



Client Gathering: November 30, 2011
John D. Fox — Director of Research

John welcomed the attendees and said he wanted to talk about the economic environment today, why it is taking longer than normal to get better, and what opportunities it is presenting.

“The recession that occurred in 2008/2009 was not a normal recession, but a recession accompanied by a financial crisis. While this is unusual, it is not as rare as you might think. There have been 17 countries around the world that have had a similar incident since 1991. This subject, a recession with a financial crisis, has been studied by two finance professors who have published their findings in a book titled, *This Time Is Different*.” John said the authors describe the following playbook:

1. The seed of the crisis is a sharp increase in housing prices.
2. When housing prices begin to decline, this equals a banking crisis.

The normal chain of events is as follows:

Housing prices decline by 35% from their peak, stock prices decline by 50% from peak-to-trough, unemployment increases and stays elevated for a considerable time, and government debt increases by 86%, on average, from pre-crisis levels.

John asked, “Does this sound familiar to anyone?” He continued, “This is exactly what is happening in America today. In fact, in a recent speech, one of the professors described the current U.S. experience as ‘your garden-variety financial crisis.’”

So what does the textbook say about what happens next? The net result of these events is that a country’s economic growth is slower than average for a number of years following the recession. While things have been getting better for two years, and we believe will continue to move ahead slowly, we can’t count on some exceptional improvement to help our investments.

If this is the case, “What can an investor do with their money?” John indicated that we have three ideas:

1. Invest in companies that are currently doing well and are in an environment in which they can win. We invest in many corporations on your behalf that will report record earnings this year. These businesses have grown their earnings

- through the recession and are now earning all-time high profits – they don't need a better environment – they are winning now.
2. Global Reach – while America may be in a slow-growth mode, the world is growing and domestic firms are expanding overseas. We invest in 19 companies on your behalf that garner more than 35% of their sales internationally.
 3. Buy dividend-paying stocks. Today, you can own a portfolio of dividend-paying stocks that generate more income than many long-term bonds and have the potential of capital appreciation over time. For example, our FAM Equity-Income Fund (Fenimore is the investment advisor to FAM Funds) owns 32 stocks with an average yield of nearly 3%. In addition, many of these holdings are increasing their dividends. So it is possible today to invest in a growing income stream. In fact, 16 of the stocks in the Fund have a current yield of more than 3%.

John stated, "I would like to close with how we have been spending our time. Benjamin Graham, the Father of Value Investing, said that investment is most intelligent when it is most business-like. We agree and are focusing our time on investing in great businesses. This year we have talked to the management teams of more than 60 new ideas. These are corporations that we have never looked at before. They are in a wide range of industries, including: chemicals, utilities, food and soft drinks, real estate, computer chips, auto parts, timber, gold mining, banking, and pest control."

John went on to say that in addition to new ideas, we are also keeping a close watch on the enterprises in which we are invested. We have completed more than 50 company visits and are conducting five more this week.

All of these businesses have some things in common:

1. They are highly profitable.
2. The balance sheets are strong with little or no debt.
3. The companies generate more cash than they need. The money can be used for dividends, investment for future growth, and acquisitions.
4. They have strong management teams that in many cases are delivering record profits.

John concluded, "With the overall stock market trading at 20-year low valuations, we think a portfolio of high-quality holdings can produce a good result over the next several years."