PHILOSMITH

Investors and Advisors Since 1962

September 2012 - Market Outlook

Our performance was up 14.3% in the first nine months of 2012. Performance was nicely ahead of the 9.4% performance of the three-index benchmark against which we measure performance. Third quarter performance, up 3.7% was also better than the 2.8% gain by the benchmark. In the main the performance was the result of good performance by many of the holdings bolstered by strong gains of several of the larger holdings. Overall performance was slightly offset by poor performance of a few of the smaller holdings.

Our results in the first nine months of 2012 reflected continued strength in core insurance holdings, particularly property casualty stocks. All sub-sectors in property casualty: primary, specialty, personal likes, commercial lines, and reinsurance showed gains. The stock performance follows the upswing in premium rates reported in most lines of business. We continue to adjust the portfolios to take further advantage of the upswing in the cycle. So far the anemic growth of the economy has not negatively impacted insurance stock performance in a significant way. Title insurance stock performance, up over 50% on average in the first nine months, was extremely strong. The title companies have benefitted from record low interest rates, which have allowed many homeowners to refinance existing mortgages.

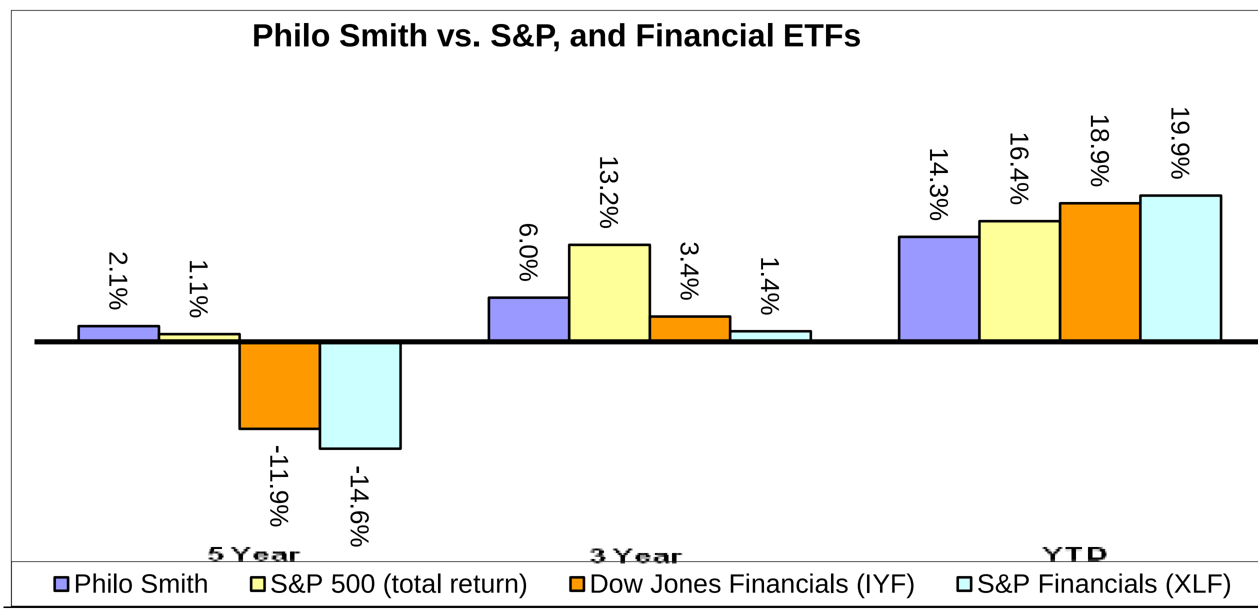
The Portfolio

Specialty property casualty insurers account for 35% of our holdings. Hiscox and HCC were our top performing specialty insurers in the first half. London based Hiscox was up 35.4% year-to-date. Hiscox is well positioned to not only deliver strong underwriting results, but also capitalize on growth initiatives. HCC's stock performance follows its strong operating performance. HCC's industry leading expense advantage coupled with excellent loss ratios should allow for continued above-average performance down the road. Horace Mann's 31.2% year-to-date gain also had a noticeable impact on overall performance. The company, focused on the teacher market, continues to reap the benefit of a strategy to improve underwriting profitability while gaining market share. RLI, off 8.5% year-to-date had a disappointing year so far, but that follows excellent performance during 2011 when it was up 51.7% while also paying an extraordinary dividend and regular dividends in 2011 equal to 16.4% of prior year end stockholders equity. The company's operating results continue to be excellent and we have every expectation RLI will outperform its peers over the long term. Asset managers, Ameriprise Financial and Waddell & Reed had above-average performance in an improving stock market. We believe they both will continue to gain market share going forward.

Outlook and Strategy

The property casualty market is in the early stages of a market upturn. We hold some of the highest quality companies and believe that with their real competitive advantages, they will gain market share. Despite the gains exhibited by the stocks we hold, we believe the holdings in the portfolio are undervalued relative to intrinsic value. Many property casualty stocks, for example, continue to sell for tangible book value or less. These valuations give us continued optimism.

Performance through September, 2012



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