

2012 Third Quarter Investment Commentary

October 14, 2012

“Patriotism is the conviction that your country is superior to all others because you were born in it.”
-George Bernard Shaw

“If you cut wages, you cut the number of your own customers. If an employer does not share prosperity with those who make him prosperous, then pretty soon there will be no prosperity to share. We like to have plenty of customers.”
-Henry Ford

“For with much wisdom comes much sorrow; the more knowledge, the more grief.”
-Ecclesiastes 1:18

“Every gun that is made, every warship launched, every rocket fired, signifies in the final sense a theft from those who hunger and are not fed, those who are cold and are not clothed.”
-Dwight D. Eisenhower

(60% of our annual federal budget goes towards military expenditures. This is \$2.2 million every minute)

“You have a disturbingly large number of politicians and business leaders who are sociopaths and psychopaths. Something like 30% to 50% are borderline really bad people. You can get away with that in a world where you jump between places. That’s going to be much harder in a world that’s more networked and more transparent.”
- Peter Thiel (co-founder, Paypal)

“When S&P stripped the US government of its top credit rating...predictions of doom followed. Mitt Romney called it a ‘meltdown’...Paul Ryan said the cost of mortgages would rise...Mohamed El-Erian...of PIMCO...forecast the erosion in the...dollar and U.S. financial markets. **THEY WERE WRONG.**”
(Bottomline: A year after S&P took away the AAA credit rating of the U.S., almost every major economic indicator has improved.)
-Bloomberg Businessweek

So far, so good for this year: Our accounts are up an average of 9.2% through September 30. The “sell in May and go away” concept didn’t hold much water this year, as the major equity averages on September 30 closed higher than their May levels. June and July offered many opportunities to purchase equities at favorable prices and we took advantage of these when able. Since we remain close to fully invested most of the time, we didn’t have much cash to work with, but used what we had to buy. July 12, with the DJIA closing at 12,573, proved to be the low point during the third quarter. We received our proceeds from the Goodrich takeover by United Technologies on July 27 and did our best to “bottom fish” for positions we found exceedingly attractive with this cash. Corning, Eaton, Timken and ION Geophysical are included in this group. To date, only ION hit our buy limits. We were hoping for additional market weakness during September and October. However, September proved to have been unseasonably strong. In fact, on the 6th the DJIA closed at its highest level (13292) since December 2007. This close was exceeded several times during September and October. The all-time closing high on the DJIA was 14,164 on October 8, 2007, five years ago. We approached this level on October 5 when the DJIA closed at 13,610, only 555 points, or 3.9%, away.

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As the market climbs its' preverbal "wall of worry" we expect the DOW to exceed this 14,164 within the next year despite the uncertainty within Europe, the U.S. political scene, the looming "fiscal cliff", almost certain changes in our tax levels, Syria, Iran, the Middle East, China, etc., etc. We continue to find U.S. equities very attractive values and will continue to nibble into more as sellers deliver their shares to us.

It is noteworthy to record that bond returns this year have retreated from their stellar 2011 pace. Vanguard's Extended Duration Treasury Index Fund (VEDTX), as a proxy, increasing in only 2.68% value through October 9. We continue to believe that the significant cash deposited into Treasury securities during the past four years leave the holders exposed to substantial downside risk once interest rates begin to rise. Most fixed income assets hold the same downside exposure and we shy away from them electing to own equities with dividends or great growth potential instead. The editors at Kiplinger's state in their Investing for Income letter that, "you could easily lose as much as 25% of your principal" in bonds once the economy catches fire and yields increase. While, we can't state with certitude that a loss will approach this amount, we use their position to underscore our concern that we've held for the past three years over fixed income investments. Overall, we hold only 18% of assets in bonds, so we will not be punished too badly once the tide turns.

We hold most of our investments in equity mutual funds (12%) and stocks directly (62%) and should benefit once investors return to these markets. It is difficult to calm the fears of those who seek "safe" holdings. There is no such animal. This is especially clear once one understands the potential downside of every investment option. Equities will prevail over the long-term, despite their volatility.

This year we have experience with several long-term holdings that support our proposition. Goodrich was finally taken over by United Technologies for \$127.50. We originally bought GR in November 2002 at \$15 per share. That's a 747% return over the 9.5 years that we held the stock throughout two of the greatest downturns in the equity markets in our lifetimes. We current sit on unrealized gains of significant values in many positions we'd held through thick and thin over the past several years. These include A&W Royalty Trust, ABB Corp, BHP Billiton, Boeing, Cedar Fair LP, EZChip, Manitowoc, PetroChina, Teck Cominco and others. While all of these are "off" their highs, they all still are well above our buy price. I don't wish to paint a picture of complete success, as we always will have our share of losers too. We continue to hold many positions that trade lower than our buy prices. The stories associated with each continue. In most cases, the gains are only deferred. Overall, and this posture of mine is nothing new to our long-time clients, our diversified approach to investing has served us well over the years. Patience and frequent buying when others are fleeing will deliver above average returns over time.

I wish that you for whom we've recently (this means over the past two years) purchased Dragonwave, Anadigics, CIA Siderurgica, Corning, Enerplus Resources, Pace Oil & Gas, Finisar, MIPS Tech, STMicroelectronics, among others, will continue to exercise patience with these selections. These will eventually come around. MIPS is up 65.7% this year. It is only a matter of time for these to prove profitable. I know that this is difficult to believe, especially when your portfolio continues to reflect lower prices, but these will eventually come around. We continue to add all of these to portfolios that do not currently hold them and to those that do IF cash is available in the account. I encourage you to periodically add cash to your account so that we can take advantage of lower stock prices.

As we move into the final quarter, please remember that we have our presidential and congressional elections coming up on November 6th. I know that many in our country are disenchanting with our political system. I have fleeting thoughts of the futility of this system too on occasion. However, until and unless we come up with something better, we are obliged to participate. Do make an informed vote on the 6th.

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It does matter who we send to Washington to craft our laws. You may wish to visit Project Vote Smart at www.votesmart.org as an objective source of information on those who are running. This may be the only truly bi-partisan source of data and an organization rooted in promoting an informed, educated and thinking citizenry. A people get the government they deserve. Let's join together to make sure that we get one we deserve. Let us commit to becoming and remaining informed, wise and unwavering in our pursuit of the best for all Americans.

Your progress reports are enclosed along with a 2012 Tax Planning guide (for use before the year is out) and our most recent edition of Loose Change.

Please call to discuss any questions or concerns you may hold. I again thank you on behalf of all of us at Michael J. Porro & Co. for your continued confidence and business.

“A generous man will prosper; whoever refreshed others will be refreshed.”
-Proverbs 11:25

“We forget that Mr. Market is an ingenious sadist, and that he delights in torturing us in different ways.”
-Barton Biggs
(who passed away this July)