SLOCUM, GORDON & CO. LLP
INVESTMENT MANAGEMENT AND COUNSEL

VIEWPOINTS

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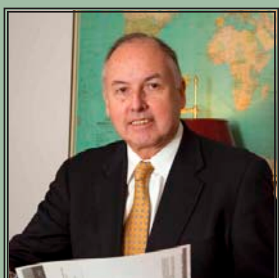
This Economic Commentary is designed to present the Firm's current views on timely topics that we feel may be of interest to our clients. Viewpoints is also available electronically on our website: slocumgordon.com.



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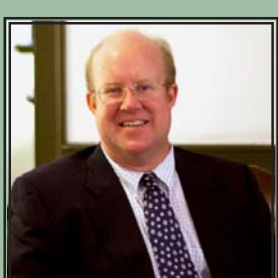


KENNETH M. P. LINDH

A respected colleague in our field of investment management recently shared with us his expertise in the revolutionary science of behavioral finance. As a guest lecturer at the Harvard Kennedy School for Executive Education, he teaches the principles to understand what investors actually do in a given set of circumstances— such as the dramatic uncertainties associated with debt crises in nations around the world— versus what rational analysis prescribes. The program explains how markets respond to the natural proclivities of investors, and how the recent meltdown in financial markets, including the collapse or near collapse of major financial institutions, can best be understood using a behavioral perspective. Of particular interest, students learn how and why financial bubbles develop, and how they can be recognized.

So much of what investment professionals contend with on a day-to-day basis is directly related to this concept of behavioral finance and how normal human reactions to events can impact the visceral decision to buy or sell. In the vernacular of the business, markets are often guided by the formidable emotions of greed and fear, and both can lead to irrational decisions. Further aggravating the condition, the world is locked in a high-speed race for immediate information that stock traders feed on instantaneously.

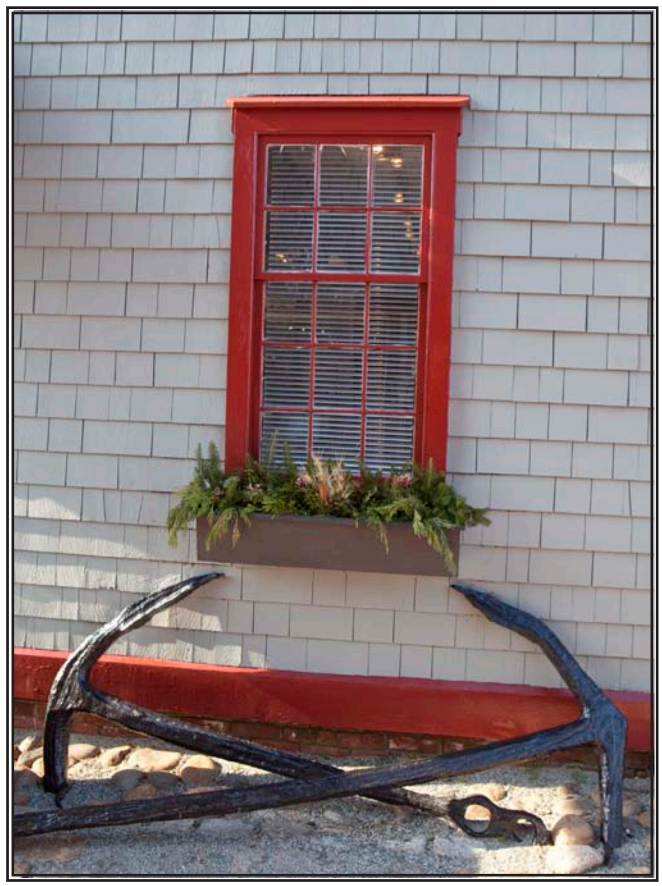
As investors work through the adjustment period that naturally occurs after a major market collapse and credit bubble, a lingering fear of the unknown is very much a normal behavioral contributor to decision making. We tend to extrapolate the impact of recent events, good or bad, in a way that can cloud rational analysis. Interestingly, at the present moment some market forecasters feel that global financial dislocation will continue since there has been no evidence of its slowing, while others believe that a traditional recession-expansion snapback is inevitable because that is the typical path in the US economy. With four years of this necessary adjustment period behind investors, reality, it would seem to us, is probably somewhere in between.

We have always advocated for a fairly simple, logical, uncomplicated approach to investing assets in long term portfolios. Basically, it revolves around the old-fashioned idea that a stock price should, in the ideal world, mirror the underlying growth in that company's earnings. Together with its dividend, the total return should be able to provide reasonable growth and income over time. The key, we have found over the years, is this concept of the dividend.

Using rational analysis rather than emotional reactions, our evaluation of current conditions suggests that our interest in higher yielding stocks is likely to continue for some time to come for the following reasons:

1. Low interest rates. The Fed is running out of arrows in their quiver. The historically low rate environment has done little to stimulate the economy, and the Fed has even committed to little or no change in short-term rates for the next two years, at least.

2. Shortage of income. Maturing higher-coupon bonds can only be replaced with very much lower current coupons, and with living expenses maintaining an upward trajectory, pressure is building for investors to cover this income gap. Realizing capital gains from stocks might have been the source of these funds in the past, but for most investors in this market, that is not a current option.



3. Demographics. Baby Boomer retirements between 2010 and 2040 will grow to over 20% of the population. These people will be depending on their investment income for their living needs, and the credit markets are not providing sufficiently high rates without inordinately increasing risk.

4. Pension plans are under pressure. In the similar analysis of its demographic, mature, old-fashioned defined benefit pension plans are now in a payout mode for retirees. Here too, total return (income and capital gains) had once provided sufficient funds for their payout to fulfill promises to employees that were made in a very different economic environment to the one they are contending with today.

5. Inflation. While we have not been concerned with inflation as an investment criteria for some years now, (in fact deflation has been our watchword for more than a decade) there is a normal inflation rate that seems to be built into the general economy of historically 2 - 3%.

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Even with a low inflation rate, buying power from fixed income investments can erode very quickly, particularly when rates are as low as they are currently.

Good companies generally have a history of paying dividends in all economic climates. Those are the companies that we want to own, and market volatility like this can provide superior opportunities if one can take a longer term view and filter out the daily stimuli of the emotional roller coaster that investors are riding at the moment. Having steered through the shoals so far, we are confident that with patience and prudent management we will navigate through this unsettled period.

Finally, in compliance with Rule 204-3 (c) of the Investment Advisers Act of 1940, we are making our annual offer to send you our current brochure.

Best wishes for a prosperous New Year.