This economic commentary is designed to present the firm's current views on timely topics that we feel may be of interest to our clients. Viewpoints is also available electronically on our website: SLOCUMGORDON.COM.

Those of us in the investment business who were influenced by the wisdom of pioneering professionals such as Benjamin Graham, David L. Babson, and Charles Ellis, might say that we had a head start on the complex work of money management. Long term investing, as distinct from short term speculation, requires a unique discipline that comes with experience, insight, and most importantly, patience. In his 1970 publication "Extraordinary Tennis for the Ordinary Player," Dr. Simon Ramo, a renowned polymath, unknowingly set forth an investment philosophy which five years later was set in stone by Charles Ellis in his famous essay on investment, "Winning the Loser's Game."

Dr. Ramo is best known for his development of the intercontinental ballistic missile (ICBM) with John von Neumann as well as General Electric's first electron microscope, but it is his study of tennis strategy that strongly resonates with us here on Mill Street. Ramo concluded that the sport of tennis actually consists of two games: the Winner's Game played by the professionals, and the Loser's Game played by the rest of us. Although superficially the games appear one in the same, they differ in that professionals *win* points, while amateurs *lose* points. Through statistical analysis, Ramo demonstrated that in professional tennis 80% of points are won with winners and forced errors, and in amateur tennis 80% of points are lost with unforced errors, double faults, mental blunders, etc.

In our view modern investing in a wider context has evolved into a Loser's Game, with the majority of managers underperforming as a result of overconfidence in their forecasting ability, excessive portfolio turnover and portfolio holdings, and a tendency to adapt their style to the current market environment or recent results. In a Loser's Game, like investing, success is derived from fewer misses and a consistent strategy. Our preference for defense is the defining characteristic of our approach, and a style we stick with regardless of market conditions. We strive to generate above-average returns by seeking to outperform the market in bad times and keeping pace when the market is enjoying good times. The current stock market environment offers a good example of an important concept of our investing style as influenced by Benjamin Graham: seeking out quality companies at prices that afford both the potential for growth (of capital and dividends) as well as a sufficient margin of safety in the event of a down market cycle. As market prices have moved incessantly

higher recently, we do not look to "new high lists" in order to chase momentum stocks that may seem overpriced, particularly in newer accounts that may have larger cash reserve balances. Instead, we seek out companies that have recently suffered a market decline for what we consider to be transient reasons.

Our emphasis on US-based, large-capitalization, dividend-paying stocks is a further reflection of this strategy. Such stocks serve the dual purpose of providing both capital appreciation and income, one of the few things in scarce supply in today's economy. We focus on large-cap domestic equities for several reasons: lower volatility, familiarity, minimal risk of bankruptcy or obsolescence, less foreign exchange risk, and our long-term confidence in the US economy relative to the rest of the world. Furthermore, our research has shown that over extended periods of time stocks that pay and increase their dividends have outperformed the broader market. We expect this will continue. Although the upside potential for being right about growth stocks is generally more dramatic (and more conducive to cocktail party conversation), the upside potential for being right about dividend-paying value stocks is more consistent over the long term.

As advisors, we perhaps add the most value to our clients through our strategic asset allocation, that is to say our target weightings of stocks, bonds, and money market funds. Contrary to the growing claim that investing can be reduced to an algorithm, through the use of index funds and fixed asset allocations, we believe investing is as much an art as it is a science. We spend a considerable amount of time analyzing a number of variables that can serve as leading indicators for the future direction of asset prices, including: valuation relative to historical norms, the state of the business cycle, the direction of monetary and fiscal policy, investor sentiment, calendar effects, and others.

Consequently, our "pressure on the gas pedal" will correspond with our views of where we currently lie in the cycle. In other words, the speed at which we deploy new cash will be inversely related to current price levels. In the late stages of a bull market, the opportunities to buy securities at a discount to their fundamental value (margin of safety) are often scarce, and many times the best course of action is to patiently wait for bargains to appear. Our goal is to identify companies with promising long-term prospects and ideally to wait for the stock price to fall below the intrinsic value of the business before purchasing, providing that margin of safety to protect our clients' assets on the downside.

Dr. Ramo further declares that "every game boils down to doing the things you do best, and doing them over and over again." Like most sports, the key to winning in investing is to play your own game and to assess how favorable the present conditions are to assert your particular style. Unlike most athletes, however, we investors have the luxury of swinging only when we see fit.

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