Dear Investor,

We have experienced a tough July with the Standard & Poor 500, the Dow Jones Industrial Average, and the Nasdaq declining 2.15%, 2.18%, and 0.62%, respectively. So far August has been just as tough. I know my clients want to hear from me, and not because I have anything brilliant to offer, but to review our investment thesis and to get clarity on why this thesis is particularly appropriate for a tough market.

I am not going to bore you with the usual bromides. I am not going to tell you that just because we have a strong portfolio (I speak of portfolio in the singular because I own, and I have always made it a discipline to own, the same portfolio of companies that my clients own), that the portfolio is invulnerable to price downdrafts, is sequestered from volatility, a market volatility that exists not only from day to day, but from month to month, and sometimes from hour to hour. Volatility is unavoidable in the common stock or equity game, or arena, or jungle. Just three months ago, for example, U.S. investors could not buy common stocks fast enough. Their outlook for common stocks, for the economy, was ebullient. They were optimistic. They ignored some of the real problems our country faces (and we have faced many difficulties, such as World War II, and we have survived and done well). We faced mounting debt three months ago. Sure, Standard & Poor's downgraded our debt, the economy has slowed, but this is not the first time, nor will it be the last, that we face fiscal challenges and a slowing economy. We have overcome these difficulties, and we will overcome the problems that we now face.

There is no getting around the fact that stocks move up and down quickly, sometimes with nasty surprises. There is no doubt that economies, and this includes the United States, also move up and down, usually with the stock market anticipating or discounting changes in the economy. So, if the foregoing is true, then it is important, and very reassuring, to know, to remember, several facts that obviate the force of rapid down and up movements, a phenomenon that we term volatility. (Understanding market or economy volatility is easier if you can recall a friend or a neighbor whose outlook, whose views, whose approach to duties, to tasks, and to life, is highly unpredictable. Their moods change quickly. Their behavior is highly unpredictable. This is what the stock market is.)

But while the stock market changes its mood, sometimes violently, there are important protections that our method of investing, our portfolio offers. Let's take the J.M. Smucker Co. (NYSE: SJM).

If there is any company known in the United States for high quality, yet reasonably priced, jams and jellies it is the J.M. Smucker Co. In my first line of defensive research, I made sure that I liked the company's jams and jellies. In fact, I have been using the company's products for more than a decade. I particularly like the low-sugar strawberry jam coupled with the peanut butter, which is one of the few peanut butters that has no sugar and is not hydrogenated. This is a company that enjoys high barriers to entry, making it difficult for someone to enter the company's market and giving the power of pricing flexibility to Smucker. High barriers to entry, an intangible that is complemented by a reputation for delivering a high quality service or product, is an important dimension in our investment thinking. Smucker has both.

Another dimension in our approach is to invest in companies with steady earnings and cash flow. (Some investors emphasize cash flow more than steady earnings as earnings or income are often a subjective figure, and frequently misleading or distorted.)

Smucker's numbers are in a league of their own. In 1999, the company earned $1.26 per share and its cash flow was $2.46 per share. Every year the company has increased cash flow and earnings per share, as well as its dividend, through today. It is a remarkable record, and one that is not entirely surprising to me every morning when I eat a peanut butter and jelly or jam sandwich made with the company's products. (Incidentally, the common stock performance, along with the dividend, has given Smucker shareholders a return since 1999 that vastly exceeds the performance of the broad common stock market as measured by the Standard & Poor 500.)

So we live with the reality of volatility. We understand it, and we ought not to be disturbed by it. It is not going away. And in fact, as I show below, it can be our closest friend.

Volatility ought to have little impact on the outlook of an investor with the kind of portfolio we have constructed. James Grant, editor of the highly acclaimed *Grant's Interest Rate Observer,* an astute analyst of the American economy, and a shrewd observer of investor psychology, wrote, in 2008, a book called *Mr. Market Miscalculates: The Bubble Years and Beyond.* Grant described Mr. Market, the fictional invention of Benjamin Graham, Warren Buffett's professor at Columbia University's Graduate School of Business. I thought Grant's description of Graham's insight into investor moodiness, contrasted with the much more stable value and intrinsic value of a powerful business such as J.M. Smucker or Stericycle, Inc. (NASDAQ: SRCL) or The Coca-Cola Company (NYSE: KO), tells you much about how to think about the stock market.

I also thought that in Grant's description of Mr. Market, printed below, was an important insight, or implication of erratic everday investor behavior and mood. The thought is as follows: volatility is sometimes uncomfortable but IT CAN PROVIDE GREAT OPPORTUNITY OR SIGNICANT CAPIAL GAINS. If Illinois Tool Works is valued in July at 54, could not 43 in August probably be a bargain?

> Mr. Market […] is the flighty anthropomorphic invention of Benjamin Graham. […] Graham would invite his students at Columbia University to imagine going into business with a manic-depressive, a certain Mr. Market. When the sun shines, this strange duck pesters you to sell him your share of the business. But when darkness falls, he begs you to buy his interest […] Any resemblance between Mr. Market and the calculating and even-tempered human being who features in the economics texts is, therefore, purely accidental. Homo economicus would never be a party to anything so irrational as a financial bubble. Mr. Market, on the other hand, can't seem to help himself. (Grant, James. *Mr. Market Miscalculates: The Bubble Years and Beyond.* Mount Jackson, VA: Axios Press, 2008. ix.)

Warren Buffett captured the opportunity that comes with understanding investor mood. He said, "…be fearful when everyone is greedy, and be greedy when everyone is fearful." No one could have captured the ironic essence of volatility any better than that.

Best regards,

Fredric E. Russell