

Please, Turn Down the Volume

March 2010- Market Outlook

Our portfolio was up over 2% in February, which lagged the market slightly. For now, caution has kept us from buying back into some of the names we sold back in 2008, which in hindsight was a decision that kept our loss to 9% for the year vs. the 57% drop in financials. However, as we monitor capital concerns we've maintained a respectable return with a very acceptable level of risk. Speaking of risk, financial sector investors recognize the volume of noise from Washington has been disproportionately caused by issues centered on banks and insurance companies. At a high level it may appear the entire sector is in the crosshairs: banks may face additional taxes, or may have business lines clipped, and insurance companies may be forced to accept a revamp of certain products, and on, and on. The volume of noise from Washington has certainly caused a general level of uncertainty, but due to individual management teams, and individual corporate structure the impact will not be similar from company to company.

Important Skill Set: We give some thought to a company's "Washington prowess". It has long been the case that certain stocks seem to successfully maneuver through changing regulatory environments. Looking ahead, it would be no surprise if certain banks manage to sidestep a potential earnings hit if selected businesses are curtailed, such a prop desks, and investments in hedge funds. The same might be said for certain insurance companies that appear isolated from the political outcry for cuts in product pricing.

Run From Smoke: Other than sizing up the capabilities of management teams to assess Washington prowess, there is the mere structure of a company to consider. Large market cap seems to attract attention. High-margin products seem to attract attention. By no means do these attributes signal of a problem, but it is more likely that investors should consider if the management of these companies exhibit the Washington prowess skill set.

Simple Screen: Ask management if a company representative has recently been invited to testify before a government committee. If anything, it will probably prompt an interesting conversation. Some executives love to talk about time in Washington, while others may have less-than-favorable memories. The important thing is if there is smoke from the structure, it's worth asking the Washington question.

If you have questions regarding the financial services sector, or would like to discuss our investment approach, please contact us at the phone number below, or visit our website. (www.PhiloSmith.com)

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Year-over-year through December 31st, 2009

