

FRENCH BROAD  
GLOBAL  
INVESTORS  
A LETTER TO OUR CLIENTS

OCTOBER 2011

Dear Clients,

Our investment and economic recovery has faltered over the last quarter. If the global economy muddles thru with slow growth, stocks should recover. If we experience another recession, then it will be harder for stocks to progress in the short run. However, I believe much of the uncertainty has been discounted in the decline in equities pricing. The most prominent negative overhang is Europe, if they could contain their sovereign debt crisis it would remove a dark cloud that threatens the global economy. In the last week some European progress has been accomplished, which allowed markets to rally. At this point patience is the key to maintain our investment perspective. It is impossible to predict the economy and stock prices in the short term, but today's stock valuation are so reasonable that it is difficult to imagine that long term returns won't be rewarding.

Initially market weakness was a reaction to a slowing in economic growth as consumers pulled back expenditures in the face of rising oil and commodity prices. Compounded with natural disasters in Japan and the United States economic growth has slowed to about one percent. This planted a seed of doubt in investor's minds that the economy could falter and that expectations for corporate profits would be scaled back. To a large extent short term market movement is a momentum game, when profit expectations are reduced the market goes down, when profit expectations are expanding then the market follows suit. This summer fear escalated from angst of a slowing economy, to concern of a potential double dip recession. In September investors focused once again on Europe and the sovereign debt crisis, highlighted by Greece. The ultimate concern is financial "contagion" within Europe but as we indicated above, it seems that steps are being taken to avert this.

Our investment focus has been that even with a troubling economic outlook, equities are undervalued sufficiently to provide satisfactory returns on a five to ten year basis. We maintained this premise, but realize that the short term outlook has become increasingly unpredictable. Because of the rising chance of a weaker economy, we have marginally bought some less economically sensitive stocks

and high dividend yielding stocks. However, we remain heavily invested in economically sensitive stocks. Why are we not more defensive? Valuation is the key determinate. Defensive stocks (less cyclical) are fairly valued in most cases while economically sensitive stocks are undervalued on what we estimate are normal earnings. Normal earnings are what a company can earn under normal economic conditions. Overall 2011 earnings for companies could be considered fairly normal. I cannot predict if 2012 will be better or worse, but over time normal prevails. Hence, I fall back to normal stock valuations levels as my main investing tool and let time determine when our returns are realized. The most important factor in investment success is buying at the right price. Having said this, I would like to remind you that only your wealth that is not needed in the next few years should be invested in stocks.

As a global stock investor it has been a challenging environment, as all markets have recently performed poorly, leaving no safe havens to diversify into. As mentioned we have increased our allocation to United States stocks, and do not have any immediate intention to change this. Emerging markets are becoming a better value, and I can anticipate reinvesting as some point.

Looking at the United States political and economic environment, I do not believe that are fiscal (debt) problems will be addressed until after the 2012 election. One way or another, after the election we must find a way to put our economic system on a firmer footing. The tricky part is to implement long term systemic changes to government (entitlement and tax reform) while not drastically cutting expenditures in the short term. However, by prolonging the long term fix, it makes it difficult to moderate this change.

Thank you for your continued investment confidence in French Broad Global Investors during these turbulent times. I hope to personally speak with you soon. Please contact us if you have any thoughts or questions.

Warm Regards,

Dan Jacobs CFA