October 17, 2014

Dear Investor,

Accounts were up an average of 4.6% through the end of September. That return is 3.6% behind the S&P 500, in line with the the Dow Jones Industrial Average, and several percent ahead of the Russell 2000 small cap index.

This was not one of our better quarters. Several of the stocks we hold fell substantially in value in September. Particularly hard hit were our investments in agricultural and energy companies. Agricultural stocks fell in response to falling grain prices, after an extended period of good weather has boosted grain reserves. Oil stocks fell because of weaker global economic growth and consequent weaker demand, even as new sources of oil increased supply.

Recent economic reports have pointed to a heightened risk of a European recession. Data released last week indicated that German industrial orders fell 4% in August, a sign of weakness in Europe's largest economy. Fear of a deep European recession has affected stock markets around the world, including the US market. Trading activity in the first week of October has been particularly turbulent.

There are still positives which should be supportive of US stocks over the medium term. In particular, interest rates are unlikely to rise substantially over the next few years, leaving few alternatives to stocks for investors targeting higher returns. In addition, many of our holdings are in excellent shape financially, and have substantial excess cash to reinvest in their businesses. That said, the weakening economic environment in Europe introduces an additional headwind to US economic growth.

With the recent market pullback I am seeing improving value for stocks, although prices may fall further in the near term. I have raised cash levels in recent days, creating flexibility to gradually add back to stock positions at lower prices. I am also opportunistically reducing exposure to our most economically sensitive investments, while adding to investments in somewhat more defensive industries.

Notes on current holdings

The current period is unique for the number of our holdings which have paid off their debt and are now accumulating cash through ongoing profitability. Among current investments, these include US Lime, Seaboard, Span America, Visa, and WellPoint.

The growing cash balances on these corporate balance sheets have real value to us as shareholders. First, they constitute a reserve for future dividend payments. Second, they make it possible for the managers of these businesses to invest in new growth opportunities without taking on substantial debt. Management quality is important here. We don't want the managements of our companies to squander their cash reserves on ill-advised investments. However none of them have shown any propensity to do this.

All else equal, the continued accumulation of cash by companies we own should gradually lead to higher stock prices.

Notes on Agricultural Products Holdings

Our agricultural investments have not done well this year, despite having done well for us in the past. Our investments here include crop chemicals, fertilizer and seed (Agrium and FMC), as well as irrigation equipment (Lindsay).

These businesses do better when prices are high for corn, wheat and soy. Farmers then try to grow as much as possible per acre of land and in consequence buy seed, fertilizer and farm equipment. This year's unusually benign spring and summer weather in both North and South America resulted in record grain harvests and low grain prices. Farmers recognized that there was little reason to try to obtain still larger harvests and so little reason to buy fertilizers and crop chemicals. Present indications of supply and demand suggest that low grain prices will persist into next year.

That said, grain prices will not remain low in perpetuity. Indeed, global demand for grains will continue to rise as a function of both population growth and increases in the use of grain for animal feed and fuel. In addition, weather is volatile and there will continue to be good and bad harvests, and in the bad years prices will rise. Furthermore, the agricultural seed and chemical manufacturers appear likely to remain highly profitable despite depressed crop prices - just not as profitable as they were in years past.

FMC Corp, a manufacturer of crop chemicals and plant based food additives (colorings, thickeners) is a good example of an attractive business in the agricultural sector. FMC's largest end market is soybeans, but more than half of their agricultural earnings are from smaller crops like sugar, vegetables and cotton, where prices have held up better, and from food additives like carrageenan, sales of which are growing quickly due to its inclusion in almond milk and other high growth food products.

FMC Corp has generated excellent earnings growth in recent years under the stewardship of Pierre Brondeau. Brondeau was formerly chief executive of Rohm and Haas. In that role he helped Rohm and Haas become a strong niche chemical producer and then sold the company at a substantial premium to its then trading price. Brondeau appears to be following a similar play book with FMC, where he is again building a well-positioned, highly profitable specialty chemical company. FMC may well attract the attention of a larger competitor in the next few years.

As a result of concerns about crop prices, FMC's stock is not particularly expensive at this time, trading at a discount to the broader market and its average trading multiple over the last few years. I plan to add incrementally to our holdings over time, particularly when there are indications of improving crop prices.

Notes on other holdings

Our best performing names for the quarter and the year have been two very small companies – Radiant Logistics and Infusystems. Both are well positioned and well managed US based service companies, with good niche positions in their respective markets – logistics for Radiant, health services for Infusystems. Both continue to post solid earnings, which in turn have led to rising stock prices. I am actively searching for more good small companies like these.

As always, feel free to call with any questions.

Doug

Note: This information is intended as a general discussion of past account performance and investment strategy. It is not a recommendation to purchase any specific security or type of security. An investment in securities involves the risk of loss. Douglas S. Weiss is a registered investment advisor, member FINRA. Client performance is based on the arithmetic average return across all accounts managed for at least one year, net of management fees. Data is unaudited. Individual client returns vary reflecting risk profile as well as tax and other considerations. S&P 500 index return is based on total index return, inclusive of dividends.

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