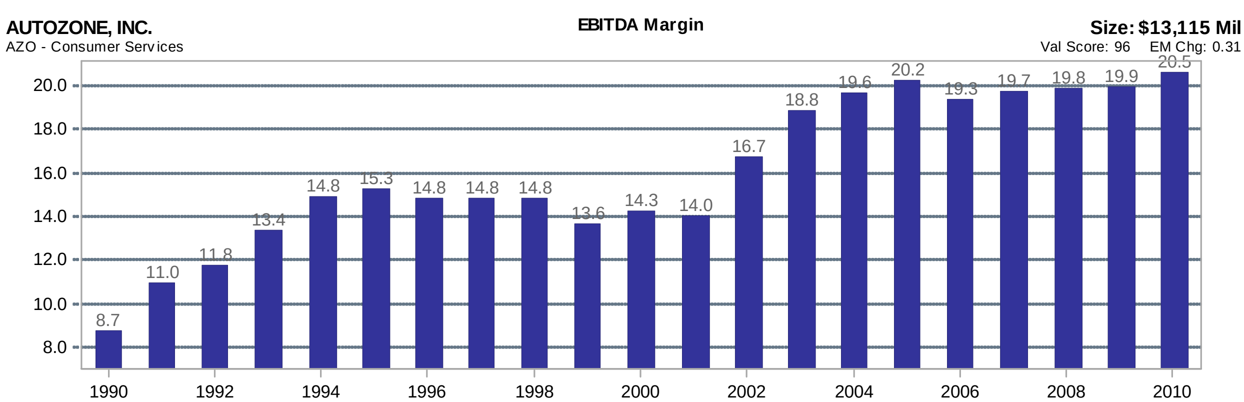


Figure 3. AZO EBITDA Margin 1990-2010 Source: AfgView.com

The focus in 2001 was to increase margins mostly by reducing costs and wasteful spending. To increase EVA, the cost structure was dramatically overhauled. This took about 2.5 years. Since 2003, the EBITDA margin has been very consistent at industry highs around 19% — approaching 21% this past quarter.

This margin is now very stable as the company has been extremely good at trading off between lower/higher gross margins and lower/higher fixed costs spread over a growing store base.

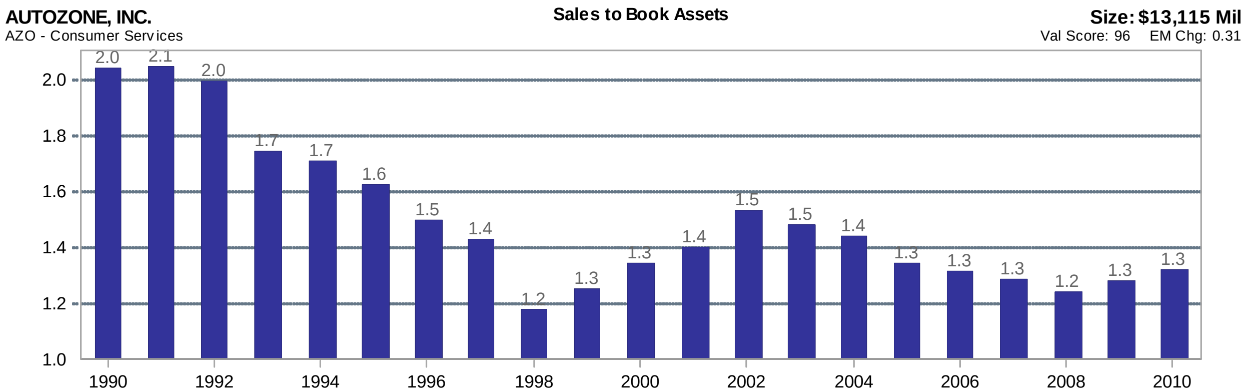


Figure 4. AZO Asset Turnover 1990-2010. Source AfgView.com

The other way to increase ROIC is to increase turnover, which is sales per capital (assets) invested. Efficiency is gained, or EVA grows, when capital growth is slower than sales growth. But just because capital turnover is slightly decreasing above, AZO still has been able to increase EVA and ROIC because of the aforementioned careful and steady investment in inventory to increase parts coverage, while at the same time increasing margins and sales enough to cover higher capital costs. One noteworthy trend is that since the bottom in 2008 turnover is steadily increasing for two reasons: 1) Increased investment in inventory per store has helped to increase sales-per-store, and 2) The steady and careful growth of AZO's commercial business, where it sells parts to commercial do-it-for-me mechanics and it adds to sales without costing much extra cash. AZO is expanding the top of the ROIC equation without expanding the bottom as fast.

