

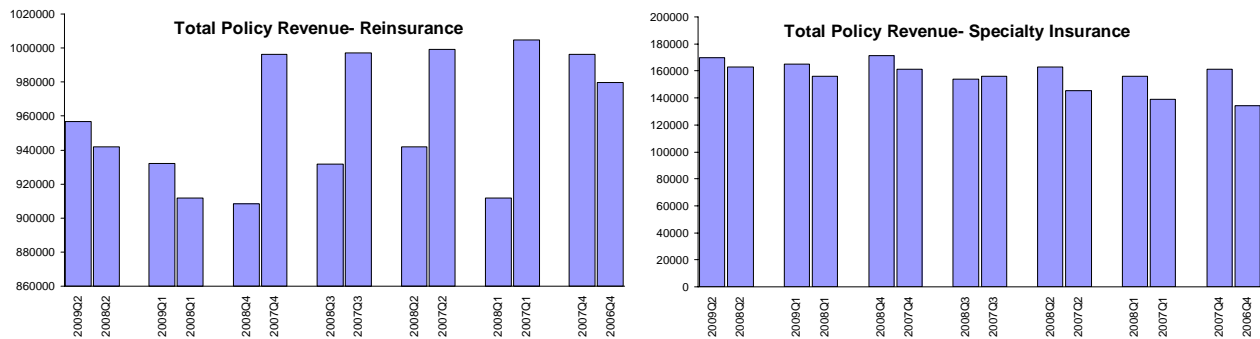
Revenue: “Get Granular” for Profitable Growth

September 2009- Market Outlook

Absence of revenue growth is the dark cloud that hangs over the recent rally in financial stocks. Investors have correctly questioned the role that one-timers (such as cost cuts, and mark-to-market improvements) played in the rise of stock prices over the past two quarters.

Profitable Revenue Growth: Our ultimate quest is to find companies priced below peers, yet well positioned to produce profitable revenue growth. Most recently we focused on the revenue opportunity for certain reinsurance stocks given the constrained capital of primary companies, and problems with two, large reinsurance peers. The chart on the left shows the turnaround in revenues for one of the reinsurance companies in our portfolio.

The graph on the right is a “specialty insurance company” we own in the portfolio, and expect to produce improved revenue growth over the next several quarters. There are two reasons for our optimism: niche businesses that have benefitted from price increases, and an expected pull-back by competitors once losses emerge from previously underpriced business.



Surprise: The simple insurance model – collect recurring premiums, pay claims, and keep the difference – has proven a viable model in both recession and boom time. The difference can not be over emphasized between the simple insurance model vs. banks that may rely on revenues from one-off underwriting, and are subject to consumer credit woes.

Portfolio Position: Our portfolio investments over the past year gravitated towards the simple insurance model: more specifically, companies with “inelastic” premiums needed to protect major assets, such as auto insurance, homeowners insurance, and certain business insurance lines.

More recently we increased positions in reinsurance companies expected to benefit from the well-publicized problems within the financial sector.

Looking ahead, we expect the revenue growth of several specialty companies to benefit from competitor fallout as problems emerge from overly-aggressive price cuts to win new business, or retain existing business.

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.

E. Stewart Johnson
Portfolio Manager

Performance

Year-over-year through August 31st, 2009

