



FENIMORE
Asset Management, Inc.
MANAGER OF THE FAM FUNDS

384 North Grand Street, PO Box 310
Cobleskill, New York 12043
(800) 721-5391
www.fenimoreasset.com

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John D. Fox — Director of Research & Co-Manager - FAM Value Fund

John extended a warm welcome to everyone and noted that he would elaborate on Tom's comments and focus on three aspects: the economy, the financial markets, and the mindset of Corporate America.

ECONOMY

Holding a newspaper, John began with, "The economy is better. I know some of you are skeptical of that so I was thinking about how I could convince you." He said he got an idea from Will Roger's quote, "All I know is what I read in the newspaper." In a skit from *The Will Rogers Follies*, Rogers traveled Middle America on a train and read excerpts from local newspapers; he would then spin the articles and comment on human nature.

John read information he had collected from newspapers during the previous week.

- The Purchasing Managers Index out of Chicago, which measures manufacturing activity in the Midwest, hit a 15-month high.
- The ISM Indices showed economic activity in manufacturing expanded in November for the fourth consecutive month.
- Contracts to buy previously owned houses rose unexpectedly in October — the ninth consecutive monthly gain.
- Jewelry sales were up five percent in November and that was the third consecutive month of increases.
- Consumer spending and incomes rose in October over September.
- The average weekly overtime hours in manufacturing were up 14 percent from the second quarter.
- Traffic at the Port of Long Beach where most of the imports/exports flow to-and from the U.S. is up for several months in a row.
- Initial jobless claims are at the lowest level in a year.
- New home sales are up six percent.
- Auto sales for November were up from one year ago.
- A big iron ore company says the China steel industry is strong, market sentiment has improved, and demand is beginning to increase in other countries.
- Staples said they had positive customer traffic in their stores for the first time in nine quarters.

- The St. Barts real estate office that rents homes for \$15,000 a week stated that “September and October weren’t bad and November was fantastic!”

John wrapped up the economy saying it has gotten better and there are many more positive statistics. It has regained its footing, stabilized, and is getting more robust every month.

FINANCIAL MARKETS

John said that financial market indicators are not as obvious as what you read in the newspaper. He indicated that the financial and credit markets are like the oil in our economic engine. He underscored, “You can’t see it, but it’s in the engine and working and boy that engine won’t work without it!” He recalled a time when he was a teen and his brother drove the car without oil in it — the engine melted into one piece of metal and seized. The same thing can happen in our economy. Without credit running through the system, if companies can’t borrow and institutions won’t lend, then the oil of the economy dries up and our economic engine stops. John continued, “I can tell you that today the financial markets and credit markets are better than last year.” He said that there are many indicators we review that demonstrate this fact.

He went on to say that corporate debt issuance will be very good this year. Companies are once again able to borrow for growth or to refinance their debt whereas nine to 12 months ago they were not able to do so. The terms may not be as good as they were two years ago, “but companies have access to capital and that’s very positive.”

Also, in the IPO (Initial Public Offering) arena where new companies come into the marketplace, there have been 55 this year. It may not be a great number, but it’s encouraging that companies can raise money again. Notable names include Hilton Hotels and Rosetta Stone.

Regarding corporate mergers and acquisitions, John said, “Virtually every day we go into the office there’s a new deal.” There are some brand names you’re familiar with like Hershey, Cadbury, Kraft, Black & Decker, Stanley Tools, Xerox, Dell, and Oracle. But there are also unfamiliar names including an \$800 million deal yesterday in the energy industry and the companies were able to get financing and execute the transaction. This is also positive.

John summarized by saying that the financial markets are open and vastly improved from a year ago.

CORPORATE AMERICA MINDSET

John cited that a year ago Corporate America’s strategy was “defense.” They saw their sales orders dwindle and banks stop lending so they “ran their businesses for cash. They reduced their costs by reducing people and inventory thus generating cash and putting it in the bank.” There was no investing in growth “and that’s not good for the economy.”

“We need companies to invest. We need companies not to play defense but to play offense. The good news is that we’re starting to see this.” John highlighted some examples of “offense” from existing holdings in private portfolios and FAM Funds:

- Brookfield Asset Management just bought some great assets from a bankrupt competitor in Australia including railroads and transmission lines. They’ve also raised \$4 billion to buy commercial real estate.
- Markel Insurance just raised \$300 million in the bond market and has made three acquisitions in the last two months including one today.

- Westamerica Bank purchased a California bank from the FDIC and they received all the branches, employees, good loans, and deposits they wanted and the FDIC kept the rest.
- Bed Bath & Beyond is negotiating terrific leases with landlords seeking to fill space.

“We see companies starting to play offense. This is very good for the businesses we invest in and it’s a good symbol for what’s going on in the economy.”

John concluded his remarks pointing out that Tom spoke about macroeconomic indicators and although we are very aware of these forces, our main focus is researching companies. “What we do is invest in individual businesses. In the past year we looked at 66 new investment ideas seriously and about 200 not so seriously along with our approximate 50 holdings that we spend a lot of time on. We are looking for businesses that are financially strong, have good balance sheets, generate cash profits, and are managed by competent, talented, honest people. And then we look to buy those at a discount to what we think they are worth. That’s what we’ve always done and will continue to do.”