AZO has managed very well through the Great Recesssion. Its stock has shot up since the worst part of the panic. In fact, since the bottom of the stock market on March 9, 2009, AZO is up +113%. It's more than doubled, while market is up only about half as much. More impressive is that since 2001, when the company began its VBM program, the shareowner has made a lot more money than if they were invested in the market. The market without dividends is actually down -1% since 2001 ended, while AZO is up +345%.

Anti-Dilution

There's more. Look how AZO's huge excess cash flow enabled management to buy back oodles of stock so the number of shares outstanding has steadily fallen over that period. I have heard a bunch of gurus on TV and the radio complain that companies are buying back stock too often. Those companies, they cry, are wasting growth opportunities or admitting that they have none. Much of that is true, but it's not the buying back of its own shares that is bad or good. It's the outcome that matters. If the company maintains a stable balance sheet, grows EVA and buys back stock where the number of shares decreases, then they ought to buy back as much as they can. AZO does that consistently.

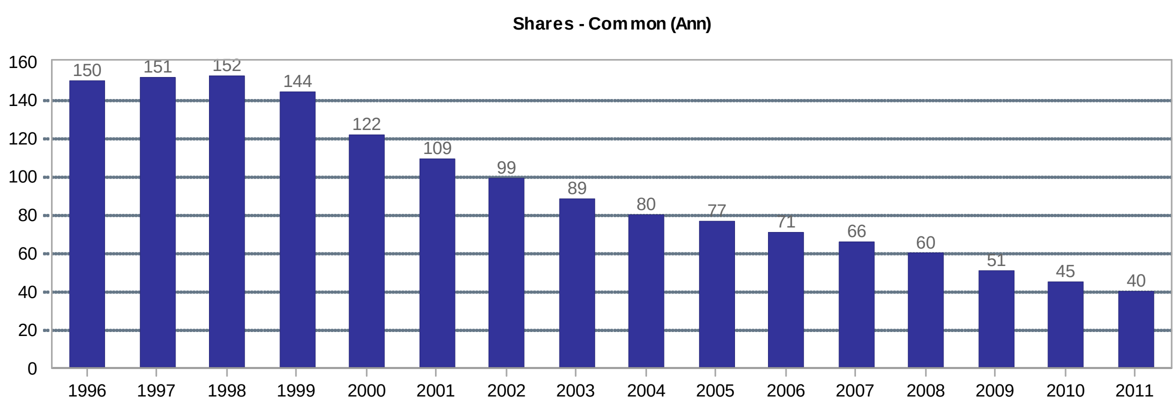


Figure 5. AZO Share Outstanding (millions) 1996-2011

Let's say we bought 10 million shares in 1998, when the shares outstanding were 152 million. Our share of the ownership of the company would have started at 6.9%. If we simply held the original 10 million shares, we would own 25% of the company in 2011! And remember the dollar amount of EVA has been growing the whole time.

That's why we invest in EVA companies or what we call ValueAligned® companies. Management is not only capable but is aligned with our goal to increase intrinsic value per share by increasing EVA over time and reducing shares. Not surprising, AZO is in the 99th percentile of all companies for anti-dilutive buybacks.

MARKET PERFORMANCE IN THE THIRD QUARTER

"This country comes back; we came back from Pearl Harbour and we're coming back now."
Warren Buffett, Charlie Rose Show – Friday September 30

"You can't count out the largest, the most innovative economy in the world. The US has the economic, political and legal constitution to solve issues. Those factors aren't apparent in the Far East, they aren't apparent in China."
Jim Leech, CEO, Ontario Teachers' Pension Plan

This has been a year of contrasts, starting with a first quarter that saw strong increases in the U.S. and Europe followed by a flat second quarter. There was no place to hide in the third quarter. **The U.S. did second best, down only -14.5%.** Europe and the Emerging Markets were down -23%, a bear market in one quarter.

