

**We have good news, some bad news and then very good news.**

**First the good news. The global economy survived 2009. There were points during the fourth quarter of 2008 and the first quarter of 2009 where the global financial system was close to shutting down. The massive leverage accumulated by large financial institutions coupled with the complexity of their investments almost put all of us over the cliff. Reading reports and comments from those that were closely involved in the crisis makes it very apparent that we were at the brink of disaster. Catastrophe was avoided by the Federal Reserve's flood of liquidity and their role as lender and guarantor of last resort. We strongly believe that had the Federal Reserve and central banks around the world not put forth an aggressive co-coordinated effort international commerce would have ground to a halt.**

**The recession appears to be over. The efforts of all the stimulus appeared to have helped the economy show positive growth during the fourth quarter. Gross domestic product in the U.S. surged 5.9% - the fastest pace since late 2003. Growth was positively impacted by the replenishment of inventories, increasing investment and a rise in exports.**

**Now for the bad news. A large component of the fourth quarter's GDP growth was due to inventory buildup; this source of growth is unsustainable. Other factors weighing down growth include a slowdown in personal expenditures, lower sales of new homes and existing properties, declining construction spending and sluggish orders for durable goods. In addition, unemployment remains at a stubbornly high rate and consumer confidence is fragile.**

**We strongly believe that future economic growth is likely to be tepid. Historical precedents suggest that it takes several years for economic output to reach its previous peak after severe financial crisis. In their comprehensive study of past financial crisis, This Time is**

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**Different Eight Centuries of Financial Folly<sup>1</sup>, Reinhart & Rogoff draw the following conclusions about the aftermath of such severe economic events:**

- **The duration of housing price declines is approximately six years**
- **Equity prices decline about fifty five per cent and the drop lasts about three and one half years**
- **Unemployment rises for about five years and the unemployment rate increases about seven percentage points**
- **The length of the average recession was nearly two years and GDP declined a little more than nine per cent**
- **In post war crisis it has taken almost four and half years for economic output to reach its pre-crisis level.**

**These facts are supported by our “boots on the ground.” In our reading of financial reports, listening to senior management discussions and talking to operating executives the message is nearly unanimous; the deceleration has stopped but growth is bumping along the bottom.**

**While the above facts are sobering what is most important to us is the level of equity valuations. In essence do valuations reflect the risk of the current environment and do they provide an acceptable rate of return given those risks? In our estimation, current aggregate equity prices have run far ahead of economic fundamentals. Our concerns centre on the following issues:**

- **Valuations are substantially above historical levels**
- **Improved earnings are a result of cost cutting measures instead of sales growth**
- **High risk, low quality companies have posted the strongest performance**
- **We are once again having trouble finding new securities that meet our criteria**

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<sup>1</sup> This Time is Different Eight Centuries of Financial Folly, Reinhart, Carmen N. & Rogoff, Kenneth S. Princeton University Press 2009.

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**In light of both the underlying fundamentals and risk/reward offered by equities from today's levels we remain cautious going forward.**

**The very good news is that we are approximately sixty per cent invested; the highest that we have ever been in our High Net Worth client portfolios. Most importantly, our investments are still trading at a discount to their estimated intrinsic value and many provide high dividends with the potential to increase over time. We also believe that the companies that we own have the following characteristics:**

- **strong balance sheets**
- **generate free cash flow**
- **valuable brand names**
- **substantial competitive advantages**
- **are well managed**

**The combination of fundamentally sound companies trading at discounts to their true worth provides us with the comfort that the potential for the permanent loss of capital is low and that long term returns remain attractive. In addition, our portfolios are anchored by a substantial cash position. This “reservoir” provides a safe harbour during turbulent times and gives us the resources to take advantage of future opportunities that may arise. And that is indeed very good news!**

**Over the past year we have been very fortunate to have several new clients join us. As a result we thought that now might be a good time to reiterate our core beliefs and investment principals:**

- ✓ **We are fiduciaries first and foremost; we will always put your interests before ours**
  - ✓ **All of our personal and corporate capital is invested right along with yours**
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- ✓ **We focus on the preservation of capital; we will not risk your money and ours in pursuit of potential returns**
  - ✓ **Our investment discipline is uncompromising; we will only purchase high quality companies at substantial discounts to their estimated value**
  - ✓ **Our portfolios are very concentrated; we only own approximately twenty securities**
  - ✓ **We behave very differently from others and our portfolios will look very different from benchmarks and other investors**
  - ✓ **Our focus is on the long term; short term results are of no relevance to us**
  - ✓ **In the short to medium term our performance will vary widely; particularly when compared to an index. Our only interest is to maximize long term returns at the lowest possible risk.**

**The last eighteen months have been very rewarding for us at PCM; we have provided you with peace of mind while preserving and growing your capital; our business has grown and we have received some recognition for our longer term achievements. However, most rewarding is your continued trust and support. It is a pleasure and privilege for Domenic and I to serve you!**

**Vito Maida**

**February 27, 2010**

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