Institutions Liquidate – The Stocks They Didn't Own Outperformed

The average stock in the S&P 500 fell a whopping -17.9% in the third quarter. In the Bespoke Investment Group's third quarter analysis for the index, the best performing stocks in the third quarter were the *ones with the highest yields.* The average performance of the stocks in this top decile was -3.4%. Conversely, the lowest yielding stocks (or no yield) significantly underperformed. 10 year treasury yields fell -39% in the quarter from 3.16% to 1.92%. With interest rates falling so much in the third quarter, investors wanted big safe dividend paying stocks as the market fell.

The second best performing stocks were made up of the 50 stocks in the S&P 500 *with the least amount of institutional ownership*. Based on this evidence, the third quarter declines were caused by *heavy selling by hedge funds, mutual funds and other types of financial institutions*. Individuals are sitting the stock market out—BIG MISTAKE.

Japan's Earthquake Effects Lead to Global Recession Fears

Sovereign debt and deficits dominated the headlines through much of the quarter. In the United States, a heated battle over raising the debt ceiling led the nation to the brink of default. A last-minute deal averted the immediate crisis as both sides agreed to create a bipartisan congressional committee to consider ways to balance the budget and bring down the deficit. **Despite the deal, Standard & Poor's downgraded the United States' sovereign debt rating to AA+ from AAA.**

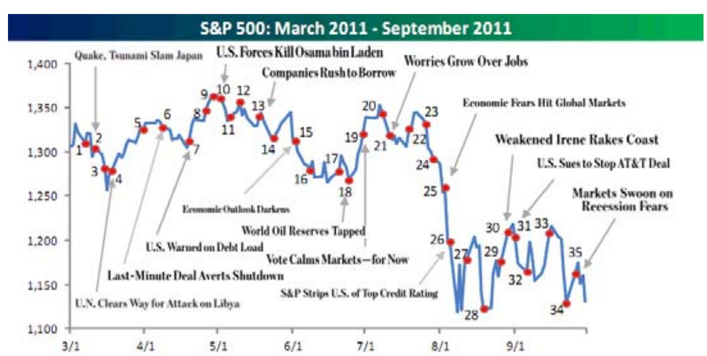


Figure 6. S&P 500 with Major Events for the Last Six Months.
Source: BESPOKE Investment Group

But in many ways the real action was in Europe. Successive plans to stem the sovereign debt crisis and contain it to peripheral Eurozone economies failed to calm investors. Worries that the problems could lead to bank failures, or to the end of the euro altogether, sent shares of French and other European banks plummeting and credit spreads on sovereign debt soaring. Coordinated central bank intervention, continued promises from leaders that they are willing to act, and another round of Greek austerity measures calmed markets somewhat toward the end of the quarter. But there remain many outstanding questions about whether the Eurozone is taking the right steps to solve the crisis and get Europe back on the path to growth.

Experts Were Too Negative At The Beginning Of The Quarter

Backward economic data during the quarter caused analysts to rapidly lower expectations for economic growth. While much of the slowdown in backward indicators could be attributed to the slowdown in global manufacturing due to the Japanese earthquake and tsunami, the European crack-up and downgrading of U.S. debt panicked investors, consumers and corporate managers, who told pollsters that they were really, really worried. But way back in July we could see that expectations had clearly been beaten down

Figure 7. Citi Economic Surprise Index - U.S.
Source: Bloomberg

more than enough in the U.S., as the Citigroup Economic Surprise Index (below) showed signs of another Summer upturn. There weren't signs that the U.S. economy was completely collapsing, but there also weren't any clear signs that the economy was returning to robust growth.

As Morningstar's Bob Johnson puts it, “the economy remains stuck in neutral. Job growth is anemic, at best, the housing market remains stuck in the basement, and manufacturing data showed some weakness as well in the quarter. On the other hand, consumer spending remained surprisingly resilient, and inflation stayed largely in check.” The story was similar in Europe, where fear about the debt crisis led to very slow growth. Emerging markets remained largely robust, but fear that European woes would spill over was on investors' minds.

Below are results for key markets.

% Change in MSCI (all in $US)

2011	US	Europe	Japan	Emerging Markets	World Markets
First quarter	5.5%	5.9%	-5.9%	1.7%	4.3%
Second quarter	-0.3%	0.8%	0.1%	-2.1%	-0.3%
Third quarter	**-14.5%**	**-23.0%**	**-7.3%**	**-23.2%**	**-17.0%**

Source: Bloomberg

So that’s what’s behind us; the key question is what’s ahead.

MARKET OUTLOOK

The short-term performance and volatility of the stock market is frustrating. My long-term outlook is extremely bullish, though. As long-time readers know, I monitor objective measures of Investor Sentiment, Monetary Conditions and Valuation so that emotions don't take over the decision-making process.

The measures are sending an extremely bullish message—only a few times in history kind of opportunity. The typically "wrong way" or "dumb" investors are extremely fearful. On the other hand, the "smart money" investors like corporate insiders are buying their company's stock on all the dips in record quantities.

I strongly disagree with Federal Reserve monetary policy. I thought the emergency interventions after Lehman's demise in 2008 were necessary. But that should've been the end of it. Its insistence on manipulating interest rates, the price of money, is one of the main road blocks to recovery. Price controls on anything, let alone on money (we call the price of money interest rates), deprive market participants of valuable signals. High interest rates are not the problem. Understanding what's next from a capricious government is the problem. The Fed has been penalizing risk-averse savers with very low savings rates. It's been begging them to invest in the stock market to get the economy's "animal spirits" going. It's not working. They ought to stop.

Notwithstanding my criticism of Fed policies, historically, an accommodative Fed is very good for stock market returns. And since my job is to make money in the stock market, I must grade monetary conditions from this point as being near the *best ever* for forward looking returns.

Finally, considering a current S&P 500 forward Price to Earnings ratio (P/E) around 11x and bond yields at historically low levels, Hays Advisory's, Morningstar's and Value Line's valuation composites suggest that stocks are **extremely undervalued**. These measurements are based upon their historical correlation to the market; they all are screaming to buy stocks.

This volatile and scary stock market which surely has tested our patience is about to move substantially higher. When? I don't know for sure. However, I think there is a very high probability, perhaps an 80% chance, that the reward versus risk is about +25% up and only -5% down (5 to 1). If those odds prove correct, our stocks of great ValueAligned® companies will typically lead the market higher.

A TIME FOR CHOOSING BEING TWO VISIONS: A FAIR SHARE OR A FAIR SHOT

> *This is the issue of this election: Whether we believe in our capacity for self-government or whether we abandon the American Revolution and confess that a little, intellectual elite in a far-distant capitol can plan our lives for us better than we can plan them ourselves.*
>
> **—Ronald Reagan, "A Time For Choosing" (The Speech – October 27, 1964)**

> *This debate over budgets and deficits is about more than just numbers on a page, more than just cutting and spending. It's about the kind of future we want. It's about the kind of country we believe in…As a country that values fairness, wealthier individuals have traditionally born a greater share of this burden than the middle class or those less fortunate. This is not because we begrudge those who've done well—we rightly celebrate their success. Rather, it is a basic reflection of our belief that those who have benefitted most from our way of life can afford to give a bit more back.*
>
> **—President Barack Obama, "The Country We Believe In", George Washington University, Washington, DC, April 13, 2011**

I want to repeat a part of last quarter's letter here. I had selected the quotes above from Ronald Reagan and Barack Obama written 50 years apart to highlight the monumental choice Americans are in the middle of making. It's the choice between two irreconcilable visions of America's future. **Will the United**

States be a society where its government gives people their "fair share" or where government gives people its "fair shot"?

Either we'll continue with "Economic Liberalization"— less government involvement in the economy, where the emphasis is on making the *processes* "fair" and the *opportunities* "equal", or we'll have a "Social Democracy"— a dominant public sector, where a small group of experts, elected, appointed and accountable only to a small group of intellectual elites, make policies whose goal is to make society's *results* more "fair" and "equal".

Economic Liberalization

As you know, we have been monitoring the relative growth rates of the public versus the private sector in the United States and around the world. The market bottom in March of 2009 and the ensuing bull market suggest **that American voters are having second thoughts about the dramatic increase in the relative size of the public sector that they unwittingly voted for in 2006 and then again in 2008.**

My thesis is that the stock market will continue in its bull trend as long as it senses that U.S. federal government spending as a percentage of GDP is on its way down. If the political climate favors less government intervention in the private economy, then we expect the stock market in the intermediate term to continue making extra-ordinary gains. We will use the periodic corrections to plant new capital as long as the trend continues. **Grid-lock, austerity and the growing realization of the failure of government intervention lead us to conclude that liberalization is still on track.**

Economic & Political Freedom in the 1970s, 1980s & 1990s and 2000s

One of the problems with the current political divide is that the members of the current regime—those responsible for the current fiscal and monetary policy—argue against a caricature of pro-growth economic policies instead of confronting the argument that is actually made.

With lessons learned from the century's tougher decades, including the Great Depression of the '30s and the Great Inflation of the '70s, America entered a period of unprecedented economic stability and growth in the '80s and '90s. Not only was job growth amazingly strong—44 million jobs were created during those expansions—it was a more stable and sustained growth period than ever before in American history. John Taylor in "The End of Growth" writes:

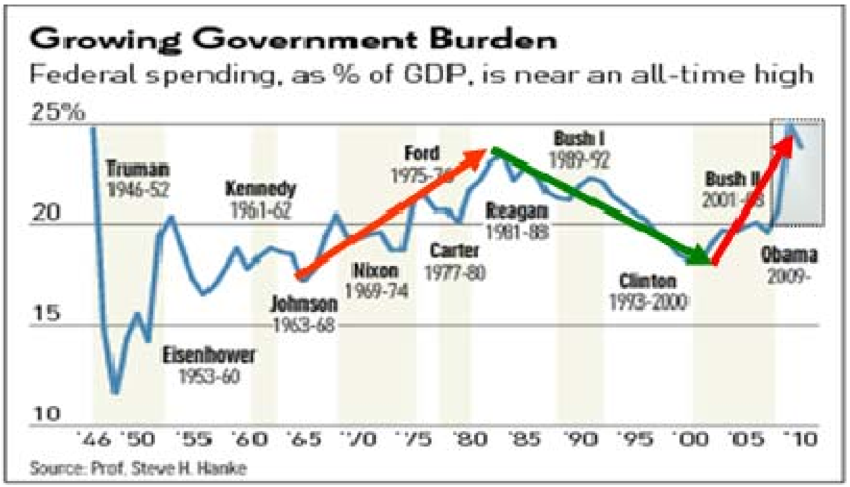
> *Economic policy in the '80s and '90s was decidedly noninterventionist, especially in comparison with the damaging wage and price controls of the '70s. Attention was paid to the principles of economic and political liberty: limited government, incentives, private markets, and a predictable rule of law. Monetary policy focused on price stability. Tax reform led to lower marginal tax rates. Regulatory reform encouraged competition and innovation. Welfare reform devolved decisions to the states. And with strong economic growth and spending restraint, the federal budget moved into balance.*
>
> *As the 21st century began, many hoped that applying these same limited-government and market-based policy principles to Social Security, education and health care would create greater opportunities and better lives for all Americans.*
>
> *But policy veered in a different direction. Public officials from both parties apparently found the limited government approach to be a disadvantage, some simply because they wanted to do more—whether to tame the business cycle, increase homeownership, or provide the elderly with better drug coverage.*

Federal policy moved in a more interventionist direction. The result was an "epidemic of unintended consequences—a financial crisis, a great recession, ballooning debt and today's nonexistent recovery" says Taylor.

The change in policy direction did not occur overnight. The federal government increasingly intervened in the housing market beginning in the late 1990s. And, of course, interventionism reached a new peak with the massive government bailouts of Detroit and Wall Street in 2008. The economy is in a stall. Unemployment is way too high and consumer spending is restrained.

The good news is that we know what works: a relatively smaller public sector and a larger private sector, lower public spending, and lower taxes. It's not easy, but governments can be persuaded to shrink. By doing so, we will enter another prosperous era.

When the Berlin Wall collapsed in 1989, followed by the demise of the Soviet Union in 1991, it seemed that everyone would recognize that the private sector's versus the public sector's allocation of resources raises everyone's standard of living. After the fall, government planning should have been thoroughly discredited.



But just 20 years later, the second red line on the above graph show that we are on the brink of the most significant erosion of the market economy since the New Deal. In a few short centuries, economic liberalization has taken much of the world's population from subsistence to remarkable prosperity. **We believe that Americans aren't ready to abandon its free enterprise system and replace it with something similar to what resulted in the chaos in the European Union.**

Why Does Economic Liberalization Work?

As with so many things in the social sciences, the underlying reasons are somewhat elusive. However, we do have loads of empirical evidence to suggest that real wealth increases after economic liberalization, just as it decreases when the growth of the public sector outpaces the growth of the private sector. For example, Chile, China and India's real wealth increased by a factor of four after it unleashed their private sectors. After economic de-liberalization programs, Argentina, Cuba and Zimbabwe's standard of living for everyone dramatically declined.

I hypothesize that reduced efficiency in the public versus private sector and reduced incentives from higher tax rates explain the empirical connection between economic liberalization and prosperity.

Professor Richard roll of UCLA's Anderson school of management suggests that most explanations of the 2008 financial crisis, including excessive leverage, subprime mortgages, exotic derivatives, reckless risk-taking, and easy money that spawned a housing bubble, are misdiagnoses of the main underlying cause—**the *perception* that government intervention in the private sector was beginning to grow as the Pelosi-Reid Congress took over at the beginning of 2007.**

> *Markets are forward-looking, and in 2007, global market participants began to notice a major sea change washing ashore in many countries. Reversing the trend of at least the previous decade, the private sector's fraction of GDP began to perceptibly decline relative to the public sector's fraction. This phenomenon was observable in Europe, Latin America, and North America—especially in the United States, where the public*

> *expenditure bailouts that began the Bush administration and continued into 2009 brought the largest deficits in US history. Other public sector plans, such as health care reform, promised to divert even more spending from the private sector to the public sector in the United States and elsewhere.*

Over the last decade since 2000, investors moved capital out of economically productive assets in the private sector into hard, tangible hedges. These hedges guarantee stability and a return *of* capital but they do not provide jobs and growth for others. They do not give all our citizens their *fair* shot.

I am optimistic for our growth prospects when we get policy right, and I believe we are in the process of getting policy right. A return to those policies consistent with the uniquely American values of free enterprise, individual liberty and limited government suggests an asset-shift event of enormous magnitude—measured in the many trillions. **This shift will ignite the great American growth engine and lift billions out of poverty and into the middle class around the world. But the 2012 election is the pivotal factor; it is a time for choosing—again.**

It's Tough to Have Conviction When We Are at the Mercy of Politicians' Whims

> *It's tough to know where to have conviction in this market. In my lifetime, never have we been so vulnerable to the whims of policymakers in the US and in Europe and nobody has figured out where the consensus is and where they're going, they're not united.*
>
> **—Jim Leech, the CEO of the Ontario Teacher's Pension Plan**

> *I don't think this environment is any different than the 1970s. In the 1970s, the United States was worried about Japan; we really questioned the vitality of this country. We were questioning the kinds of things we were manufacturing. We had Watergate, the oil crisis, and during those ten years the S & P was up 1.5% a year and yet corporate earnings were up 12% a year during those ten years.*
>
> *The same thing is going on now where we're seeing earnings growth, but we're obviously seeing a flat market and a lot of it has to do with the uncertainty around government, very similar to the 1970s. As investors in the 1980's and 1990's and the first part of this past decade, government was not part of our thought process and now we're trying to get rebalanced; today we don't even know what the foundation is.*
>
> **—Larry Fink CEO of BlackRock, Investment Management Firm**

What This Means to You

For those investors who need growth to achieve their long term goals, which is most of us in this low interest rate environment, you need a way to have conviction in these tumultuous times. By using our indicators and constantly monitoring the reward versus risk using sentiment, monetary conditions and valuation as the instrument panel to guide us when we have zero visibility, we have conviction even when the public sector is running amok.

In addition to what Larry Fink said in the above quote, he recently suggested that for investors with cash earning nearly 0% interest, **now** is the time to invest in the stock market. Just do it! Your family's future depends on it.

One final thought, I am optimistic for our growth prospects when we get policy-makers to undo and then do nothing. I believe we the people are in the process of getting this thing right. A return to those policies consistent with the uniquely American values of free enterprise, individual liberty and limited government suggests **an asset-shift event of enormous magnitude—measured in the many trillions. This shift will ignite the great American growth engine and lift billions out of poverty and into the middle class around the world. But the 2012 election is pivotal; it is a time for choosing—again.**

Thank you for reading and the opportunity to work together.

Best regards,

David L. Berkowitz

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